MOODY'S
INVESTORS SERVICE

CREDIT OPINION
8 April 2020

Update

Rate this Research

RATINGS

**Barloworld Limited**

| | |
|---|---|
| Domicile | South Africa |
| Long Term Rating | Ba1 |
| Type | LT Corporate Family Ratings |
| Outlook | Negative |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*

Contacts

Lahlou Meksaoui +971.4.237.9522
*AVP-Analyst*
lahlou.meksaoui@moodys.com

Mario Santangelo +971.4237.9533
*Associate Managing Director*
mario.santangelo@moodys.com

Ali Amin +971.4.237.9524
*Associate Analyst*
ali.amin@moodys.com

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# Barloworld Limited

## Update following the sovereign rating action on South Africa

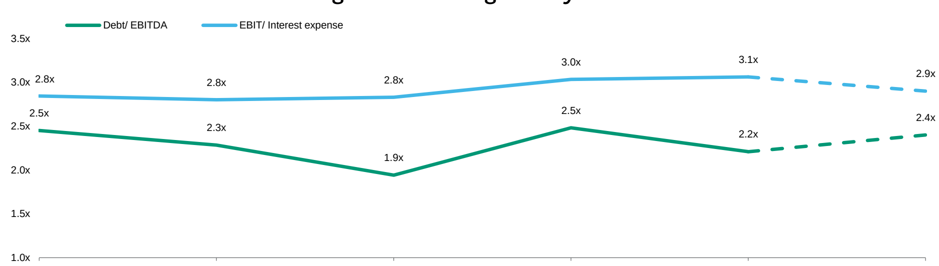
## Summary

On 4 April 2020, we have downgraded the rating of Barloworld Limited's (Barloworld) to Ba1 from Baa3 following the downgrade of the Government of South Africa to Ba1. The downgrade to Ba1 from Baa3 reflects the fact that Barloworld is intrinsically linked to the macro environment of South Africa with close to 75% of revenue and over 60% operating profit derived in the country.

The ratings recognise (1) Barloworld's leading competitive positions in the markets in which it operates, as well as its strong brand offerings and stable long-term relationships with its main suppliers; (2) its diversified product mix and its resilient business model, whereby its integrated after-sales support segments are able to soften the impact from the decline in new equipment and vehicle sales during cyclical downturns; (3) its credit metrics which have historically been relatively stable and are supported by the company's ongoing commitment to balanced financial policies.

The rating is constrained by Barloworld's exposure to: (1) the Sub-Saharan African and Russian markets, leaving it exposed to the volatile economic conditions of these countries; (2) more cyclical mining, agricultural, construction and motor related industries; (3) key supplier risk as most of its operations depend on its position as the principal agent for a number of high profile brands such as Caterpillar Inc. (CAT, A3 positive). This is mitigated by its long-term relationships and close strategic alignment which we expect to continue.

Exhibit 1
**Credit metrics have remained range bound through the cycle**




All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's forecasts are Moody's opinion and do not represent the views of the issuer. Periods are financial year-end unless indicated; LTM = last twelve months.
*Source: Moody's Financial Metrics™*

## Credit strengths

» Leading market positions supported by strong brand offerings

» Resilient operating cash flows underpinned by integrated business model and diversified product mix

» Relatively stable credit metrics through the cycle underpinned by balanced financial policies

## Credit challenges

» High exposure to cyclical end markets tied to commodity price volatility

» Concentration to Sub-Saharan African and Russian markets

» Key supplier risks mitigated by long term relationships and close strategic alignment

## Rating outlook

The negative outlook reflects Barloworld's close linkages with the Government of South Africa. Therefore the outlook is aligned with that of the sovereign.

## Factors that could lead to an upgrade

Given the negative outlook, an upgrade is unlikely in the near-term. The outlook could be changed to stable if the Government of South Africa's rating is changed to stable.

Subject to an upgrade of the South African government bond rating, an upgrade could be considered if:

» Barloworld is able to grow in size and geographic diversification

» Debt/EBITDA were to fall below 2.5x

» EBIT/interest increases above 3.5x

## Factors that could lead to a downgrade

The ratings are likely to be downgraded in case of a downgrade of the Government of South Africa's rating.

Negative pressure on the ratings would also develop if:

» Debt/EBITDA rises above 3.5x

» EBIT/interest expense falls below 2.0x

» The company's liquidity risk profile deteriorates

## Key indicators

Exhibit 2

| | 30/09/2015 | 30/09/2016 | 30/09/2017 | 30/09/2018 | 30/09/2019 | 2020e |
|---|---|---|---|---|---|---|
| Revenue (USD Billion) | $5.2 | $4.2 | $4.6 | $4.6 | $4.0 | $4.0 |
| EBIT / Interest Expense | 2.8x | 2.8x | 2.8x | 3.0x | 3.1x | 2.9x |
| RCF / Net Debt | 33.2% | 35.1% | 46.9% | 71.2% | 66.1% | 43.9% |
| Debt / EBITDA | 2.5x | 2.3x | 1.9x | 2.5x | 2.2x | 2.4x |

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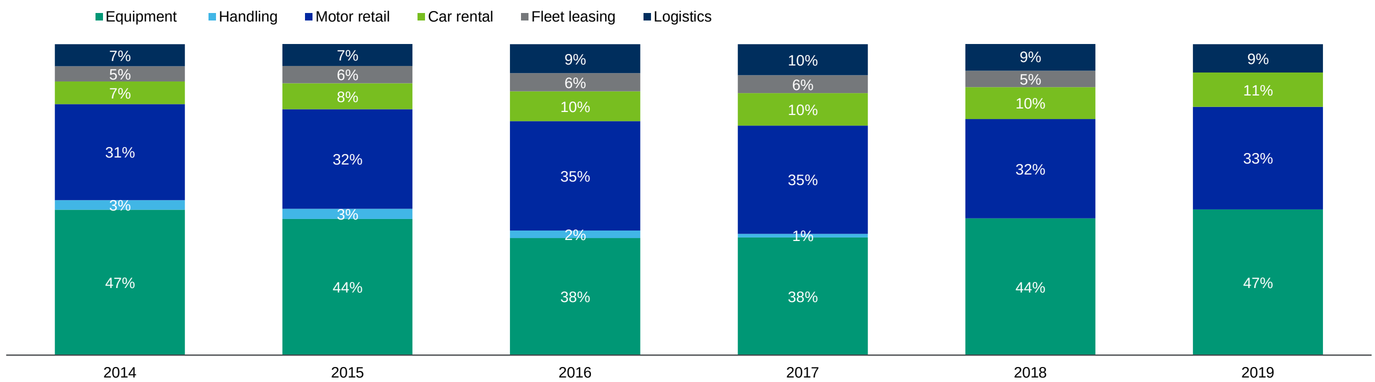
*Source: Moody's Financial Metrics™*

## Profile

Barloworld, headquartered in South Africa, is a leading distributor and after-sales support provider of heavy equipment and motor vehicles for leading international brands across southern African markets and Russia. It also provides integrated rental, fleet management, product support and logistics solutions. The core divisions of the group comprise: (1) Equipment which provides end to end solutions across the value chain on behalf of Caterpillar Inc. to the mining, construction, industrial sectors; (2) automotive which operates the motor trading, car rental, and fleet management services; and (3) logistics which provide logistics management transport and supply chain optimisation.

Exhibit 3
**Revenue Breakdown per Division (% of total revenues before eliminations)**




*Source: Company reports*

## Detailed credit considerations

### Leading market positions supported by strong brand offerings

Barloworld holds dominant market positions in heavy machinery, motor vehicle trading, motor vehicle rental and fleet businesses. The company's leadership positions, strong brand representation and broad customer coverage through its markets provides high barriers of entry given the significant investments involved. While there is some concentration risk associated with its key principal suppliers and limited long term fixed term contracts in place, we take comfort around its long term relationships and close strategic alignment between the parties and its performance of maintaining dominant and stable market positions.

Barloworld has the sole distribution rights for Caterpillar Inc. for sales of heavy equipment/machinery and after sale parts service across Sub-Saharan Africa and Russia. The company has had a long standing relationship with Caterpillar for more than 90 years. Across Southern Africa it holds mostly number 1 market positions in the various heavy machinery categories which is supported by a strong dealership network that provides on-site customer support and after sales service. The distribution agreement awarded by CAT is for an indefinite period in each of the regions although it can be terminated within 6 months. Given the long standing working relationship and close strategic alignment as well as potential disruption to customers we see no reason why the CAT relationship could be terminated on such short notice and would expect CAT to work closely with its troubled distributors through product support, as done in other jurisdictions with its other distributors.

Barloworld participates in the franchised dealer market for key premium and volume-led motor brands in South Africa. The brands contribute to 65% of total motor sales in South Africa. These include Bayerische Motoren Werke Aktiengesellschaft, Audi, Mercedes Benz, Volkswagen Aktiengesellschaft, and Toyota Motor Corporation to name a few, which have mature and stable market share positions. Barloworld's dealership strategy in high density metropolitan areas enables economies of scale and has proven to be more resilient to economic downturns.

Within its motor rental operations, Barloworld holds the Avis and Budget brands which combined hold the number 1 market position in the South African motor rental market, followed by its nearest competitor Europcar Tempest. We view favourably the Avis license as it creates greater economies of scale through sharing of infrastructure such as office space and vehicle rental pool which should drive higher rental days and vehicle utilisation rates. Furthermore, it broadens Barloworld's target market entering into the lower more budget conscious customer base.

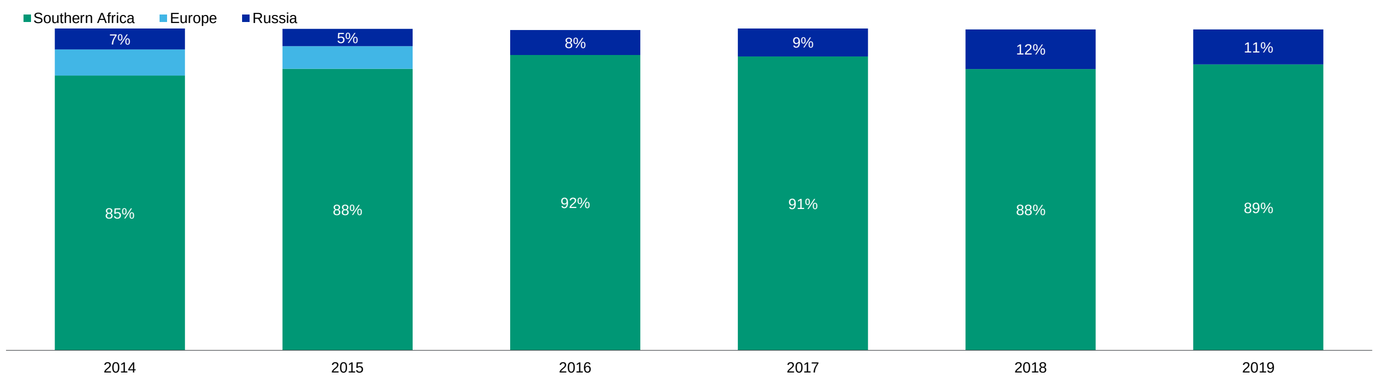
The Avis fleet business is the market leader at approximately 24% of the South African leasing market. The business has an established customer base comprising of government and corporate long term fleets, including blue chip companies with contracts durations averaging five years.

### High concentration to regions which are experiencing weak economic conditions

With close to 73% of revenue derived from South Africa, Barloworld is intrinsically linked to the macro-economic environment of South Africa. The slowdown in South Africa's economic growth, low consumer and business confidence is creating a challenging operating environment. The rest of Africa contributes to 16% of revenue and Russia (Baa3 stable) 11% of revenue. Due to the infrastructure backlog in many African countries, we see the potential for strong long term demand for Barloworld's Equipment division. Russia with its significant mining territory also offers long term growth opportunities.

Exhibit 4

**Revenue regional diversification limited to Southern Africa**




*Source: Company reports*

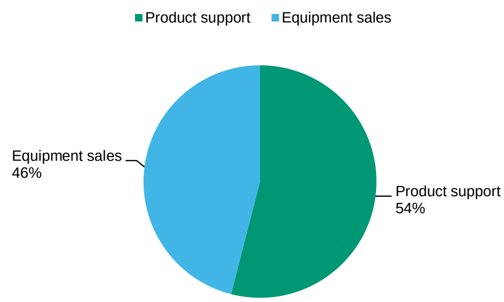
Barloworld's automotive vehicle sales are under pressure from a weak consumer confidence and high consumer indebtedness. However, the motor trading division benefits from having greater price competitive brands relative to imported vehicle brands. This is due to the largely locally based OEM's (Original Equipment Manufacturers) which are partially insulated from the currency volatility of the Rand.

### Resilient operating cash flows underpinned by integrated business model

Barloworld's operating performance has been relatively resilient through the cycles, partly due to its exposures to different industry sectors, geographic diversification and integrated product offerings down the value chain. The integrated business model provides a strong counterbalance to the anticipated declines in equipment and vehicle sales, as companies attempt to extend the lifespan of machinery beyond the traditional replacement cycle and consumers delay new vehicle purchases.

We expect performance over the next 12 months to come under pressure largely due to Barloworld's exposure to the weak South African economic environment. However, we also expect Barloworld's higher margin aftermarket services business to continue to counterbalance the anticipated declines in new equipment and vehicle sales. Over the past 5 years after service and parts revenues in the Equipment division has increased from around 33% (FYE2012) to 54% of total Equipment division revenues.

Exhibit 5
**Equipment revenue split by category**




Periods are financial year-end unless indicated.
*Source: Company reports*

### Recent acquisitions reflect new investment strategy

On 28 February 2020, Barloworld Limited entered into a sale and purchase agreement to acquire the Tongaat Hulett Starch (THS) business of Tongaat Hulett Limited for an enterprise value of ZAR5.350 billion. THS is an integrated starch producer operating separately within Tongaat Hulett Limited. This acquisition is in line with Barloworld's strategy to diversify and grow its portfolio by investing in new industries. In our view, whilst the acquisition diversifies Barloworld's business profile, it also reinforces Barloworld's operational concentration in South Africa which is currently facing low growth and a challenging operating environment. This acquisition will be moderate in terms of additional revenue (7%) and EBITDA (11%).

We note that this is the second sizeable acquisition announced by Barloworld in February 2020 after the acquisition of Wagner Asia Equipment LLC and SGMS LLC. This highlights an increased appetite for acquisitions and some integration risk. At the same time, we recognize that the funding mix of both acquisitions has been conservative in line Barloworld's track record of conservative financial policies. As a result of this acquisition and the acquisition of Wagner Asia Equipment LLC and SGMS LLC, we estimate pro forma consolidated leverage for FY2019 ending 30 September, calculated as Moody’s adjusted debt to EBITDA, to be around 2.4x from 2.2x as of 30 September 2019. Similarly, we estimate Moody's pro forma adjusted EBIT to interest expense to be around 2.9x from 3.1x as of 30 September 2019.

## ESG considerations

Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety. The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. We expect that the spread of the coronavirus will negatively impact the company's cash flow generation at least in the first half of calendar year 2020. Depending on its duration, the nationwide lock-down imposed by the South African government will negatively affect credit metrics.

## Liquidity analysis

Barloworld's liquidity is deemed sufficient to meet its near-term obligations within the next 12 months, supported by undrawn committed facilities totaling ZAR6.7 billion and unrestricted cash of ZAR5.3 billion as of 31 December 2019. This is sufficient to cover capital spending of ZAR1.04 billion, dividends of ZAR1.1 billion as well as debt maturities of ZAR2.6 billion over the next 12 months, as of 31 December 2019. The company's credit facilities are provided by a variety of leading South African banks.

## Rating methodology and scorecard factors

The principal methodology used in rating the company was Moody's Retail Industry Methodology published in May 2018, as it captures the biggest portion of its businesses being the Equipment and Automotive retail operations, representing around 80% of total revenue. The two notch differential between the scorecard-indicated outcome and the actual rating assigned is due to Barloworld's concentration risks in South Africa.

Exhibit 6

### Barloworld LimitedRating Factors

| Barloworld Limited | | | | |
|---|---|---|---|---|
| Retail Industry Scorecard [1][2] | Current FY 09/30/2019 | | Moody's 12-18 Month Forward View As of 3/29/2020 [3] | |
| **Factor 1 : Scale (10%)** | **Measure** | **Score** | **Measure** | **Score** |
| a) Revenue (USD Billion) | $4.0 | Ba | $4 - $4.1 | Ba |
| **Factor 2 : Business Profile (30%)** | | | | |
| a) Stability of Product | Ba | Ba | Ba | Ba |
| b) Execution and Competitive Position | Baa | Baa | Baa | Baa |
| **Factor 3 : Leverage and Coverage (45%)** | | | | |
| a) EBIT / Interest Expense | 3.1x | Ba | 2.9x - 3.1x | Ba |
| b) RCF / Net Debt | 66.1% | Aa | 40% - 45% | A |
| c) Debt / EBITDA | 2.2x | A | 2.2x - 2.4x | A |
| **Factor 4 : Financial Policy (15%)** | | | | |
| a) Financial Policy | Baa | Baa | Baa | Baa |
| **Rating:** | | | | |
| a) Scorecard-Indicated Outcome | | Baa2 | | Baa2 |
| b) Actual Rating Assigned | | | | Ba1 |

All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's forecasts (f) are Moody's opinion and do not represent the views of the issuer. Periods are financial year-end unless indicated; LTM = last twelve months.
*Source: Moody's Financial Metrics™*

# Appendix

Exhibit 7

## Peer comparison table

| | Barloworld Limited | | | Caterpillar Inc. | | | AutoNation, Inc. | | |
|---|---|---|---|---|---|---|---|---|---|
| | Ba1 Negative | | | A3 Positive | | | Baa3 Stable | | |
| (in US millions) | FYE Sep-17 | FYE Sep-18 | FYE Sep-19 | FYE Dec-17 | FYE Dec-18 | FYE Dec-19 | FYE Dec-18 | FYE Dec-19 | LTM Dec-19 |
| Revenue | $4,634 | $4,618 | $3,966 | $42,676 | $51,822 | $50,755 | $21,413 | $21,336 | $21,336 |
| EBITDA | $574 | $501 | $452 | $6,598 | $10,287 | $9,399 | $825 | $921 | $921 |
| Total Debt | $1,103 | $1,142 | $944 | $17,426 | $16,691 | $15,686 | $2,998 | $2,473 | $2,473 |
| Cash & Cash Equiv. | $265 | $547 | $469 | $7,381 | $6,968 | $7,299 | $49 | $42 | $42 |
| EBITDA Margin | 12.4% | 10.8% | 11.4% | 15.5% | 19.9% | 18.5% | 3.9% | 4.3% | 4.3% |
| EBIT / Int. Exp. | 2.8x | 3.0x | 3.1x | 5.2x | 12.2x | 13.4x | 4.4x | 5.6x | 5.6x |
| Debt / EBITDA | 1.9x | 2.5x | 2.2x | 2.6x | 1.6x | 1.7x | 3.6x | 2.7x | 2.7x |
| RCF / Net Debt | 46.9% | 71.2% | 66.1% | 36.8% | 77.0% | 74.7% | 20.7% | 28.4% | 28.4% |
| FCF / Debt | 15.1% | 1.9% | 15.8% | 22.7% | 25.0% | 20.1% | 2.0% | 11.7% | 11.7% |

All figures and ratios are calculated using Moody's estimates and standard adjustments.Periods are financial year-end unless indicated; LTM = last twelve months.
*Source: Moody's Financial Metrics™*

Exhibit 8

## Moody's-adjusted debt breakdown

| (in US Millions) | FYE Sep-14 | FYE Sep-15 | FYE Sep-16 | FYE Sep-17 | FYE Sep-18 | FYE Sep-19 |
|---|---|---|---|---|---|---|
| **As Reported Debt** | **1,001.6** | **949.2** | **803.1** | **716.8** | **789.3** | **515.0** |
| Pensions | 168.3 | 140.5 | 209.7 | 165.6 | 123.9 | 139.2 |
| Operating Leases | 248.8 | 250.8 | 259.8 | 218.6 | 209.2 | 226.2 |
| Non-Standard Adjustments | 0.0 | 0.0 | 0.0 | 2.4 | 19.7 | 64.0 |
| **Moody's-Adjusted Debt** | **1,418.6** | **1,340.5** | **1,272.7** | **1,103.4** | **1,142.1** | **944.4** |

All figures and ratios are calculated using Moody's estimates and standard adjustments.Periods are financial year-end unless indicated; LTM = last twelve months.
*Source: Moody's Financial Metrics™*

Exhibit 9

## Moody's-adjusted EBITDA breakdown

| (in US Millions) | FYE Sep-14 | FYE Sep-15 | FYE Sep-16 | FYE Sep-17 | FYE Sep-18 | FYE Sep-19 |
|---|---|---|---|---|---|---|
| **As Reported EBITDA** | **595.3** | **512.0** | **441.1** | **488.9** | **425.0** | **375.0** |
| Pensions | 2.3 | 1.4 | 1.0 | 0.8 | 1.1 | 6.9 |
| Operating Leases | 88.7 | 96.6 | 80.9 | 73.6 | 66.7 | 79.8 |
| Unusual | -19.9 | 21.7 | -2.4 | 10.6 | 7.7 | -9.3 |
| **Moody's-Adjusted EBITDA** | **666.4** | **631.7** | **520.5** | **573.9** | **500.5** | **452.4** |

All figures and ratios are calculated using Moody's estimates and standard adjustments.Periods are financial year-end unless indicated; LTM = last twelve months.
*Source: Moody's Financial Metrics™*

## Ratings

Exhibit 10

| Category | Moody's Rating |
|---|---|
| **BARLOWORLD LIMITED** | |
| Outlook | Negative |
| Corporate Family Rating | Ba1 |
| ST Issuer Rating -Dom Curr | NP |
| NSR LT Issuer Rating | Aa2.za |
| NSR ST Issuer Rating | P-1.za |

*Source: Moody's Investors Service*

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