CONSOLIDATED
STEEL INDUSTRIES

29 October 2020

CONSOLIDATED STEEL INDUSTRIES (PTY) LIMITED
(In Business Rescue) ("CSI" or the Company")

SECTION 132(3)(A) REPORT TO AFFECTED PERSONS
FOR THE QUARTER ENDED 30 SEPTEMBER 2020

The Company's directors and duly appointed Business Rescue Practitioners ("**BRP's**") have pleasure in submitting their report on the trading performance and financial position of Consolidated Steel Industries for the three-month period ended 30 September 2020 ("**Quarter 1**").

INTRODUCTION AND BACKGROUND

CSI is one of South Africa's market leading industrial conglomerates comprising two distinct principal business units, namely:

- Global Roofing Solutions ("**GRS**"), one of the oldest and largest metal roofing and roofing accessory manufacturers in South Africa that services the construction, roofing and hardware merchanting industries in South Africa and Sub-Saharan Africa; and
- Stalcor, one of the top three 'Tier 1' distributors of stainless steel and aluminium products in South Africa, servicing customers in the fabrication sector and steel merchants.

The ravaging economic effects of the Covid-19 Lockdown exacerbated by an already recessionary South African economy, systemic challenges in local steel production and a delicately capitalized CSI balance sheet gave cause for the directors of CSI to place the Company into Business Rescue on 13 July 2020, whereafter the duly appointed BRP's assumed operational control over the CSI business.

Within 5 weeks of being placed into business rescue, the BRP's published the CSI Business Rescue Plan ("**BR Plan**") on 18 August 2020, which was subsequently approved by more than 98% of creditors on 9 September 2020. As part of the approved plan, a post-commencement finance ("**PCF**") facility of R257 million was negotiated with CSI's biggest creditor to help ensure continuity of operations while the company implemented its 'back-to-basics' restructuring and business re-engineering.

The principal purpose of this report is provide feedback and insight as to the progress made in the implementation of the approved BR Plan, which highlighted the following key elements:

- Gross profit/margin maximisation
- Cost cutting
- Recovery of creditors funds
- Operational separation and restructuring
- Potential division/asset sales

TRADING AND SALES MARGINS

Sales revenues

CSI's sales revenues during Quarter 1 amounted to R322,3 million which represented an achievement of 85% of budgeted quarterly revenue as set out in the BR Plan. The principal reasons for this negative variance were:

- Notwithstanding a healthy GRS forward sales order book of over 4,000 tons, South Africa experienced a severe steel shortage leading into and continuing for the month of September 2020. This shortage was caused by local steel producers not producing sufficient galvanized and painted steel coil used in the roof manufacturing process. GRS resorted to substituting local supply with assorted parcels of imported product to meet this demand. These confirmed import parcels are expected to arrive in South Africa over the three months. ArcelorMittal have, however, indicated that it plans to re-commission its second blast furnace in January 2021, thereby satisfying local demand. The calculated effect of this supply shortage impacted GRS's sales negatively during the latter part of Quarter 1 to the extent of *circa* R30 million. GRS, however, remains confident that it will nevertheless achieve its annual budgeted sales revenues of *circa* R900 million.

- Stalcor achieved 87% of its budgeted Quarter 1 sales revenues. The reasons for this under achievement stemmed principally from its under-stocked position in July 2020. With the PCF now having been put into place, Stalcor steel procurement has resumed and the number of customers serviced has grown to nearly 700 per month. General demand for stainless steel and aluminum does, however, remain muted. Accordingly, Stalcor has forecast an annual sales revenue of R600 million, a shortfall to budget of approximately 9%.

Sales margins

CSI budgeted prime gross margins (being margin on cost of materials sold) for Quarter 1 at 16%. Actual Prime GP% achieved by the Company during this period amounted to 15.2%. The cause of this under achievement is attributed to:

- Stalcor under-achieved its Prime GP% by 1.0 percentage point due to lost volume-related discounts on stainless steel products. At this stage, it is anticipated that this volume-related margin erosion will continue into the foreseeable future.
- GRS under achieved its Prime GP% by 0.4 percentage points due to planned discounted sale of slow-moving inventories and higher than normal sale of coil to GRS's operations based in Namibia and Botswana. GRS's sales margins for the remainder of the 2021 fiscal are expected to be higher than those budgeted due to prevailing steel shortages and improved procurement practices.

Cost of sales management

Due to the stock procurement challenges mentioned above, management and the BRP's have instituted additional control mechanisms to mitigate the risk of short supply. A separate control stream has been implemented. This involves regular meetings with the divisional heads to ensure that the supply lines do not materially impact on the cash flow management stream. The immediate focus in this workstream is to shift the reliance on local supply to imports. This obviously impacts on cost of material, foreign exchange and available funding facilities. This includes the support of CSI's funders with whom management and the BRP's are in constant contact.

COST REDUCTIONS IMPLEMENTED

Prior to the Covid-19 Lockdown, CSI typically generated *circa* R210 million in monthly revenues against a total manufacturing and overhead cost-base of around R25 million per month, the majority of which were 'fixed costs' in nature.

The BR Plan anticipated that 'post Covid-19' trading activity would reduce to *circa* 60% of pre-Covid levels and, accordingly, the CSI cost base had to be urgently and decisively reduced to stop further losses. Under the guidance and direction of the BRP's, the implementation of this much needed cost-reduction and cost optimization plan was accelerated in July 2020.

We are pleased to report that through decisive intervention, the monthly cost-base of CSI (in relation to continuing operations) was reduced to R15,824 million. A saving of approximately R9,2 million per month. An analysis of these cost savings is detailed below as follows:

Payroll Costs

Regrettably, the major portion of the Company's cost-base at the time of Business Rescue comprised 'payroll costs', which, under the circumstances of significantly reduced sales and trading forecasts, could no longer be commercially justified. In accordance with the Labour Relations Act and in consultation with employees and their representative Unions, the Company concluded a Section 189 process by 31 August 2020, which led to the redundancy of 269 employees at that date. By agreement, the retrenchment settlements payable to all affected employees will be paid in four monthly tranches ending 31 December 2020. The aggregate of these retrenchment and related costs amounted to R14 million, funded by the PCF.

We sincerely empathise with each of those 269 employees negatively affected by this redundancy to whom we continue to provide counselling assistance. This unpleasant, but necessary, redundancy process saved the jobs of circa 515 remaining employees.

The full financial impact of this process will only manifest in the October 2020 results which, when compared to the average payroll costs incurred during the year ended 30 June 2020, will reflect a monthly cost saving of R6,05 million (annualized R72,6 million).

Transport and related costs

Prior to the Covid-19 Lockdown, CSI's monthly transport and related costs amounted to roughly R6,985 million per quarter. Reduced sales activity coupled with the cancelling of fuel cards, staff working from home and trip and cargo optimization, resulted in the monthly transport and related costs for the quarter ended 30 June 2020 amounting to R6,211 million – a quarterly saving of R0,774 million (annualized R3,1 million).

Operating costs

Over the quarter ended 30 September 2020, operating costs totaled R12,3 million which is a marginal reduction on the average for the year ended 30 June 2020 of R12,6 million.

Property and rental costs

These costs historically comprised 12,5% of CSI's total cost base and amounted to circa R4,1 million per month. The BRP's and CSI Management have begun the process of renegotiating the property lease agreements in terms of both rate per square meter and total gross lettable area. At 30 September 2020 this process was still underway, with the objective of reducing the cost to circa R2,2 million per month.

Once-off costs

Typical to restructuring, down-sizing and disposing of under-performing/non-core businesses, certain once-off and unbudgeted costs are incurred. The aggregated of these costs for the quarter ended 30 September 2020 amounted to R32 million. The main contributors to these once-off costs were:

- Staff retrenchment costs - 37%
- Business rescue and related costs - 15%
- Corporate financial services relating to the disposal processes – 15%
- Property rentals – 25%
- Other – 8%

CASH FLOW

The BRP's and CSI management continue to successfully focus on and manage cash flow on a daily basis. In the period to 30 September 2020, the Company had achieved close to a 95% accuracy in terms of its budgeted/forecast cash flows and remain confident and committed to the settlement of all 'ring-fenced' historical creditors (amounting to R222 million) together with the payment, within terms, of all trade payables arising post business rescue.

Regrettably, the impact of below budget sales, increased reliance on imports and the cost variances outlined above, as well as operational and funding challenges have resulted in delayed payment expectations pertaining to ring-fenced historical creditors. In this regard, certain payments have been delayed so as to ensure that CSI is able to execute on the Business Rescue Plan. Management and the BRP's remain confident of meeting business rescue creditor repayments and wish to thank creditors for their patience and assistance whilst they navigate the abovementioned challenges.

Although slightly delayed, the envisioned creditor repayments per the approved business rescue plan have progressed well with CSI having advanced payment of approximately R72m to creditors as at the end of October 2020. To date, CSI has managed to advance 81% of the planned creditor repayments which will continue over the ensuing months.

SEPARATION OF GRS AND STALCOR

The BRP's and CSI management have made significant strides in achieving the administrative, operational and physical separation of the GRS and Stalcor businesses, without incurring additional/duplicate costs. In this regard, they expect to have this process completed during Quarter 2.

The trading and financial performance of each of GRS and Stalcor are separately measurable, however, until the above-mentioned separation process is concluded, there remains an element of shared head office costs as part of their respective cost bases. These shared costs have been closely managed and remain within the amounted budgeted in the BR Plan.

POTENTIAL DIVISION/SALE OF ASSETS

Disposal/discontinuance of non-core operations

The BRP's, with the assistance of Deloitte Corporate Finance ("**Deloitte**") and CSI management have:

- Concluded the disposal/return of Stalcor's Aluminium Systems (fenestration) inventories to its principle supplier and concluded the shut-down of this business unit within Stalcor;
- Reached in-principle agreements for the sale of Stalcor's Botswana-based subsidiary;
- Reached agreement, subject to fulfilment of regulatory conditions, for the disposal of GRS's Zimbabwean-based operation. It is envisaged that this operation, Global Roofing Solutions Zimbabwe (Pvt) Limited, will continue to exclusively serve the Zimbabwean market with GRS products and services;
- Reached advanced stages of negotiation for the disposal of GRS's Robertson Ventilation Industries (RVI) after having already begun the managed winding-down of RVI's South African operations. On conclusion of this series of transactions, GRS will, however, continue to manufacture against order, the Orion ventilation systems, the design and intellectual property rights for which remain the ownership of GRS.

Sale of CSI in whole or in part

Deloitte obtained an encouraging number of expressions of interest from prospective third-party investors to acquire either:

- The entire CSI business; or

- Either GRS or Stalcor.

In accordance with the sales process, non-binding indicative offers ("**NBIO's**") were submitted by prospective purchasers on 9 September 2020. These NBIO's are currently being assessed and analysed by the BRP's with Deloitte's guidance.

Deloitte continue to engage with prospective investors to obtain or provide further clarity regarding the NBIO's, where required. The intensity of these engagements bodes well for a conclusive outcome in the near term.

It is anticipated that the sale process will be completed within Quarter 2, whereafter a presentation to CSI's creditors will be made and decisions taken by them as to the preferred bidder.

CONCLUSION AND APPRECIATION

The business rescue of CSI is progressing according to plan thanks to the continued support of its business by its most valued customers, suppliers, financiers, creditors and landlords.

The BRP's together with CSI management remain committed to maintaining and increasing the momentum of this successful business turnaround so as to maximize the return for all affected persons..

Thank you.

Chris Ransome
Executive Chairman

Andrew Winter
Chief Executive Officer

Ian Fleming
Business Rescue Practitioner

Sello Mkhondo
Business Rescue Practitioner