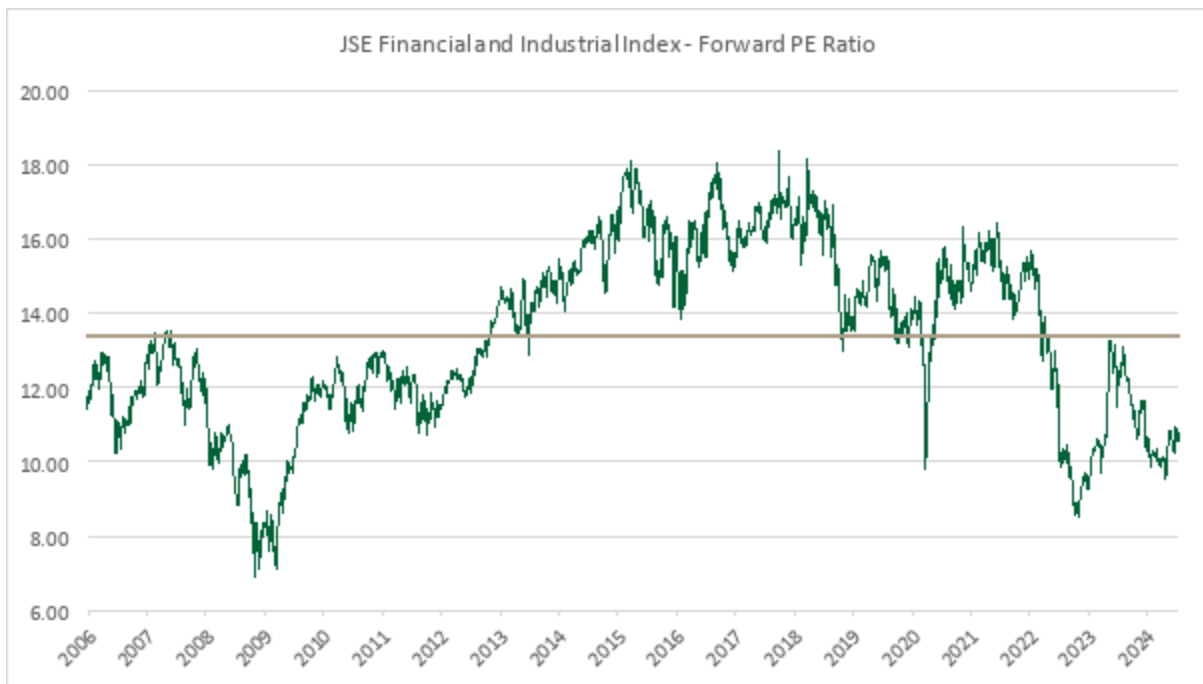


Domestic focused SA company share prices well positioned for an extended run

By: Jean-Pierre du Plessis, Director, Stonehage Fleming Equity Management, South Africa

During June, the domestic equity market benefited from much improved sentiment towards local asset classes following the Government of National Unity (GNU) announcement and the new cabinet. The JSE Financials Index returned 13.2%, enabling the JSE All Share Index to deliver a return of 4.1% for the month. Notwithstanding the recent positive rerating in domestic focused company share prices, valuations remain well below long-term averages and well positioned for an extended run given what appears to be gathering tailwinds.



Source: Bloomberg, 30 June 2024.

FirstRand and Pepkor are two such companies held in the Stonehage Fleming Equity Prescient Fund and are well-placed to benefit from these mounting tailwinds.

Reflecting our general positivity towards the domestic banking sector, the Stonehage Fleming Equity Prescient Fund has three banks among its top 10 holdings (as of 30 June 2024): FirstRand, Standard Bank and Capitec. Each of these banks has a unique competitive advantage and high-quality characteristics, and we perceive sustainable growth prospects for all.

FirstRand is, and has been for some time, our largest banking exposure. The company structure is unique in that it operates with specialist standalone entities: FNB, RMB, and Wesbank. As a group, the company has been able to generate impressive returns through its lending mix, with higher-than-average lending margins, lower-than-average credit losses due to superior underwriting with a leading rewards program, and customer retention versus peers.

Through cross-selling to their retail client base, which makes up 28% of the domestic banking sector's retail deposits, they generate the highest income per retail client in the industry. This is testament to the experience and quality of the management teams and their value proposition to clients.

The group has consistently delivered pleasing returns on equity (averaging 22% over the last five years, excl. Covid) well above the cost of capital, enabling sustained organic growth.

Within the retail sector, the Stonehage Fleming Equity Prescient Fund is invested in Shoprite, Dischem, Clicks, and Pepkor.

Pepkor has delivered a somewhat disappointing performance since listing in its current form in 2017. Impressive revenue growth has yet to translate into bottom-line growth and shareholder returns. Some of this can be attributed to their past as a subsidiary of Steinhoff, which entailed restructuring and several “once-off” type expenses. Steinhoff (now Ibex) today owns 30.2% of Pepkor.

Pepkor offers an attractive positioning to the lower end of the consumer market through their key brands, Pep and Ackermans, with defensive product lines and a compelling route to consumers. The group’s store footprint is unmatched in the apparel space (some 2.4million m² of retail space over c.5,800 stores), thereby enabling the group to sell 7 out of every 10 cellular handsets, 2 of every 3 baby garments, and 1 out of 2 children’s garments sold in South Africa.

Topline growth is forecast to continue on its growth trajectory as a result of new store openings (including in the Brazilian market, which Pepkor entered into in 2022), market share gains, a consumer tailwind resulting from lower inflation expectations and the continued rollout of the group’s Fintech offering. We forecast earnings growth to be further supported by declining load-shedding-related costs and lower interest rates, thereby reducing funding costs.

Sources: Factset, Bloomberg, Company Financials, RMB Morgan Stanley Research. 30 June 2024.

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