GNAM Investment Competition 2018/2019

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Our portfolio of 5 shares listed on the Johannesburg Stock Exchange and domiciled in South Africa is listed below:

Symbol	Name	Country	Type	Industry/Objective
BCF:SJ	Bowler Metcalf	ZA	Common	Containers-Paper/Plastic
WSL:SJ	Wescoal Holdings Ltd	ZA	Common	Coal
INL:SJ	Investec Ltd	ZA	Common	Diversified Financial Services
SSK:SJ	Stefanutti Stocks Holdings Ltd	ZA	Common	Building-Heavy Construction
SGL:SJ	Sibanye Gold Ltd	ZA	Common	Gold Mining

This document includes a detailed research report on Bowler Metcalf and short investment summaries for the other 4 companies.

Bowler Metcalf

http://www.bowlermetcalf.co.za/	
Market Cap	R876.24M
FCF (2018)	R37.63M
Net Cash (Estimate)	R562.92M
P/E	10.47
D/Y	4.20%
Price per share	R10.00
SOTP Valuation	R16.15
Upside	61.5%

Investment Highlights

Bowler Metcalf is in the boring business of making plastic containers for consumer goods products.

Run by an aligned management team, they have managed to earn high margins and enviable growth over 30 years.

Two decades ago management decided to diversify through vertical integration, by investing in a beverages company. This company weighed down on the solid results of the plastics division.

Bowler now sold their share in the beverages company, earning a solid return on their investment. Management can now focus on their cash cow, the plastics business.

Management is very conservative, and the company has no debt. The company was cash flush before the sale. After the sale, the company has significant cash resources, and indicated that they will pay out a large special dividend.

Our conservative valuation gives us an estimated fair value per share of R16.15, for an expected upside of 61.5%. Properties, recorded at significantly below market value, and cash balances provide a solid margin of safety. We calculate the net cash and property alone to be worth ~R8.28 per share.

We think that Bowler Metcalf is a simple company that generate healthy and stable profits. Due to the small size of the company it was historically overlooked by institutional investors, but this is changing slowly, with some respectable institutional investors slowly starting to build positions.

The return of cash to shareholders through a special dividend, together with a return of focus on their core business, should see long-term investors earn a healthy return going forward.

Who is Bowler Metcalf?

Bowler Metcalf was formed in 1972 and is listed under Containers and Packaging, General Industrials sector on the JSE. The company has a market cap of R875.3 million, as at 24/10/2018.

Up until recently, they consisted out of 4 main segments. The bulk of their profits were generated in Packaging (44%), Beverages (43%) and Property Investments (9%). The segmental net profit breakdown is illustrated below:

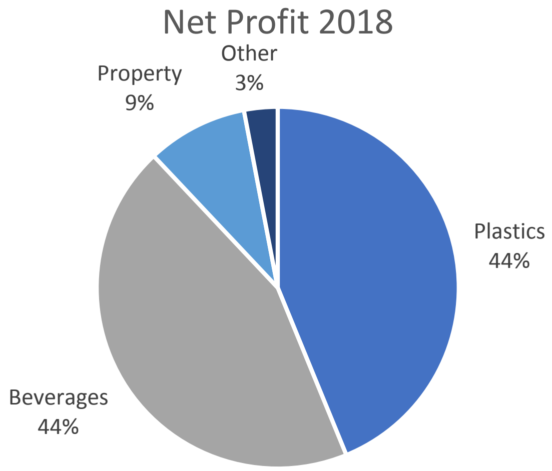


Figure 1: Net Profit Breakdown (Source: Bowler Metcalf)

The *golden goose* has always been the plastics division. This division is credited with Bowler Metcalf's fantastic long-term track record. To the delight of minority shareholders, they have consistently increased dividends over the last 20 years:

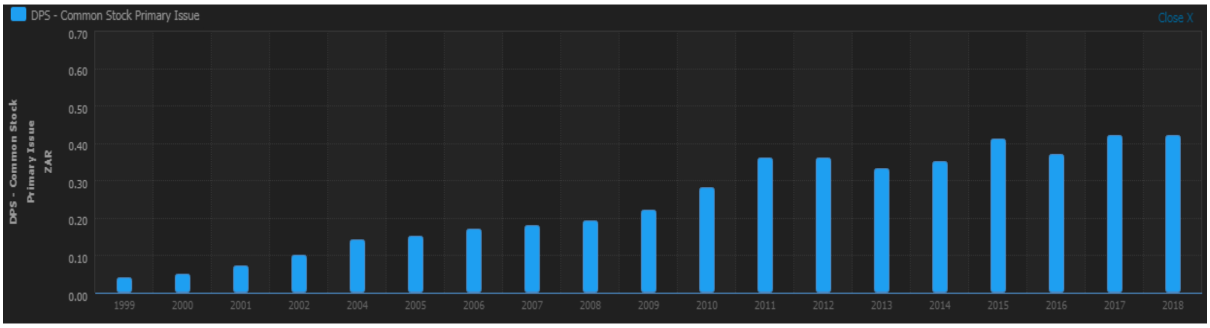


Figure 2: Long Term Dividend Per Share Growth (Source: Eikon)

However, in recent years the challenges faced by the beverages company have dragged the company down, as illustrated by the decrease in ROIC over the recent years:

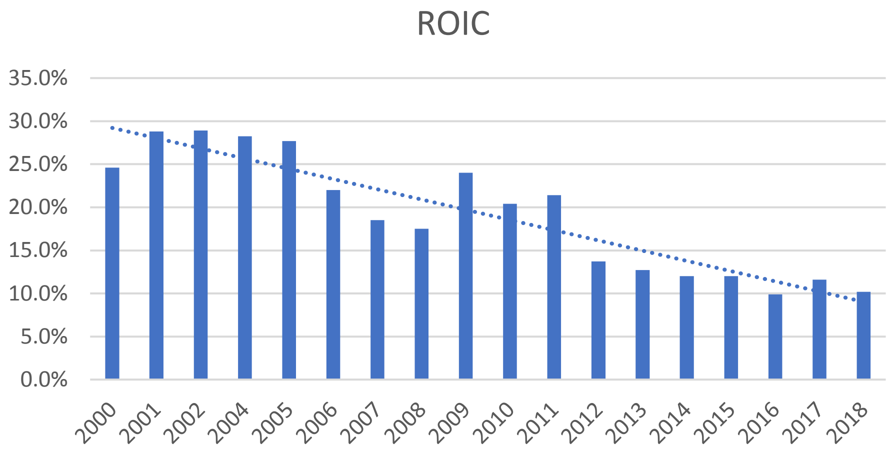


Figure 3: Return on Invested Capital (Source: Bowler Metcalf)

The segments are discussed in more depth below.

Beverages: The thorn in their side

The beverages segment consisted out of the 41.38% share of SoftBev (Pty) Ltd. SoftBev operates in the manufacturing, sales and distribution of non-alcoholic beverages, nationally.

Bowler Metcalf entered the beverages industry in the early 2000's in partnership with a start-up business. They expected that this strategy of vertical integration will lead to synergies between the 2 segments. They competed in the soft drinks category at the lower end of the price curve with brands like Jive:

Figure 4: Brands

Since the launch, this business did well in the Western Cape and Kwa-Zulu Natal. However, competing against giants like Coca Cola is no easy feat, and SoftBev struggled to find traction in Gauteng, which is the largest market in SA.

So, while SoftBev was grown into a formidable national beverages business with turnover of R1.7bil, it demanded constant time and energy from management which detracted their attention from the core plastics business. Regular impairments of this segment also weighed on the financial performance of the group

A Change of Course

Due to the underperformance of the segment, a decision was made to focus the business on their core strength of packaging and sell the Beverages segment. This was approved by shareholders on 29th June 2018.

The beverages segment was sold for R350mil after the June 2018 reporting period. This is an excess over the R233mil book value that it was valued at on the balance sheet. The base consideration in the amount of R350mil and R65mil for the shares and loan account respectively was received on the 6th August 2018.

There is also a deferred consideration element. It is expected that this consideration will be +- R40-55 million, depending on the outcome of the final audit. This will be settled in cash shortly after the completion of SoftBev's audited financial statements for the year ended June 2018. SoftBev managed a much-improved showing in the interim period to end December, so there is reason to be optimistic that the deferred consideration will be to the higher end of the guided range.

As Bowler Metcalf has a small management team, the turnaround and sale of this division demanded ever more involvement of management. Management stated that they were devoting more than 60% of their time bringing negotiations to a successful conclusion. With the sale successfully concluded, this frees them up to refocus on the profitable plastics division.

Plastics: The Goose That Lays the Golden Eggs

The Plastics segment is a beautifully boring business that makes packaging for consumer products, like toiletry, cosmetic, household, pharmaceutical and food markets. They focus on the middle to upper end of the consumer market which is affected less by the economic downturn, as the price of the products are a small expense relative to their total budgets. They partner with clients like Johnson and Johnson. Management attributes the long-term success of this business segment to their focus on partnering only with companies that make non-discretionary consumer products. The growth in the middle class in South Africa is a persistent source of growth for the division.

This segment has been showing moderate but consistent top line growth of 8.1% per year over 5 years. Volumes are growing at 1% per year, while the balance is inflationary price increases.

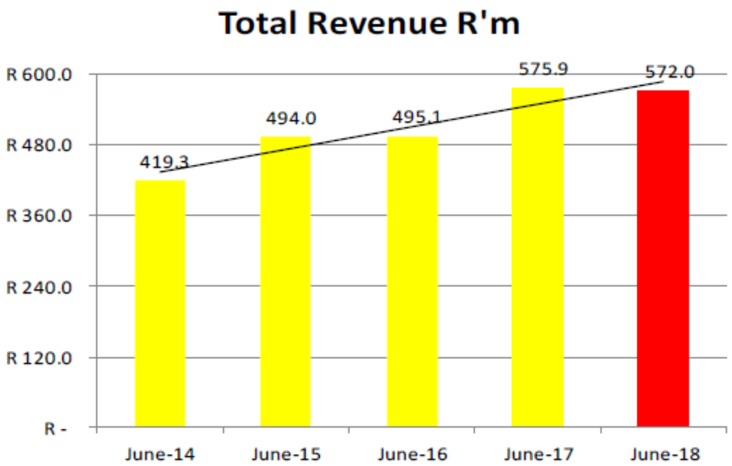


Figure 5: Plastics Revenues (Source: Bowler Metcalf)

The plastics business is integrated into the supply chain of their customers, which increases the switching costs for customers. This has resulted in relatively stable revenues and profits from this segment. In the latest year they earned profits of R68.1mil from the plastics segment. This is a 10% decline from the R76.0mil earned in 2017.

The South African economy slipped into recession in 2017/2018, and the pressure on consumers has had a knock-on effect in the whole supply chain. Consumers' disposable income is currently predominantly channelled towards life's essentials. This saw the Personal Care niche market, serviced with packaging by Bowler, facing many challenges. Some of the icon brands that Bowler services saw drops of up to 30% drop in volumes.

So, while profits declined, we believe the performance illustrates the durability of this business segment, even in the face of the most challenging trading period in more than 20 years.

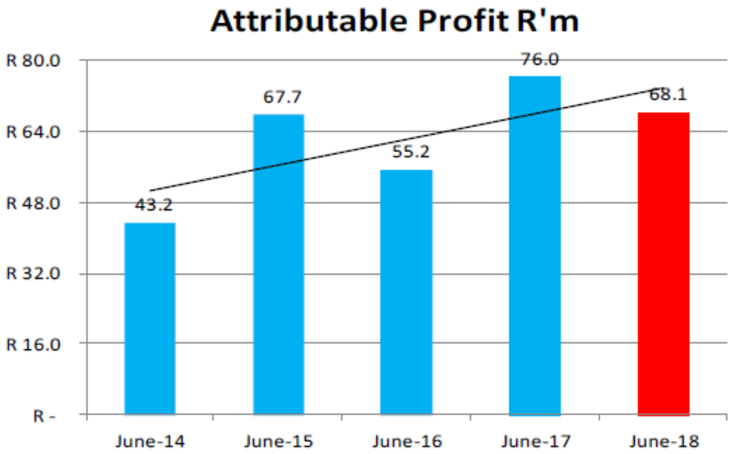


Figure 6: Plastics Profits (Source: Bowler Metcalf)

The segment has consistently earned RoE's of between 10-12%, as displayed below. They achieved this without employing any leverage and despite the large cash balances.

Figure 7: Return on Equity (Source: Bowler Metcalf)

When adjusted for non-operational cash and undervalued properties, normalised ROE is ~14%.

An Aligned Management Team

Packaging firms do not typically possess significant moats. We believe that a major reason for Bowler Metcalf's success in this industry is due to the experience and spartan approach of their aligned management team.

The company is being run by Paul Sass (CEO) and Grant Bohler (CFO).

Paul Sass has a B.Sc. Mechanical Engineering from Cape Town and worked as a design and industrial engineer before completing an internship in Europe in the plastics industry. He joined Bowler Metcalf in 1991, was appointed to the Bowler Metcalf Board as an executive director in 1998 for 7 years and then again in 2009. He was appointed Chief Executive Officer in March 2011.

The previous CEO, Michael Brain, serves as a non-executive director. He was appointed by the company in 1984. The experience and stability of the leadership team is reassuring.

Directors are aligned, and they hold ~25.5% of the outstanding shares:

Directors' Interest in Shares
The directors' interests in the company's issued share capital at 30 June 2018 were as follows:

Directors' holdings ('000)		Beneficial Direct	Beneficial Indirect	Total	%
2018					
BJ Frost (Non-Executive Chairman)	**	-	101	101	0,1
M Brain (Non-Executive)	**	66	3 046	3 112	3,6
PF Sass (Executive)	**	896	15 767	16 663	19,0
		962	18 914	19 876	22,7
Estate late HW Sass		2 413	-	2 413	2,8
		3 375	18 914	22 289	25,5
Shares in issue ('000)				87 624	

Figure 8: Aligned Management (Source: Bowler Metcalf)

In the 2018 financial year the directors' emoluments totalled R6.187M. This compares to a value of R222.89M for their equity holding in the business. Their equity holding exceeds their annual salary 36 times, which should incentivise them to act in the long-term best interest of shareholders.

It is therefore not that surprising that management is renowned for running a lean and mean operation. This becomes clear when comparing the net margins from the plastics segment to the margins achieved by competitors:

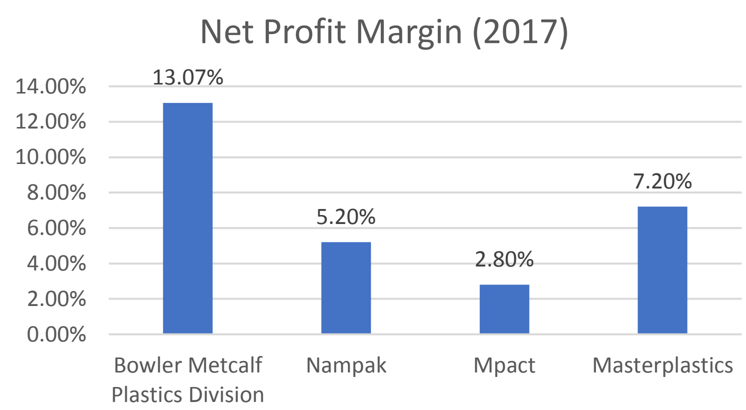


Figure 9: Net Margin Comparison (Source: Bowler Metcalf)

Show me the Money

Through its history Bowler Metcalf was a consistent dividend payer. In 2018 it returned 42cps to shareholders. They typically distribute about half of their annual net profits. From the 2019 financial year, a new “ex SoftBev” dividend regime will be implemented.

At the previous financial year-end (June 2018) Bowler had R203million in cash on their balance sheet. They did not have any debt. This cash far exceeds operational requirements.

Add to that the R415mil (R350mil for the shares and R65mil for the loan) received for SoftBev, their current cash balance should be close to R618mil. We further expect them to receive ~R50mil from the deferred consideration. The sale will incur capital gains tax, which we estimate to be ~R76mil. Based on our calculations there will be ~R589mil in cash in the bank after these tax payments.

In their June 2018 results, the directors mentioned that they will be returning +-30% if cash to shareholders as a special dividend. **This implies they will return R176.7mil to shareholders, or ~20% of market cap as a special dividend.**

A New Period of Growth

Bowler Metcalf stated that they intend to use ~50% of their cash for strategic growth initiatives.

After the return of cash to shareholders, we expect a cash balance of R294.5 million to be allocated to growth initiatives. They are undertaking a wide-ranging strategic review to position the plastics business for future growth. Some of the cash will also be used to develop their properties.

We are optimistic about management’s capital allocation skills. They do not often make large investments, but those that they do make yield good returns.

The SoftBev investment was one of their largest investments in the last 20 years. They paid R61mil for the SoftBev investment. Despite viewing the business as a drag on their plastics business, the investment yielded an impressive IRR of 21% p.a. over 16.5 years.

Considering management’s alignment, their conservative nature (they don’t use debt and rarely make large capital investments) and their track record of sound capital allocation, we are excited to see what opportunities they find. Many South African businesses are currently in very poor shape due to the recession and pressure consumers are experiencing. There are many cheap assets for sale in the domestic markets. Astute buyers with excess cash available might have great opportunities to acquire quality assets at low prices.

Valuation

When you buy shares in Bowler Metcalf, you effectively receive a share in the plastics business, a share in an investment property portfolio and a share in the cash in the bank.

We valued the current plastics business on their normalised earnings, using DCF-methodology. We conservatively expect the business to grow at 6% p.a., ignoring the 1% volume growth. At 15% cost of equity, we estimate the value of this segment at R886.3 million.

We valued the investment property portfolio at the directors' valuation of R41.5 million. The non-operational cash is estimated at R487.0 mil, after providing for the capital gains tax expense that the SoftBev sale will incur.

Asset		**Value**	**Method**
Plastics	R	886 337	DCF
Investment Property	R	41 472	Asset Value
Cash	R	562 917	Asset Value
Capital Gains Tax on Disposal	R	-75 936	
	R	1 414 790	
NOSH ('000)		87 624	
Value per share	R	16.15	

This gives us an estimated value per share of R16.15, for an expected upside of 61.5%.

Deducting the non-operational cash and the investment property portfolio from the market cap, the plastics segment is currently trading on a PE ratio of 4.6x. This is an attractive multiple to pay for a low risk, stable and perpetually profitable business that is growing at 6-8% per year.

Margin of Safety

Bowler Metcalf record their Land & Buildings and Investment Properties at book value. Since these properties were bought long ago, the book value is significantly lower than the market value of these properties.

For example: They earn R5.2 mil in rent from the Investment Properties. These properties are recorded on the Balance Sheet at R5.6 mil, implying a rental yield of 93% p.a.

The directors provide a conservative valuation of the properties. They use a ~10% capitalisation rate to value these properties. We view this as conservative. This means that the property that is recorded at R31.0mil is probably worth roughly R238.1mil:

	Book Value	**Directors Valuation**
Land and Buildings	R25.4mil	R196.7mil
Investment Properties	R5.6mil	R41.4mil
Total Value	**R31.0mil**	**R238.1mil**

Together with the cash (but ignoring other operational assets), this adds up to roughly R725mil. This provides a solid margin of safety, considering that the total market cap is R876mil.

Risks

The biggest risk is in the allocation of the large cash balance. A poor investment will again be a drag on the plastics business, sucking it dry from free cash flows. While we believe management is skilled and incentivised to act in the best interest of shareholders, we will monitor the capital allocation decisions closely.

The trading environment could stay challenging for the foreseeable future. We believe that the company's balance sheet is strong enough to face these headwinds.

Catalysts

- The sale of SoftBev
- We expect the deferred consideration to come due after the audit (R40-R55mil)
- Special dividend, as they expect to return excess cash to Shareholders (2018 Q4 & 2019 Q1)

Wescoal Holdings Limited

https://www.wescoal.com/	
Market Cap	R850.96M
FCF (2018)	R145.3M
P/E	3.96
D/Y	5.73%
PTBV	0.8
Price per share	R1.90
DCF Valuation	R3.86
Upside	103%

Wescoal is a coal focused mining company in the Mpumalanga province of South Africa. The Group incorporate mining, processing, selling and distribution of coal through its two divisions – Mining and Trading. The operating assets of the mining division consist of four mines, one each in Elandspruit, Vanggatfontein, Intibane and Khanyisa as well as four processing plants in Mpumalanga.

Wescoal's mining volumes doubled for the second consecutive year to 6,8mt ROM (Run-of-mine). The acquisition of Keaton Energy increased coal resources to 300 million tons, in comparison to 27mt in 2017. The acquisition has resulted in better than expected cost savings of R40m p.a. with further savings expected to be unlocked.

Eskom, the South African electricity public utility, makes up 47% of group revenue. In the long term this is a risk to monitor. The new president is desperately trying to kickstart the economy and any increase in business activity will increase the demand for electricity from Eskom.

The company is trading at extremely low valuation multiples and a discount of ~50% based on our DCF valuation. We believe this prices in a very pessimistic outcome. The board of directors of Wescoal has resolved to purchase a maximum of R20mil of its own shares.

Investec Ltd

https://www.investec.com/	
Market Cap	R94.38B
FCF (2018)	R430.6M
P/E	9.97
D/Y	4.70%
PTBV	1.1
Price per share	R91.99
DCF Valuation	R152.46
Upside	66.7%

Investec is an international banking and asset management specialist that offers its clients a numerous variety of financial products and services. Investec operates on an international stage, trading on both the JSE and LSE since 2002. It operates mainly in UK/EU, South Africa and Australasia regions.

The company is exposed to uncertainties in both its main markets. In the U.K. there are uncertainties around Brexit. In South Africa investor optimism is at record lows due to political instability. Despite this, the UK economy remained resilient and the South African Asset Management business saw higher levels of AUM (partly due to investors leaving another prominent SA manager).

Historically Investec traded at multiples comparable to other banking peers. However, the asset management segment contributed almost a quarter of the operating profit. Investec recently announced a strategy shift and demerger with its asset management division which will become an independently listed company on the LSE. We believe this segment will command higher valuation multiples, in line with global asset management peers.

At a market cap of R94.38B, we believe the market is offering us an opportunity to buy a share in a solid diversified financial institution at a discount, while there are corporate actions on the horizon that might unlock some of that value.

Stefanutti Stocks Holdings

http://www.stefanuttistocks.com/	
Market Cap	R554.8M
FCF (2018)	R156.0M
Forward P/E	4.50
D/Y	0%
Price/Tangible Book Value	0.35
Price per share	R2.95
Liquidation Value	R3.70
Upside	25.6%

Stefanutti Stocks Holdings Limited is an engineering and construction company. The Company's segments include Roads, Pipelines and Mining Services (RPM), Mechanical and Electrical (M&E), Structures, and Building. The Company offers various services with multidisciplinary expertise, including concrete structures, marine construction, piling and geotechnical services, roads and earthworks, bulk pipelines, mine residue disposal facilities (mainly tailings dams), open pit contract mining, all forms of building works, including housing, mechanical, electrical installation and construction.

The period leading up to the 2010 Soccer World Cup was the heyday in South African construction. Since then, however, the post-world cup hangover saw construction companies in South Africa going through an extremely tough period. It is no surprise that the share prices of most construction companies are down more than 75%. Many of Stefanutti's competitors have gone out of business, as irresponsible expansion proved to be unsustainable when infrastructure expenditure dried up.

However, Stefanutti went through a recent restructuring to improve the synergies and efficiencies in their businesses. Many of their competitors are no longer around. With the South African government hinting at increasing infrastructure spend to kickstart the economy, Stefanutti is in a good position to benefit from this. Earnings per share is expected to be between 56,75 cents and 65,48 cents per share representing an increase of between 30% and 50% more than the restated 43,65 cents per share for the comparative period.

Sibanye Gold Ltd

https://www.sibanyestillwater.com/	
Market Cap	R21.07B
Cash from Operations (2018)	R2.74M
P/E	
D/Y	0%
PTBV	0.8
Price per share	R9.30
DCF Valuation of Stillwater	R14.00
Upside	50.54%

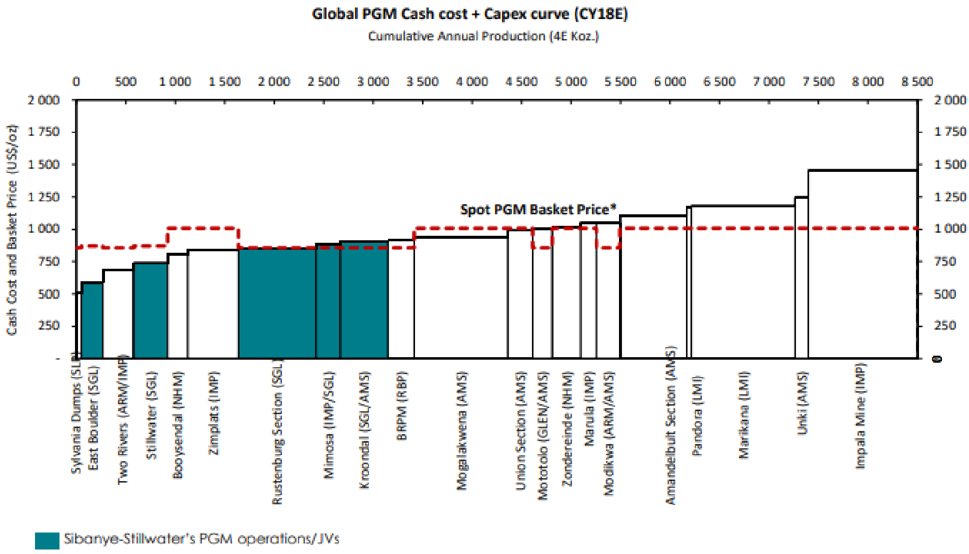
Sibanye Gold Limited is an independent, global precious metal mining company. Its products include gold, platinum group metals and by-products. Their costs to mine PGM's are at the lower end of the global cost curve.

Platinum prices are currently at the lowest levels in a decade, hurting profitability. The volatile South African political climate is also not supportive of investor confidence. Combined, these factors see Sibanye's shares trading at R9.30 per share, a long way below the ~R70 level it traded at during its peak.

Sibanye recently made an offer to take over Lonmin and the deal is expected to close by the end of the year. The Lonmin acquisition will allow them to access valuable Sibanye ore bodies through Lonmin mine shafts that border their property.

On a positive note, palladium is currently trading at its highest price in history. The Stillwater palladium mine in the USA is not affected by South African political risks. We value this mine, net of debt, at ~R14 per share. This means we get the South African gold and platinum assets at a negative valuation.

Any uptick in the platinum price and/or a favourable outcome in the annual elections in 2018 might see the share price re-rate significantly.



Source: Nedbank Research