

SA Equities: Navigating the minefield

Wim Murray

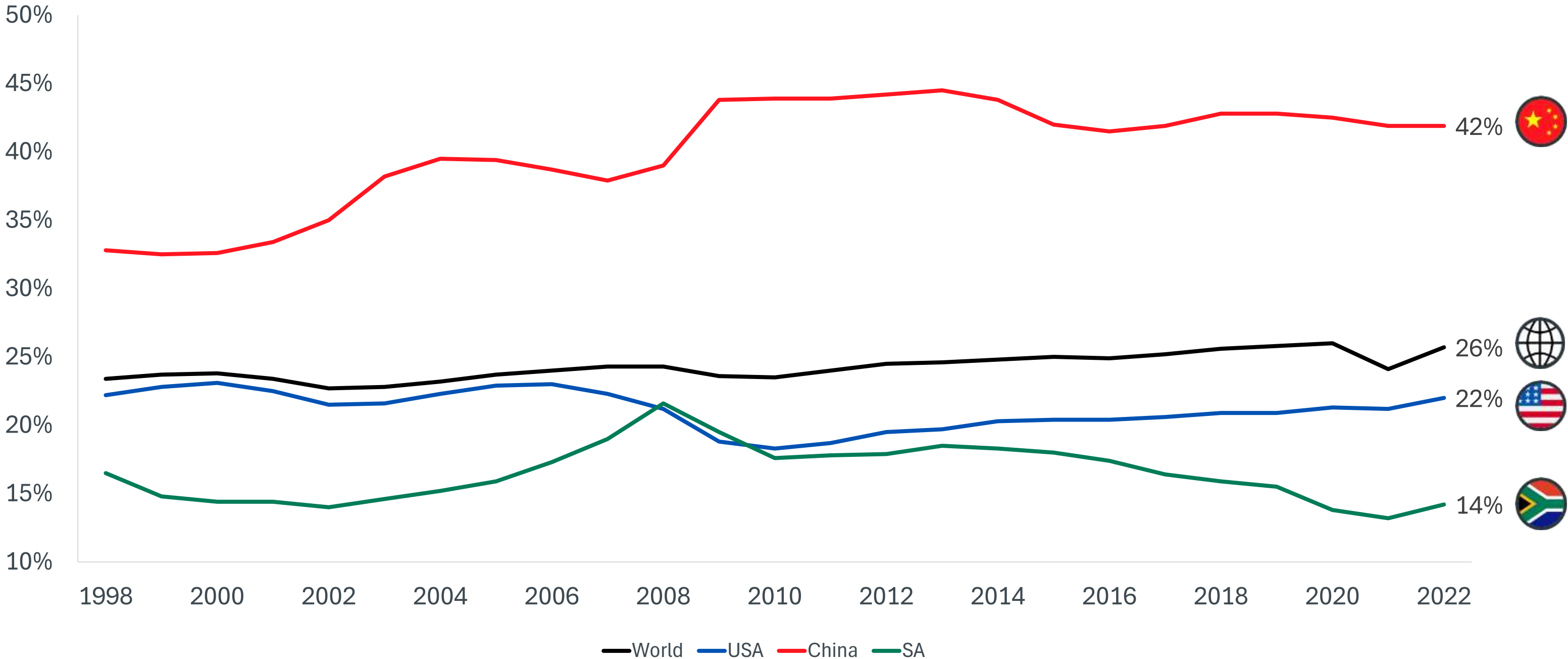
March 2024

Step 1: Understanding the problem



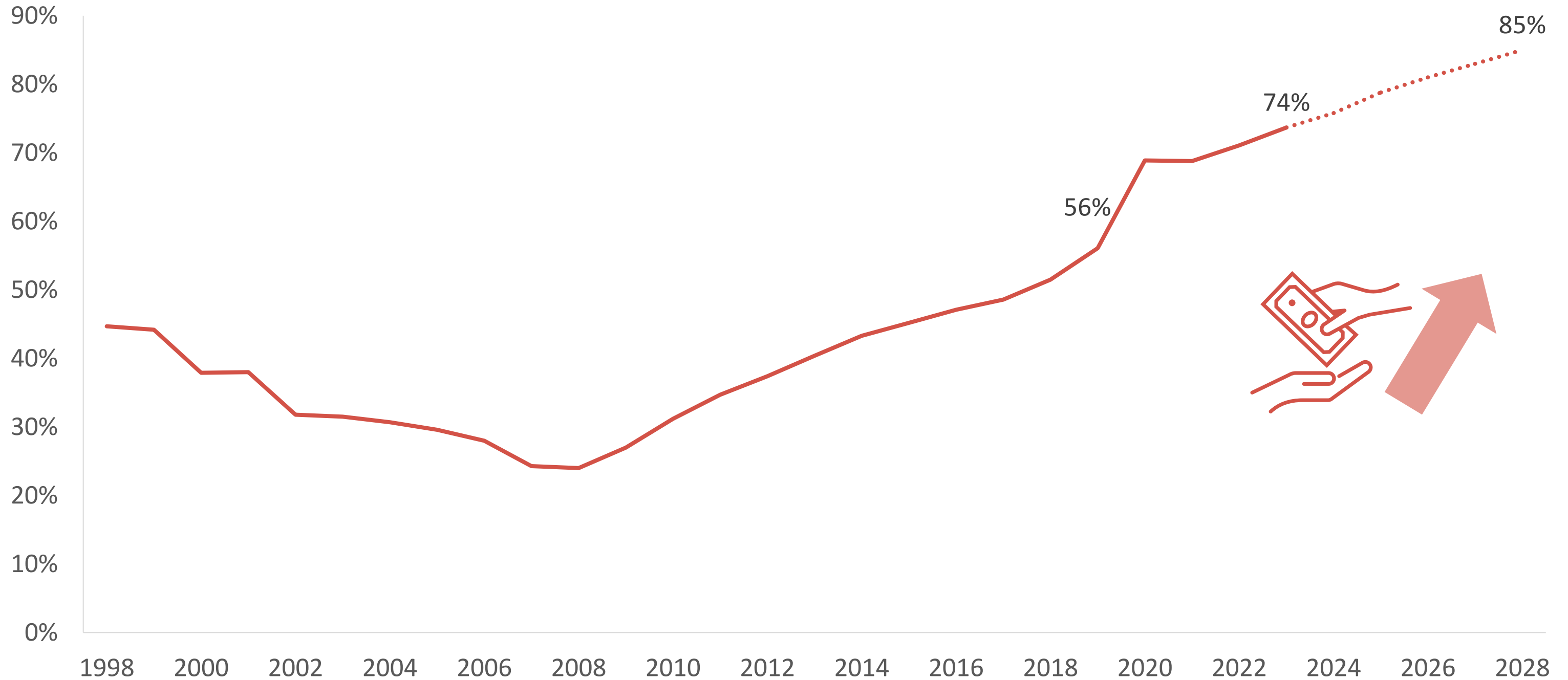
Gross Fixed Capital Formation (% of GDP)

Lack of visibility is keeping capital on the sidelines



SA Government Debt to GDP at its highest level in history

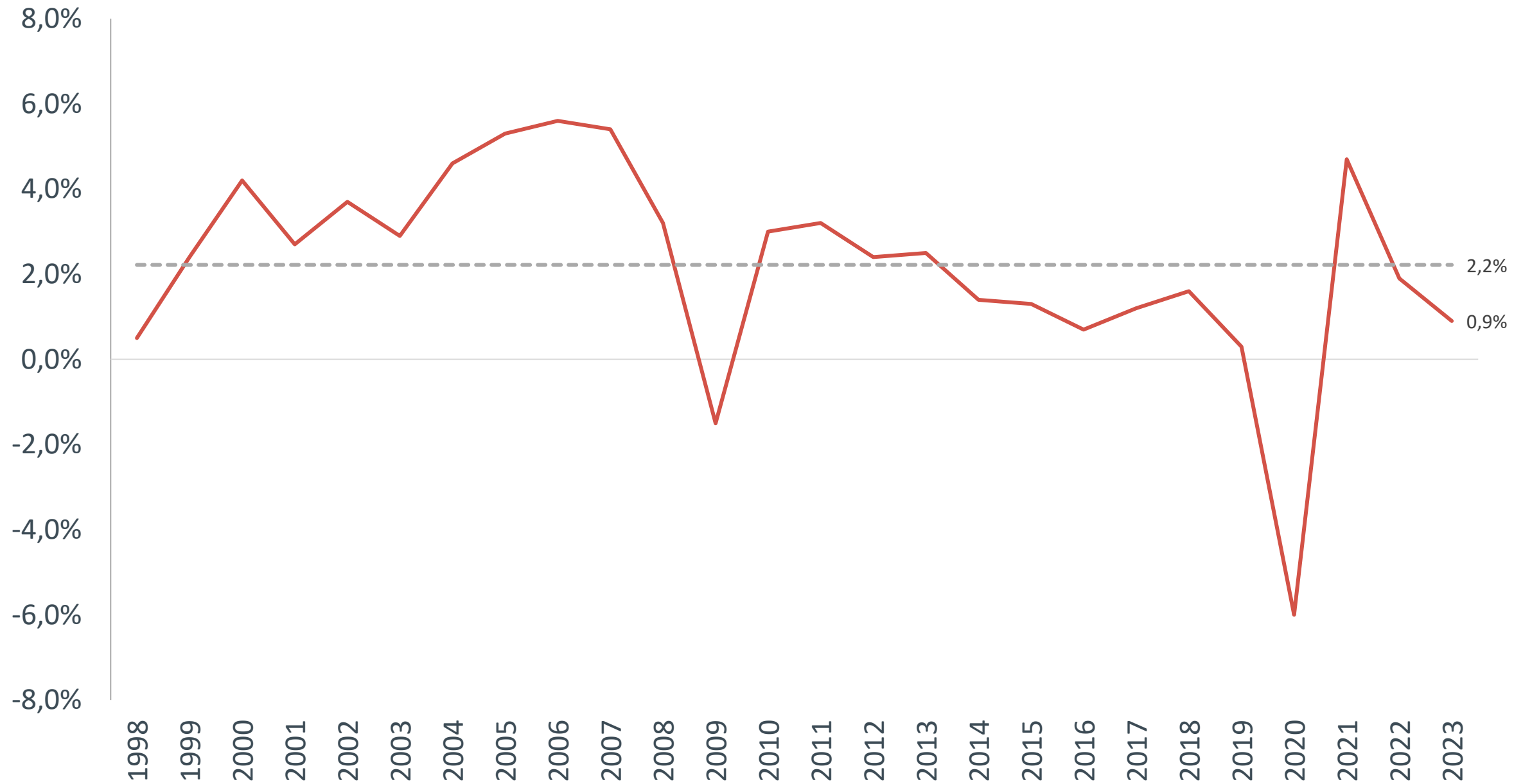
Running out of room to borrow



SA Real GDP has disappointed

Real GDP close to zero year-on-year

Real GDP growth



SARB growth projections benign
2024: 1.2%
2025: 1.3%

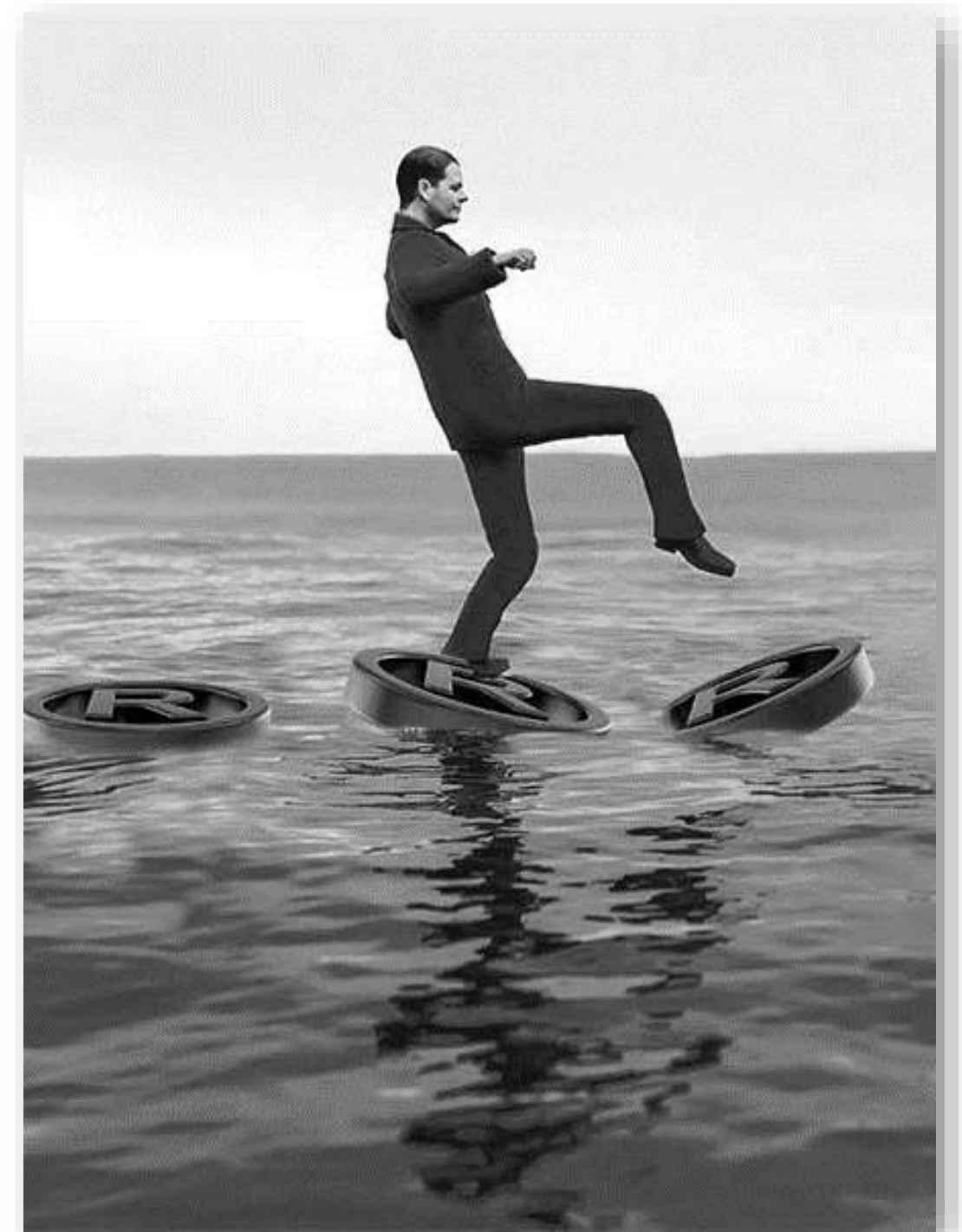
10 year Average = 1%



South Africa - Key take aways

Need to tread carefully

- It's tough out there
- Things are breaking – Eskom, Transnet, Gas (day zero), the next shoe to drop...
- Funding to address problems are drying up
- Low growth to continue

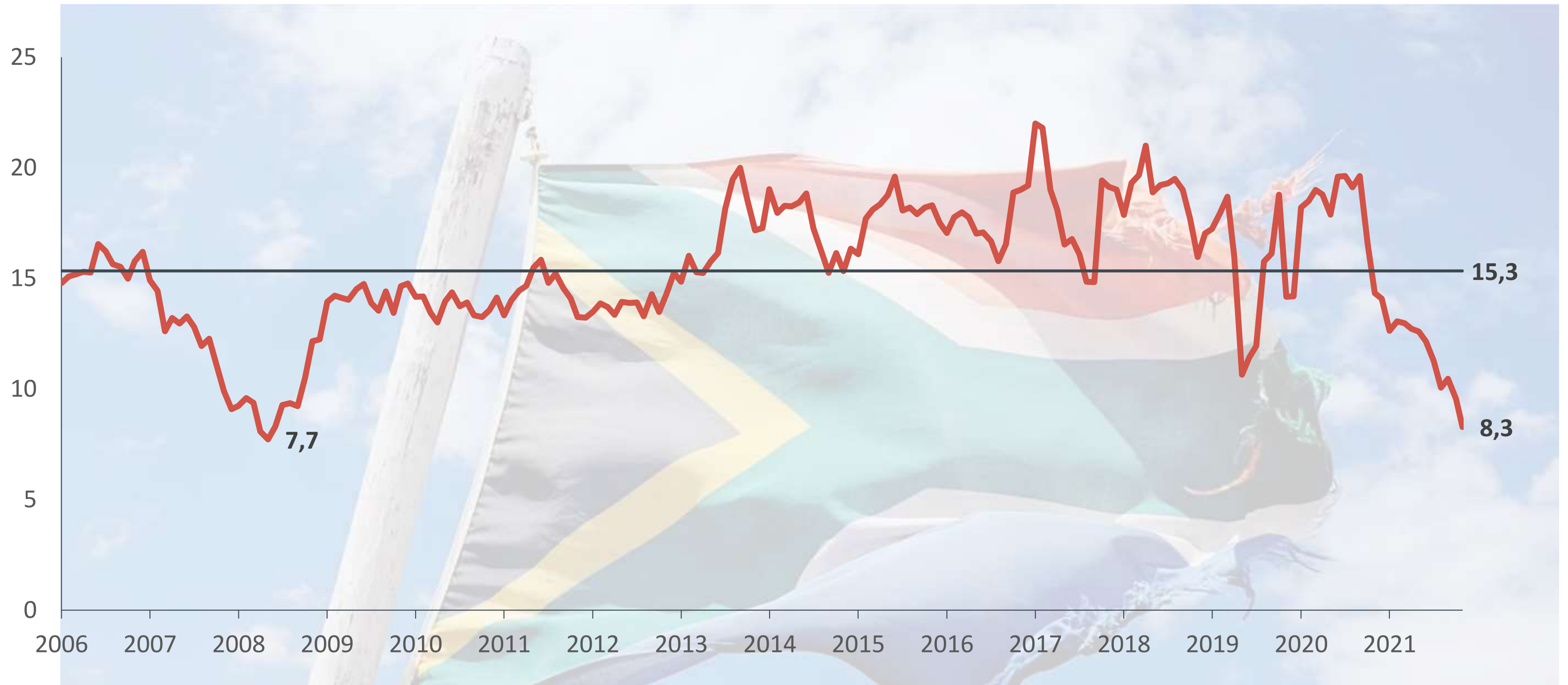


Step 2: Finding the solution



Valuations at levels last seen during Global Financial Crisis

Mid caps are a good proxy for "SA Inc"



How to approach the problem

Low growth - now what?

- Best protection: Buy quality companies with high grade management teams
 - Tough times will test sustainability of earnings
- Low growth reflected in some valuations
- Low beta opportunities: no growth, no problem
- Strong will get stronger



Identifying Opportunities: Four Buckets

Attractive SA Inc investments



Bucket 1: Quality Companies

Outsurance ticks quality boxes



1. High Return on Capital
2. Competitive Positioning
3. Sustainable Business Model
4. Ability to deal with cost pressures:
 - Pricing power
 - Variable cost

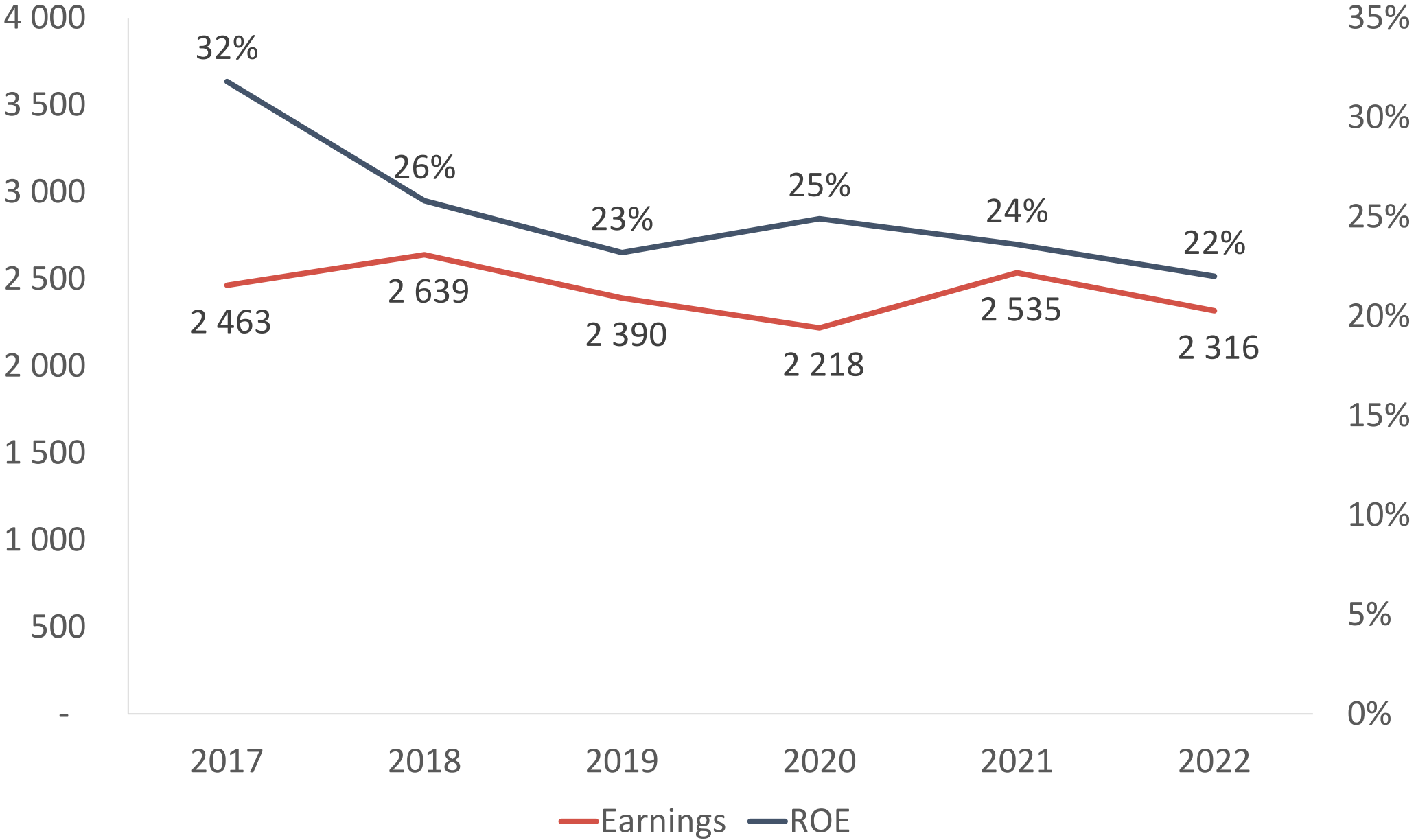


Outsurance

Finding quality



Earnings (Rm) v Return on Equity



At first glance, there is little to get excited about:

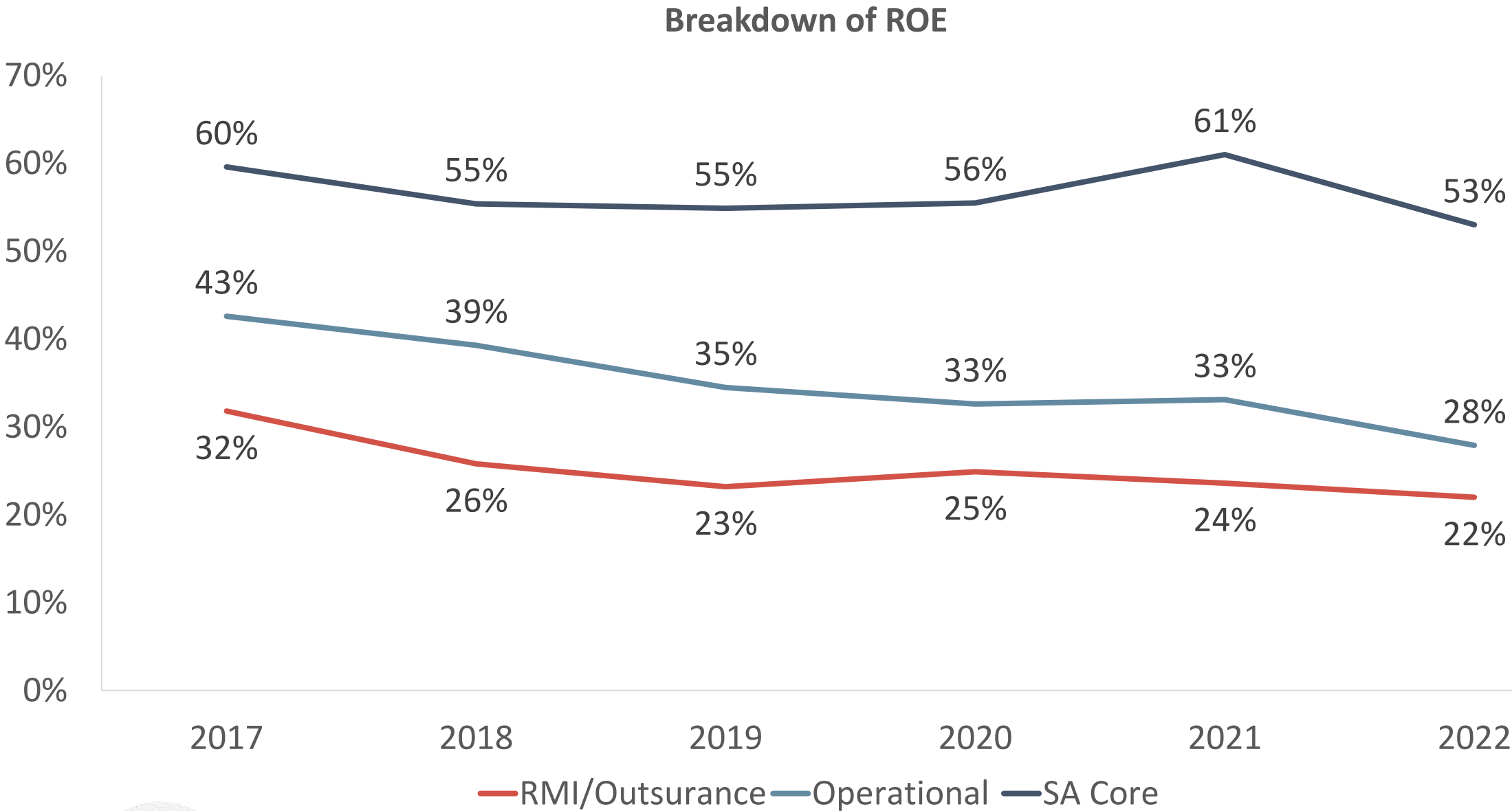
- Flat earnings for 5 years
- Decent but declining ROE



Outsurance



Understanding ROE composition – multiple temporary factors impacting returns



- RMI head office cost
- Non-core assets
 - Hasting investment
 - Incubator funds
- New initiatives
 - SA Commercial
 - SA Life



SA core insurance: the jewel at the centre

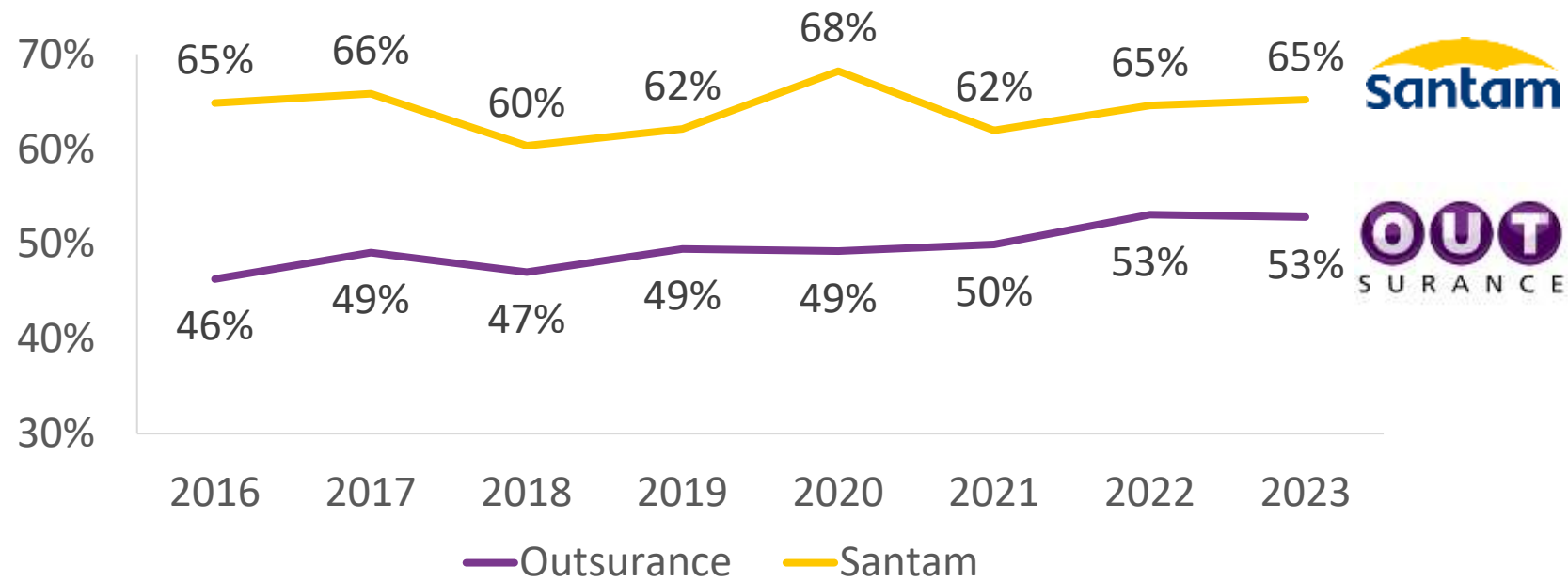


Outsurance

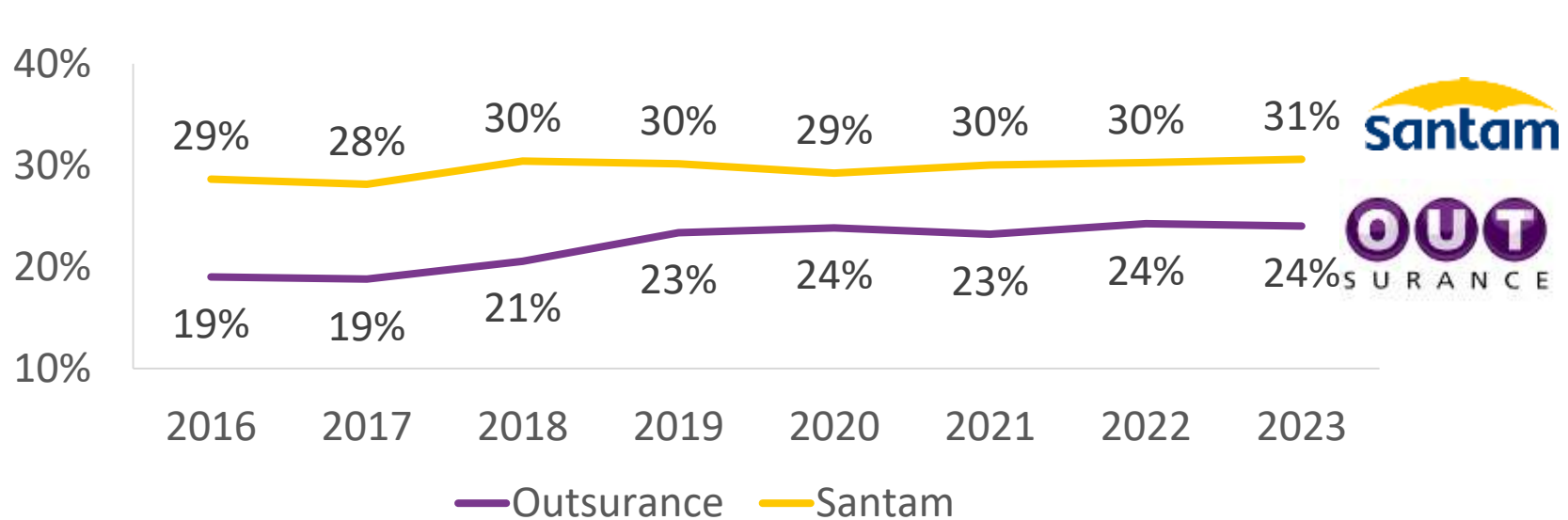
Understanding the competitive advantage



Claims ratio



Cost ratio



Superior Risk pricing

- In-house built systems
- High market share drive data
- Better at identifying risk factors and customer profiling

Lowest cost producer

- Direct model enable lower acquisition costs
- Mono-line player (largely motor) streamlines teams and eliminates duplication costs.
- Marketing drives inbound leads (as opposed to call centre)

All in cost of doing business 19% lower than peers



Outsurance

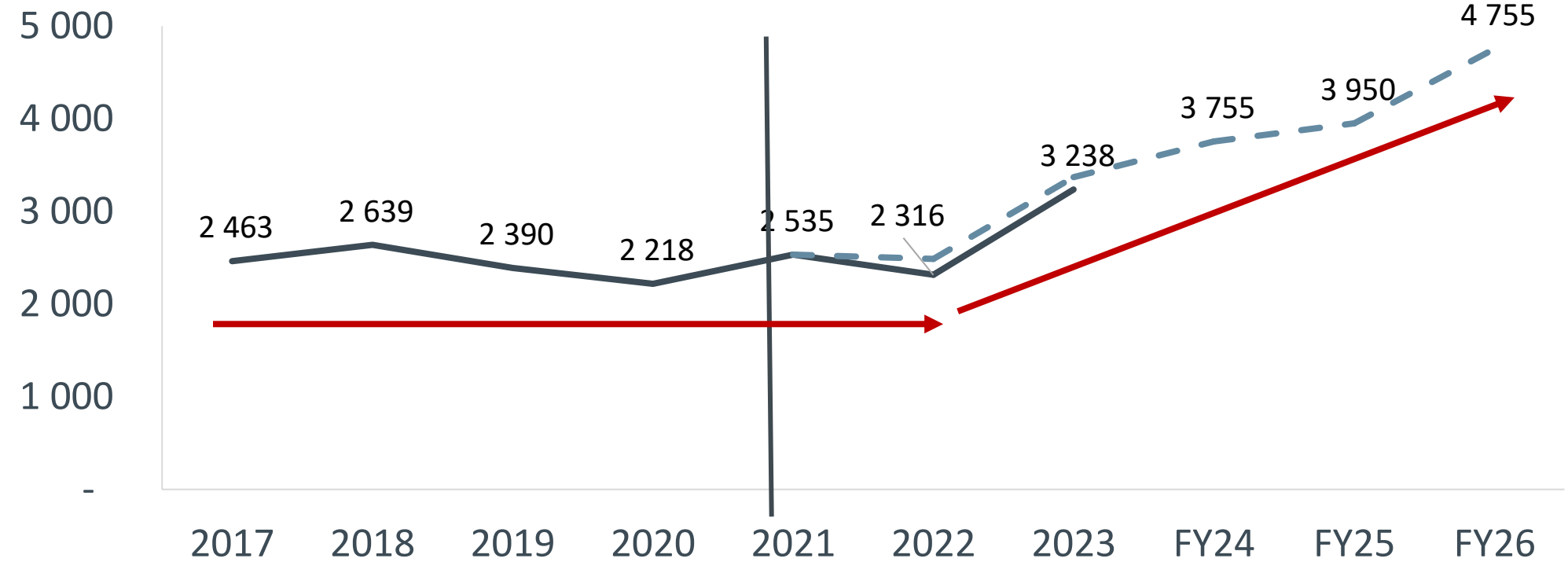
Looking Forward

High Conviction

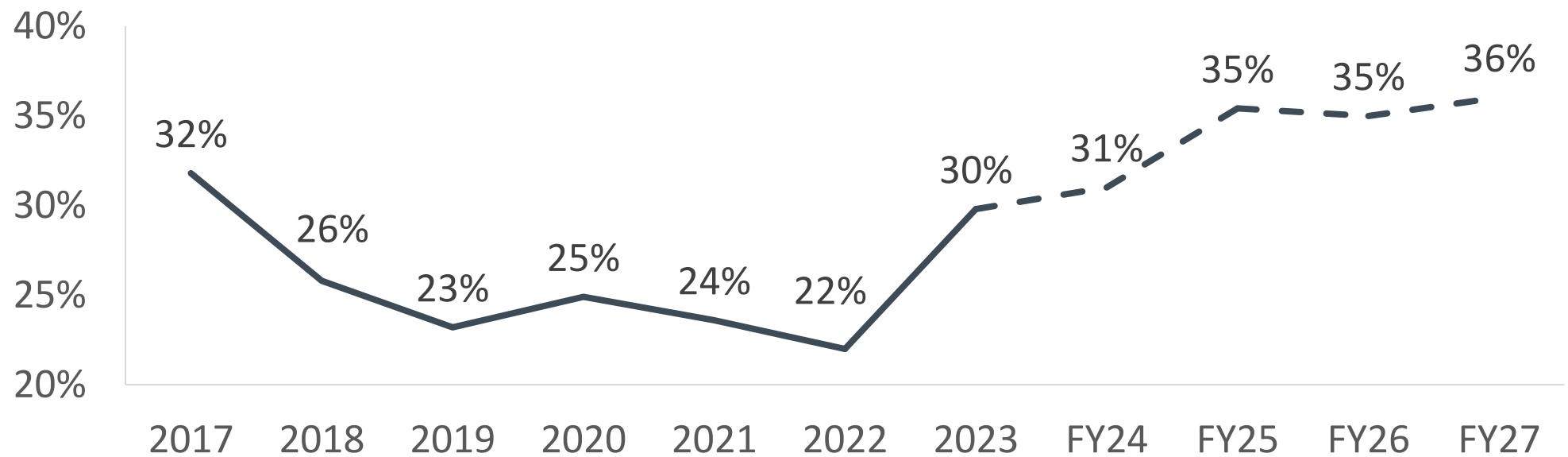
- Temporary factors to fall away
- Underlying quality to become evident
- Competitive advantage sustainable



Group Earnings (R'm)



Group ROE



Higher Earnings + Higher ROE drive meaningful shareholder returns



Bucket 2: Quality Management

Protection against the storm

Management faces daily challenges in South Africa
- competitive pressures, changing landscapes and many curveballs

Requires:

- Astute capital allocation
- Pragmatism
- Long term focus
- Incentives aligned with shareholders



Quality Management Case Study: FirstRand

Best in class management

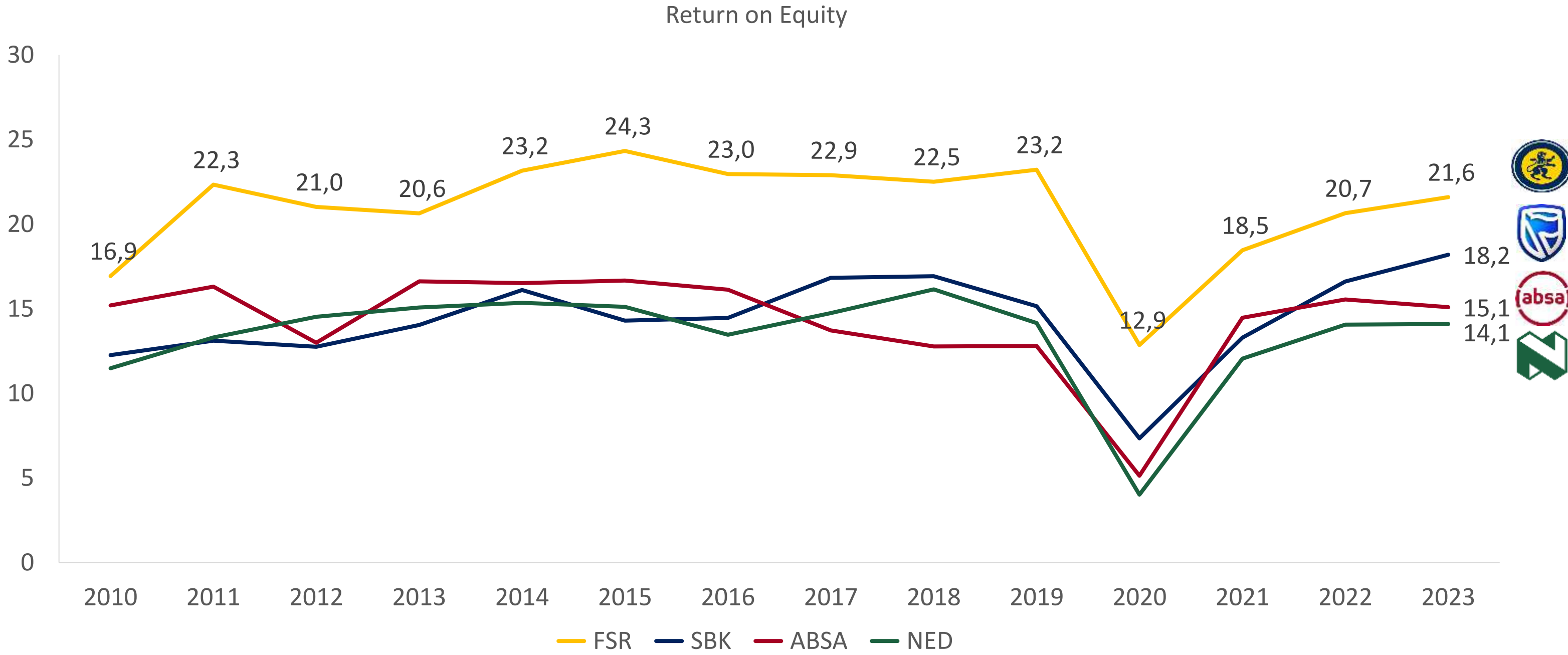
- Deep understanding of capital allocation
- Rational
- Long term focused
- Entrepreneurial
- Ownership culture
- Incentives aligned with shareholders
 - Performance based, on a divisional level
 - Considers Cost of Capital and Cost of Risk

Results in higher Return on Equity



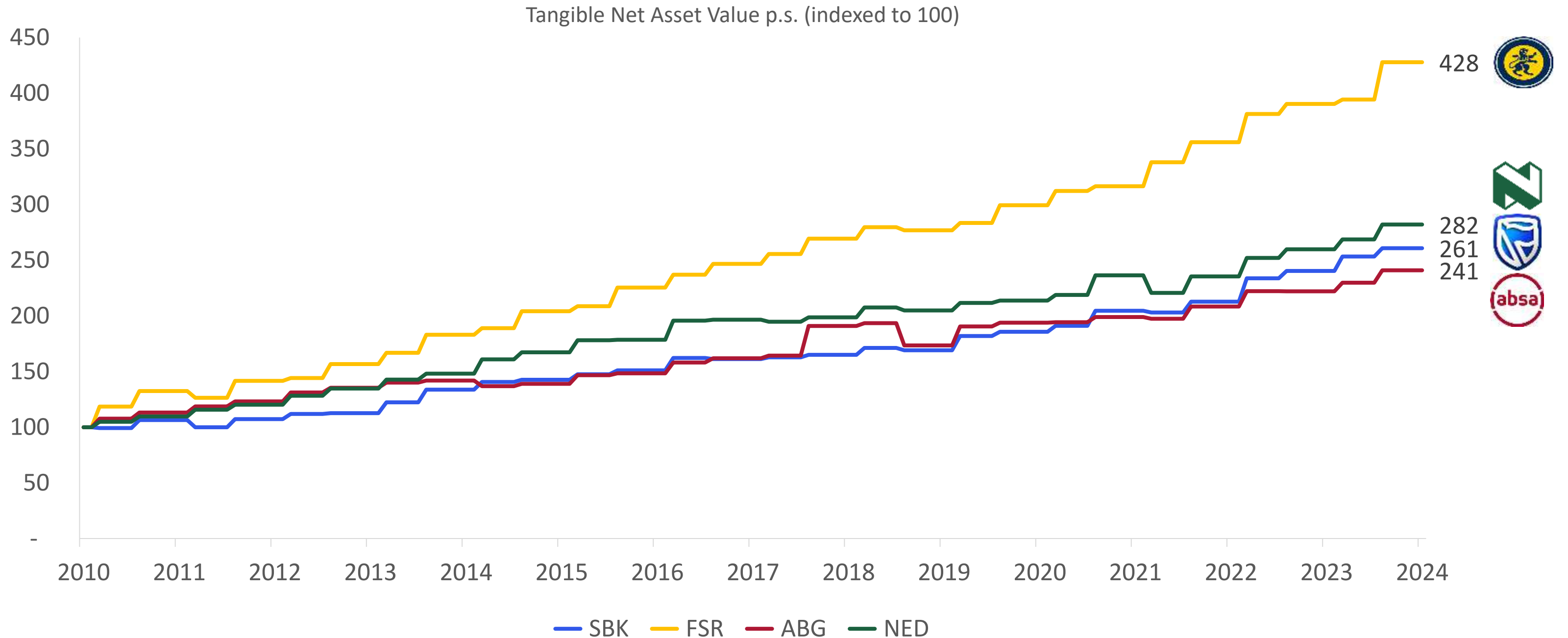
Return on Equity averaging 7% higher than peers

Higher returns at lower risk



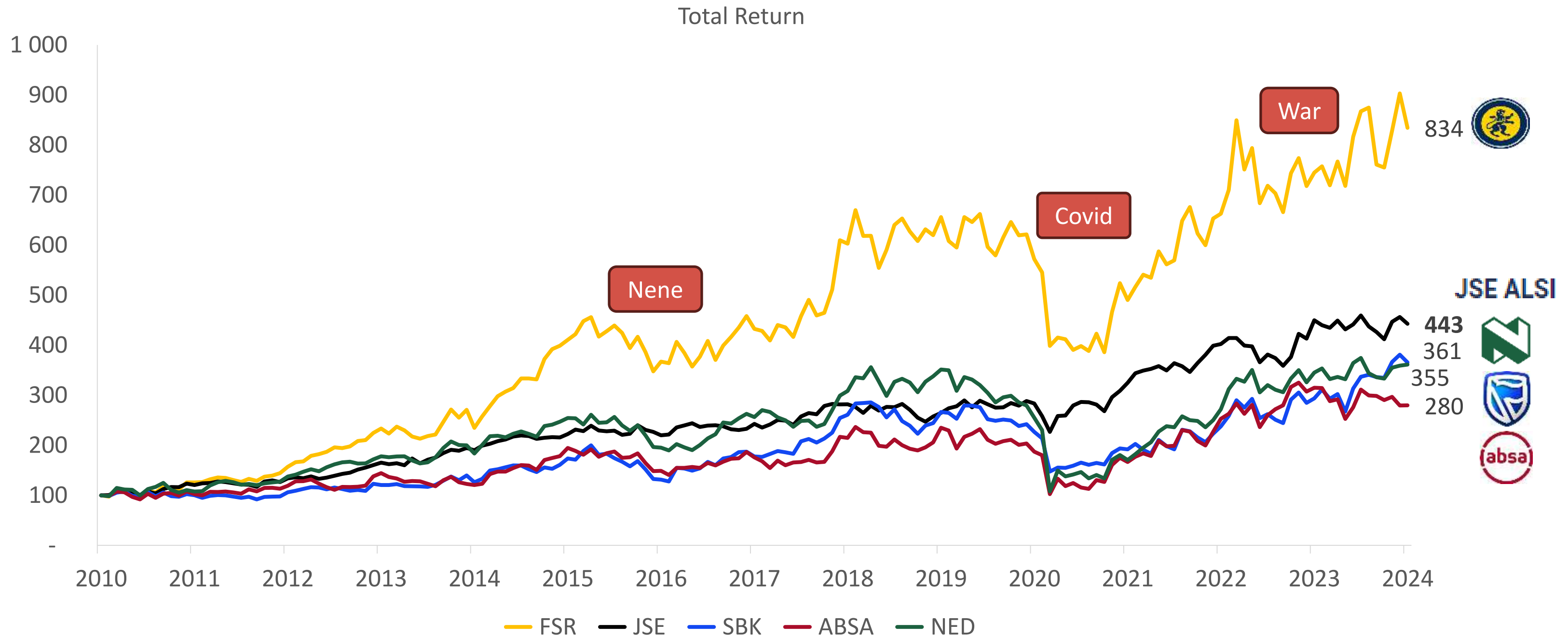
Ability to deploy capital at attractive rates

ROE + Retained Capital + Time



High Return on Equity meaningfully adds up over time

Stellar returns in a “commoditized” industry



Bucket 3: Growth in a no growth environment

There are always winners



- GDP growth is an amalgamation of various sectors - some sectors are still seeing good growth
- Within industries there are growth stories
- Competition toppling over



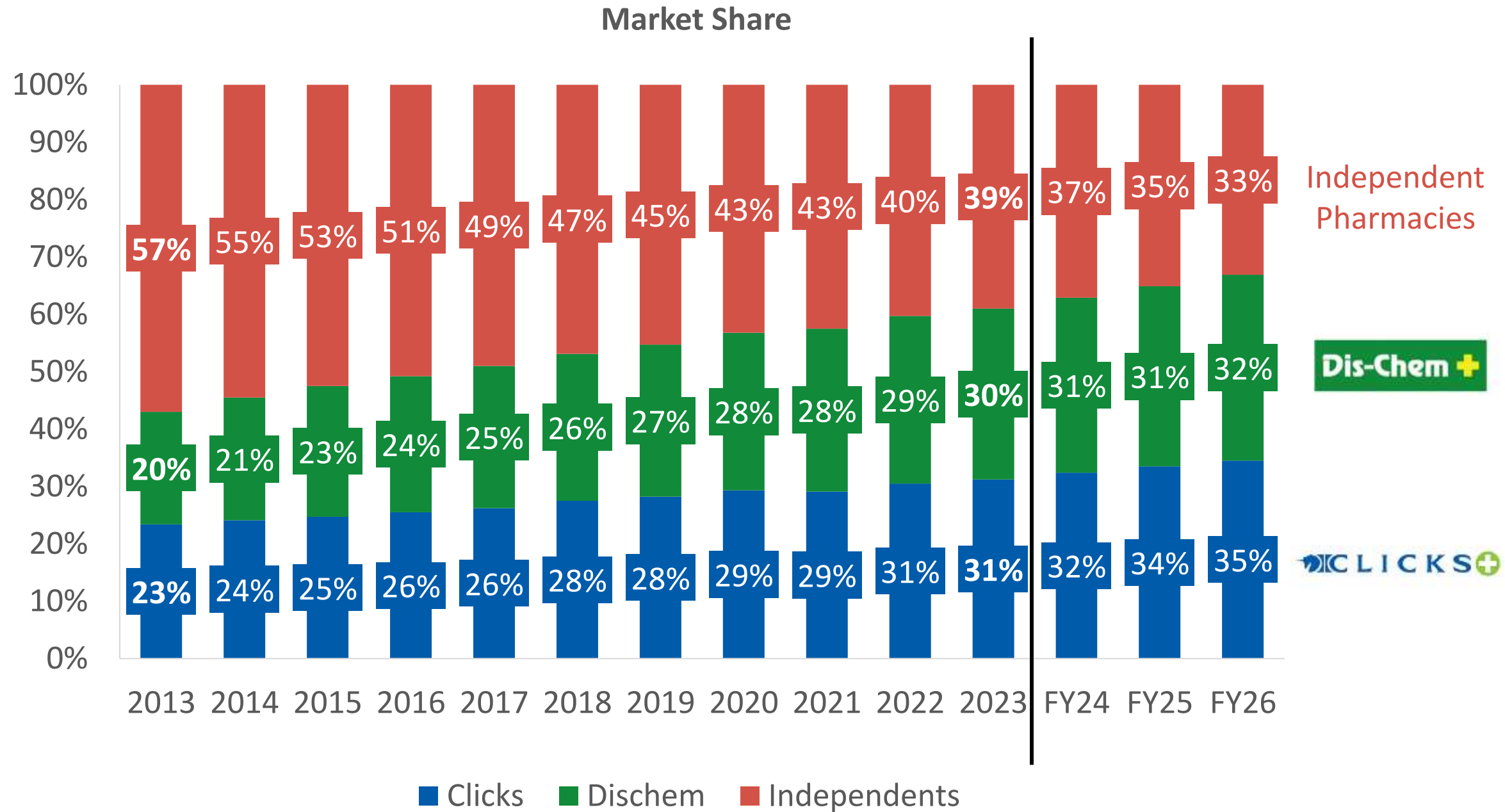
Dischem

Structural Growth Story



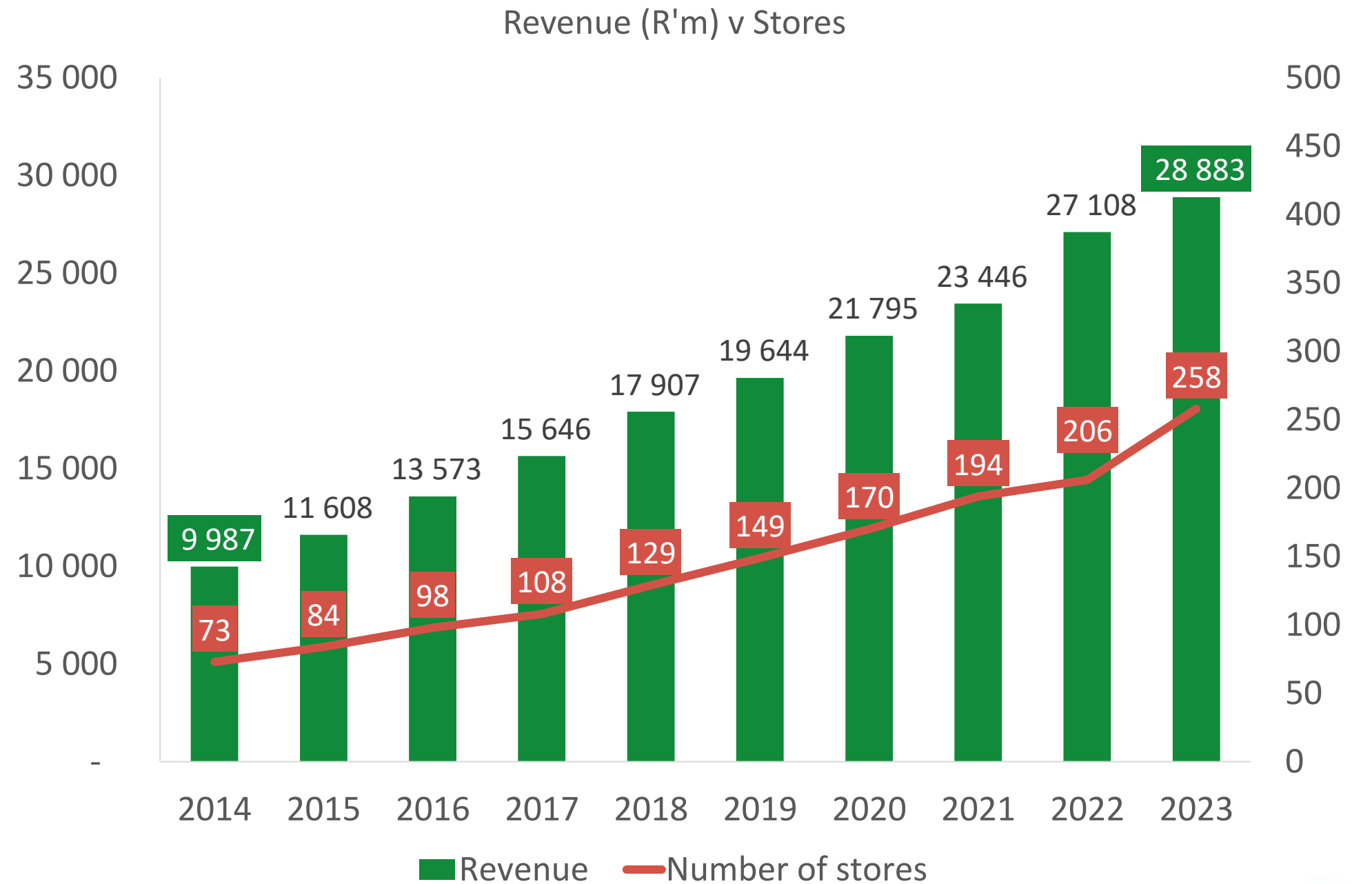
Independents toppling over

- Lost 18% market share past decade
- Unable to compete against scale of listed players



Store Footprint

- Driving revenue growth
- Focus on smaller format

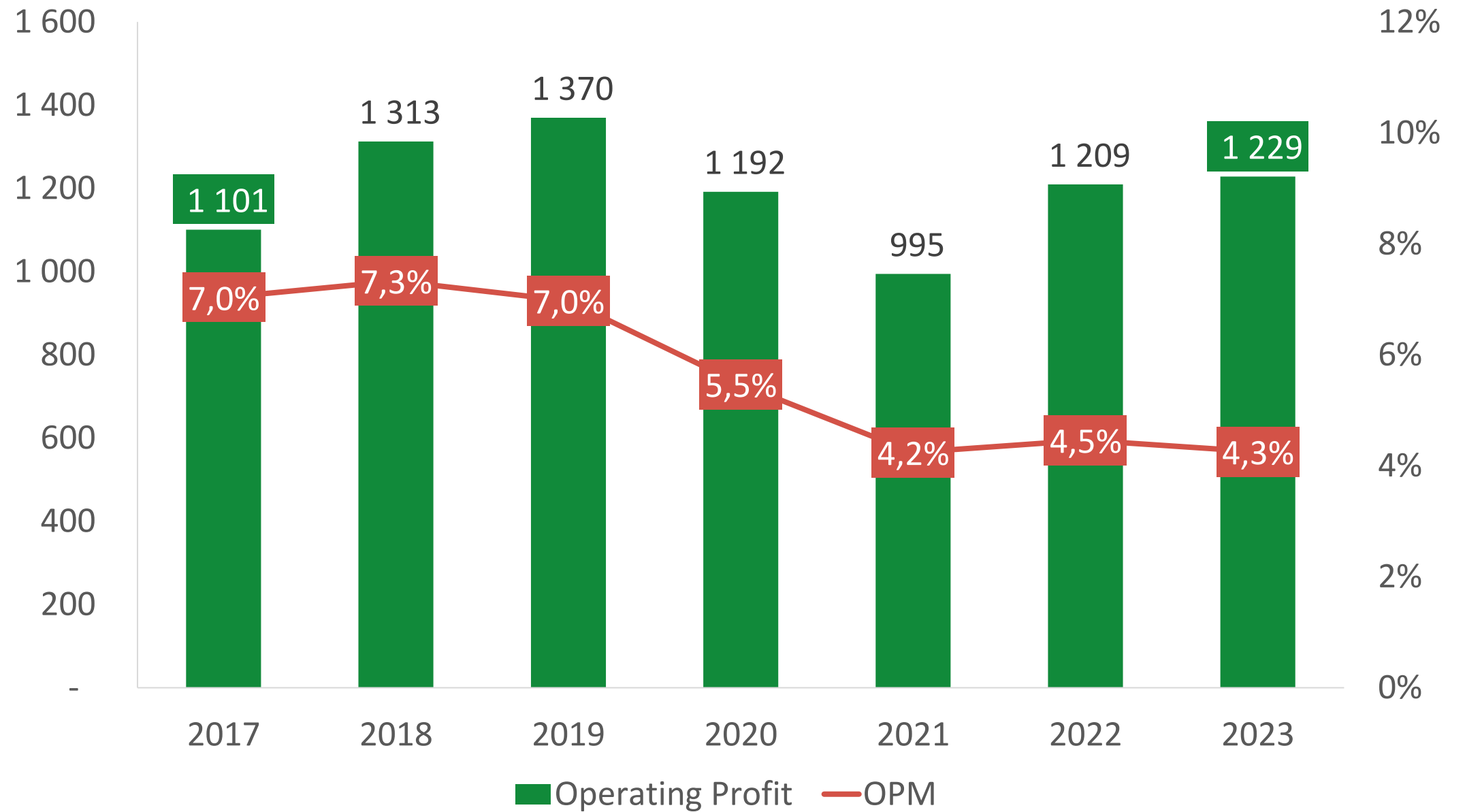


Why does the opportunity exist?

Execution since listing

- Executed on landgrab
- Little focus on costs
 - Staff cost
 - Smaller stores
- Muted operating profit

Retail - Operating Profit v Margin



Dischem

Going forward – New CEO



Clear shift in focus

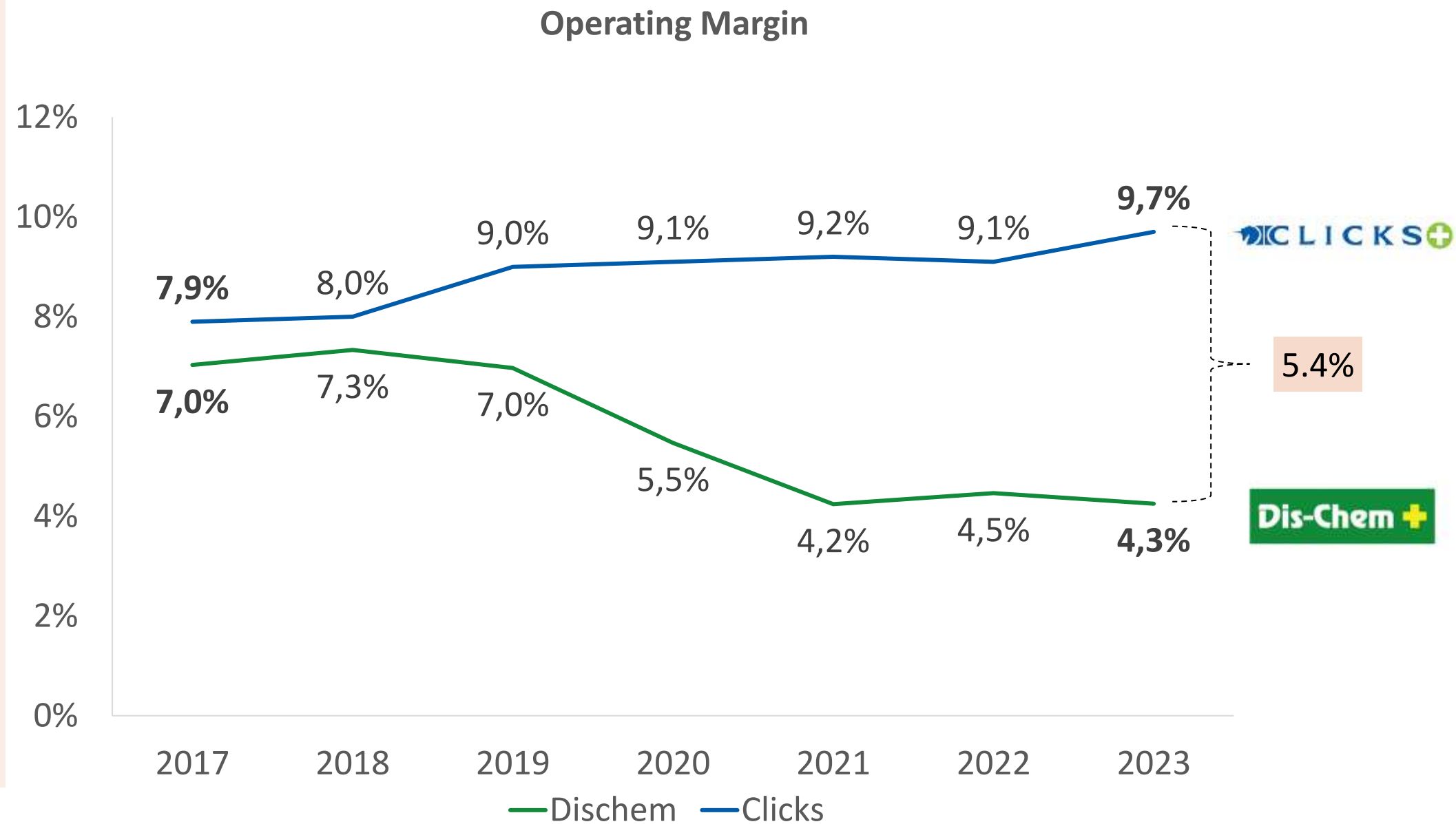
- Opex and staff cost.
- Incentivized to execute
- Fixable

Fundamentals

- No reason gap versus Clicks should exist

Outlook

- We expect margin to improve



Market is not pricing in improved margins



Bucket 4: Low Beta Opportunities

Outcome not reliant on macro environment



What we are looking for:

1. Opportunities where factors are under management's control
2. Management incentives aligned with shareholders to unlock value
3. Ability to execute swiftly

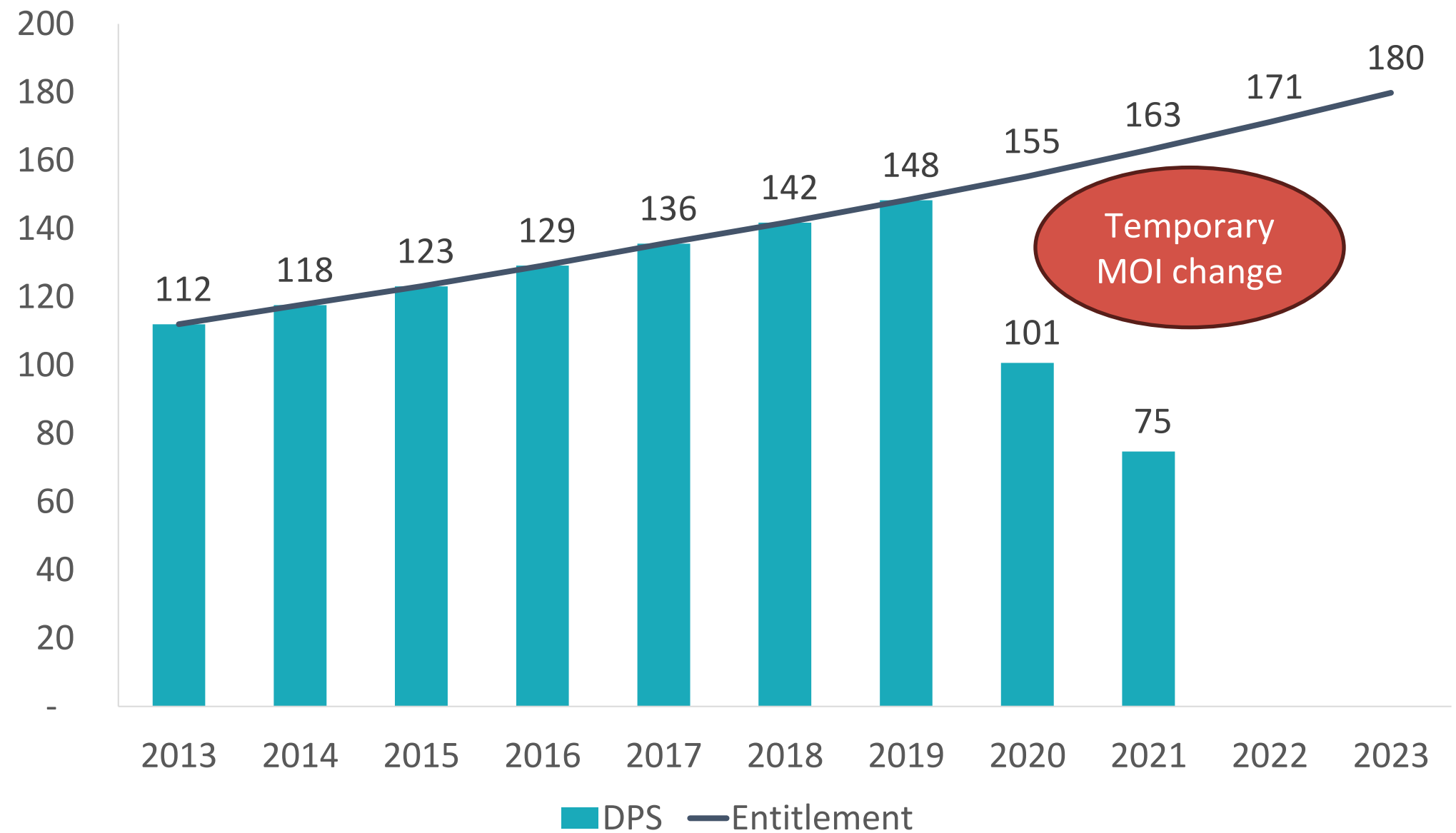


Fortress

Quasi Debt instrument backed by underlying assets we like

- A's entitlement grows at CPI
- Entitlement not met then no divi to A's or B's
- All capital retained
- Loss of REIT status

Dividend Per Share v Entitlement



Fortress

Two scenarios were at play

1. Status quo

- Recapitalize
- Resume divi in 2026 (R2.08)

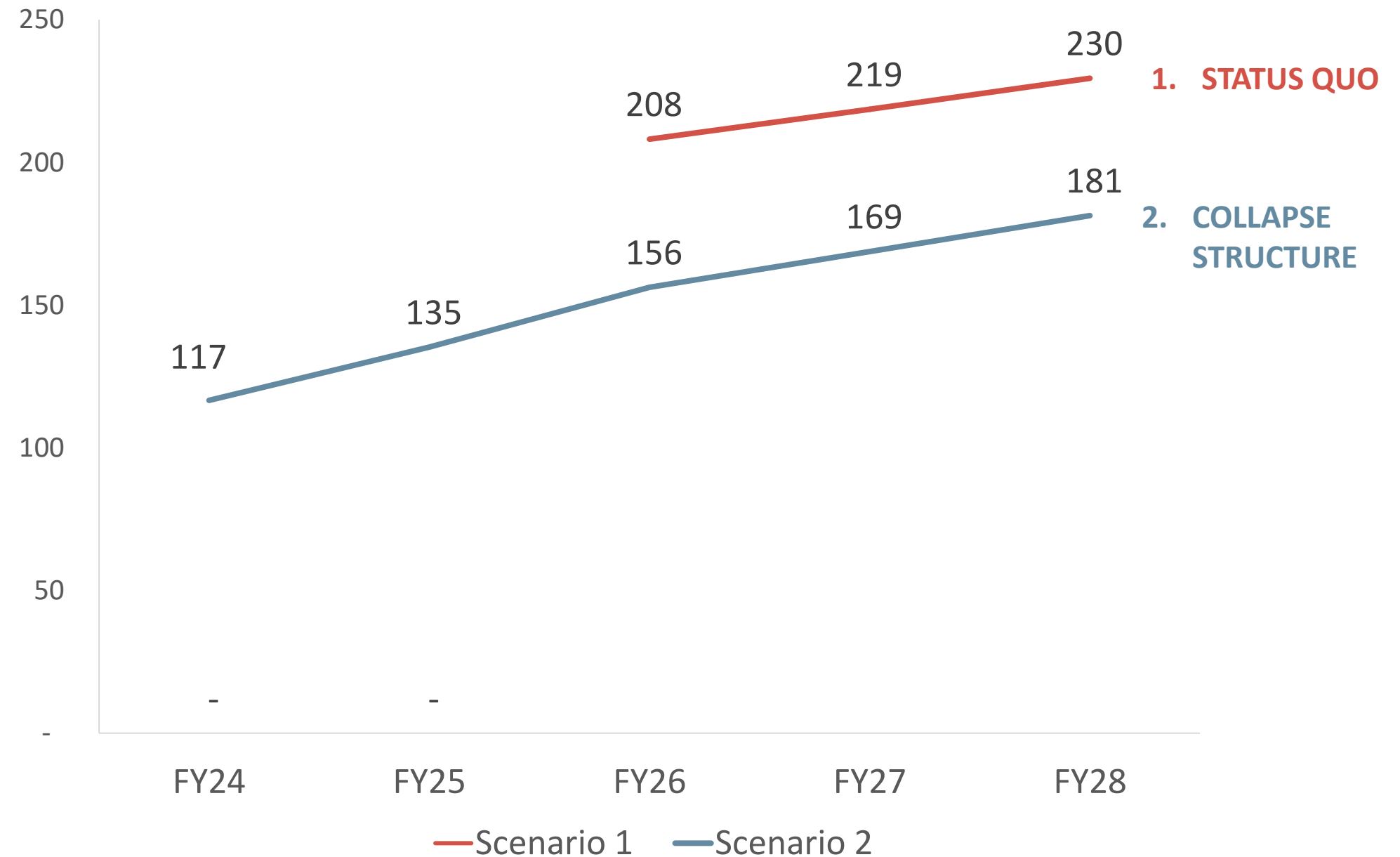
Fair Value = R17.60

2. Collapse structure

- Requires shareholder vote (75%)
- Terms uncertain

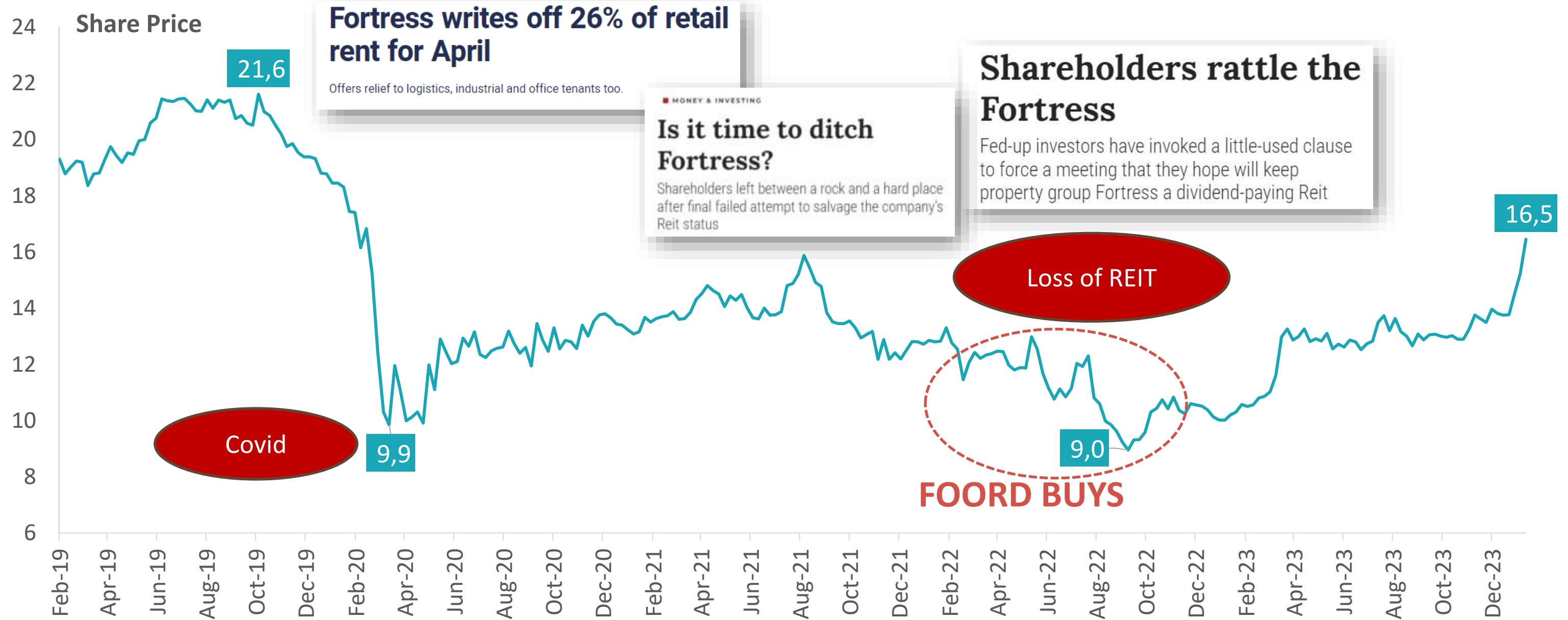
Fair Value = R15.25 to R18.70

Outlook: DPS under various scenarios



Fortress

Was in a bit of a mess...



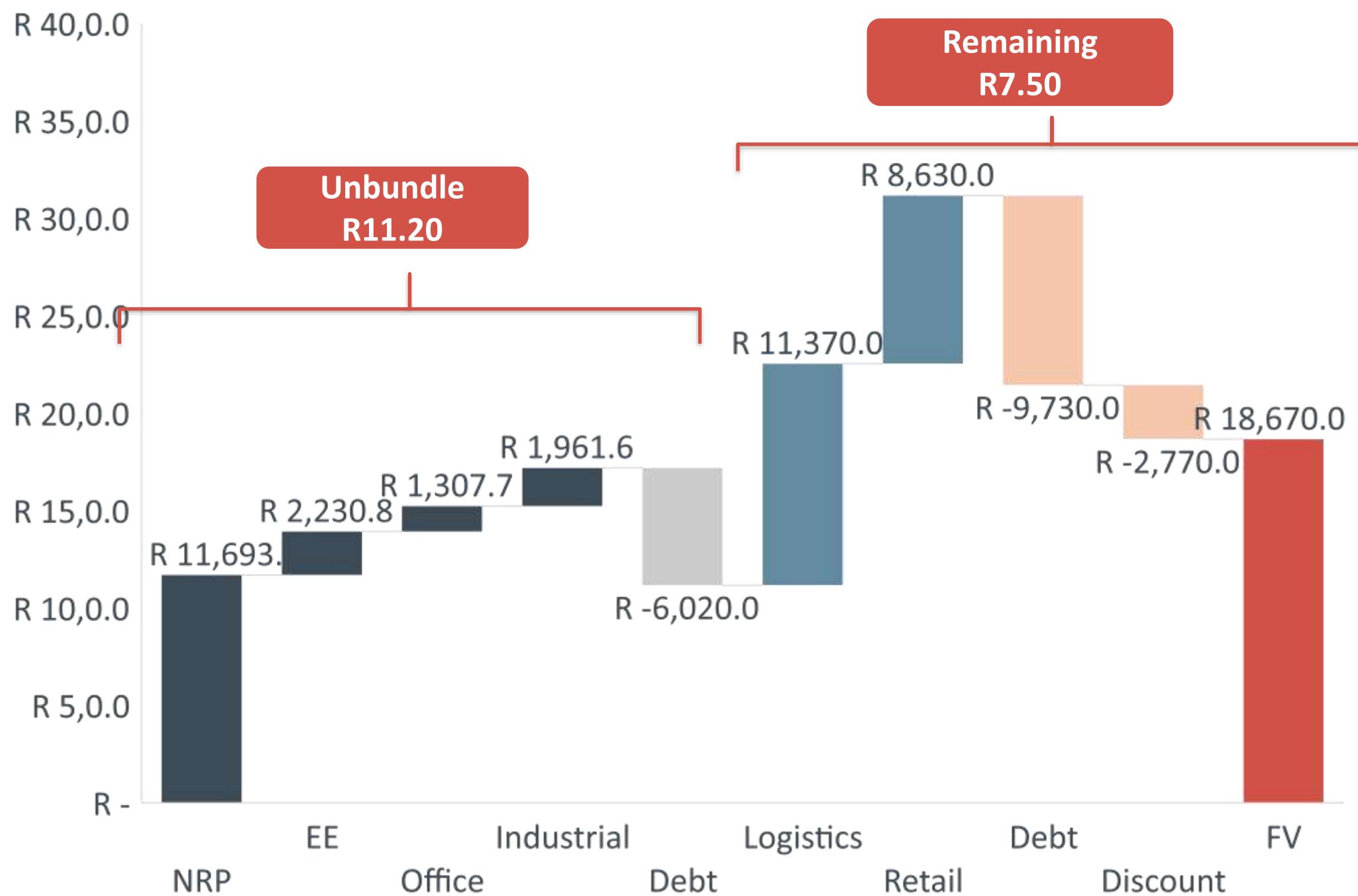
Market extrapolating bad news



Fortress

Current investment case

Breakdown of SOTP p.s



Unbundle = R11.20

- Nepi
- Non-Core
- Low yielding

Remaining = R7.50

- Logistics + Retail
- 9.0% DY with growth
- Conservative discount to NAV

Total Return around R18.70
range



SA Equities – Navigating the minefield

Four buckets where opportunities can still be found



Find companies with quality characteristics



High grade management teams provide protection



Identify companies that can still grow in a no growth environment



Look for low beta opportunities – where outcome not reliant on macros



THANK YOU

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External sources used:

1. Factset/IRESS MD SA/Bloomberg
2. BEA gov.
3. BofA Global Research
4. Federal Reserve
5. The Conference Board (© The Conference Board, Inc)
6. Bank of America
7. Yale/ Shiller data, Foord calculations
8. Goldman Sachs Global Investment Research