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CREDIT OPINION

12 November 2019

New Issue

 Rate this Research

RATINGS

Barloworld Limited

Domicile	South Africa
Long Term Rating	Baa3
Type	LT Issuer Rating - Dom Curr
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.

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Barloworld Limited

Update following the sovereign rating action on South Africa

Summary

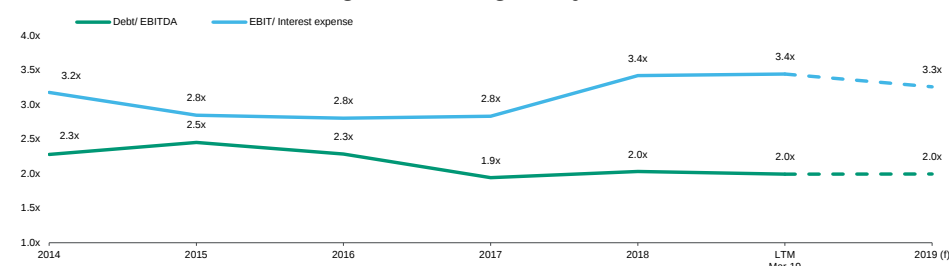
On 7 November 2019, we have affirmed the Baa3 issuer rating of Barloworld Limited and changed the rating outlook to negative from stable. This follows the affirmation of the Baa3 rating of the Government of South Africa and a change in the rating outlook to negative from stable on 1 November 2019. This action reflects Barloworld's operational concentration in South Africa, exposing the company to the heightened risks associated with the operating environment in South Africa. As a result we view Barloworld's ratings as being highly correlated with South Africa's long term bond rating and outlook.

The Baa3/Aa1.za issuer 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; (4) its good liquidity position.

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 (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™

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
- » Good liquidity profile

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](#) (Baa3 negative). 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, while maintaining its financial performance under challenging operating conditions
- » Debt/EBITDA were to fall below 2.0x
- » EBIT/interest increases above 4.0x

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 3.0x
- » EBIT/interest expense falls below 2.5x
- » The company's liquidity risk profile deteriorates

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Barloworld Limited

	2014	2015	2016	2017	2018	LTM Mar-19	2019 (f)
Revenue (USD Billion)	\$5.9	\$5.2	\$4.2	\$4.6	\$4.9	\$4.6	\$4.4
EBIT / Interest Expense	3.1x	2.9x	2.8x	2.8x	3.4x	3.4x	3.3x
RCF / Net Debt	38.6%	33.2%	35.1%	46.9%	70.3%	59.4%	72.9%
Debt / EBITDA	2.3x	2.5x	2.3x	1.9x	2.0x	2.0x	2.0x

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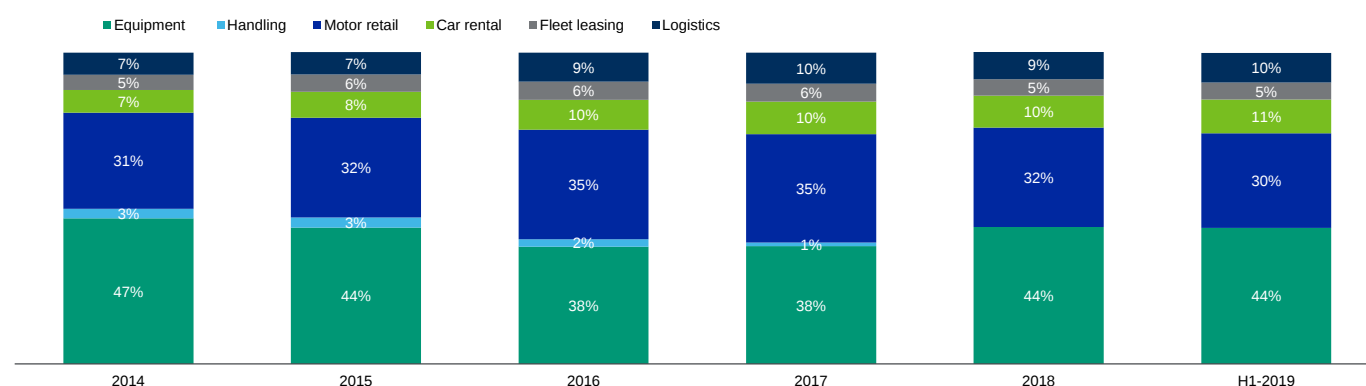
Source: Moody's Financial Metrics™

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 retail, 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 retail, 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 almost 90 years. Across Southern Africa it holds mostly No. 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, Daimler AG, 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 Budget 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.

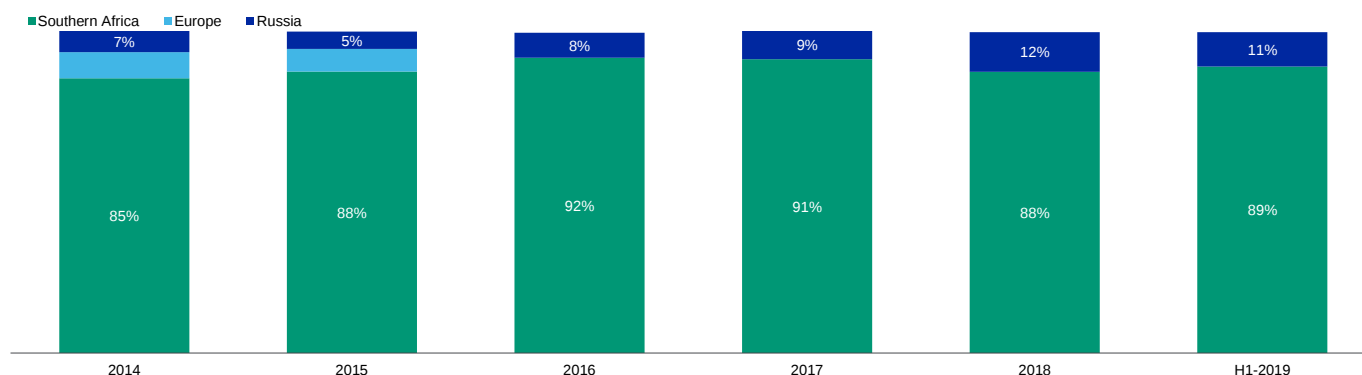
The Avis fleet business is the market leader at approximately 24% of the South African leasing market. The business has an established customer base comprising of government and corporate long term fleets, including blue chip companies with contracts durations averaging five years.

High concentration to regions which are experiencing weak economic conditions

With close to 75% 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 14% 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 motor dealership new vehicle sales are under pressure from a weak consumer confidence and high consumer indebtedness. However, the motor retail 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.

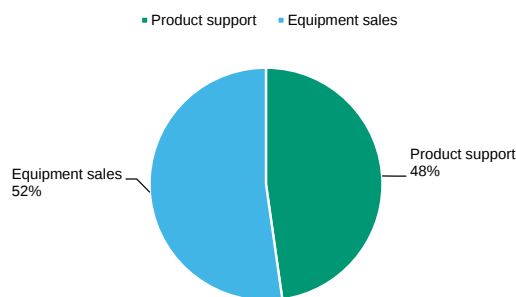
Resilient operating cash flows underpinned by integrated business model

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 (Moody's forecast of real GDP for 2019 is 0.7% and 2020 is 1.0%). 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 48% of total Equipment division revenues.

Exhibit 5

Equipment revenue split by category



Periods are financial year-end unless indicated.

Source: Company reports

Stable credit metrics supported by balanced financial policies

The resilience of Barloworld's diversified business model and balanced approach to financial management policies is further demonstrated through its historically stable credit metrics. Leverage, as measured by adjusted debt/EBITDA, of 2.0x is strongly positioned within the rating category. We expect leverage to remain relatively stable underpinned by management's internal target of net debt/ EBITDA of less than 2.5x. Barloworld's EBIT/interest cover of 3.4x, is adequately positioned for the rating but is expected to come under pressure, particularly given the rising funding cost in South Africa.

Liquidity analysis

Barloworld's liquidity is deemed sufficient to meet its near-term obligations within the next 12 months, supported by funds from operations of ZAR6.0 billion, undrawn committed facilities totaling ZAR6.8 billion and unrestricted cash of ZAR5.9 billion as of 31 March 2019. This is sufficient to cover capital spending of ZAR1.8 billion, dividends of ZAR1.06 billion as well as debt maturities of ZAR4.4 billion over the next 12 months (as at 31 March 2019). The company's credit facilities are provided by a variety of leading South African banks. We expect the company to continue to manage liquidity prudently.

Rating methodology and scorecard factors

The principal methodology used in rating the company was Moody's Retail Industry Methodology (May 2018), as it captures the biggest portion of its businesses being the Equipment and Automotive retail operations, representing around 74% of total revenue. The one 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 Limited Rating Factors

Retail Industry Scorecard			Current LTM 3/31/2019		Moody's 12-18 Month Forward View	
Factor 1 : Scale (10%)	Measure	Score			Measure	Score
a) Revenue (USD Billion)	\$4.6	Ba			\$4.4	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	3.4x	Ba			3.3x	Ba
b) RCF / Net Debt	59.4%	Aa			72.9%	Aa
c) Debt / EBITDA	2.0x	A			2.0x	A
Factor 4 : Financial Policy (15%)						
a) Financial Policy	Baa	Baa			Baa	Baa
Rating:						
a) Indicated Outcome from Scorecard		Baa2				Baa2
b) Actual Rating Assigned						Baa3

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Source: Moody's Financial Metrics™

Appendix

Exhibit 7

Peer comparison table

	Barloworld Limited			Caterpillar Inc.			AutoNation, Inc.		
	Baa3 Negative			A3 Positive			Baa3 Stable		
(in US millions)	FYE Sep-17	FYE Sep-18	LTM Mar-19	FYE Dec-17	FYE Dec-18	LTM Jun-19	FYE Dec-17	FYE Dec-18	LTM Sep-19
Revenue	\$4,634	\$4,874	\$4,594	\$42,676	\$51,822	\$52,788	\$21,535	\$21,413	\$21,199
EBIT / Interest Expense	2.8x	3.4x	3.4x	5.2x	12.2x	13.2x	5.1x	4.4x	4.9x
RCF / Net Debt	46.9%	70.3%	59.4%	36.8%	77.0%	81.0%	18.3%	20.8%	25.6%
Debt / EBITDA	1.9x	2.0x	2.0x	2.6x	1.6x	1.5x	3.5x	3.6x	3.1x

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

Barloworld Limited						
(in US Millions)	2014	2015	2016	2017	2018	LTM Mar-19
As Reported Debt	1,001.6	949.2	803.1	716.8	789.3	746.0
Pensions	168.3	140.5	209.7	165.6	123.9	121.6
Operating Leases	248.8	250.8	259.8	218.6	209.2	205.3
Non-Standard Adjustments	0.0	0.0	0.0	2.4	19.7	21.2
Moody's-Adjusted Debt	1,418.6	1,340.5	1,272.7	1,103.4	1,142.1	1,094.0

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

Barloworld Limited						
(in US Millions)	2014	2015	2016	2017	2018	LTM Mar-19
As Reported EBITDA	595.3	512.0	441.1	488.9	535.5	504.6
Pensions	2.3	1.4	1.0	0.8	1.1	1.0
Operating Leases	88.7	96.6	80.9	73.6	67.7	64.3
Unusual	(19.9)	21.7	(2.4)	10.6	7.5	8.2
Moody's-Adjusted EBITDA	666.4	631.7	520.5	573.9	611.8	578.1

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
Issuer Rating -Dom Curr	Baa3
ST Issuer Rating -Dom Curr	P-3
NSR LT Issuer Rating	Aa1.za
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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