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TAKING STOCK

JARRED HOUSTON: Mine the valuation gap

Greater scrutiny of holding companies' valuation has led to lessened appeal

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Investment holding companies in SA have over the past few years gone from tax-efficient permanent capital vehicles that allowed for tremendous value creation, to the proverbial black sheep with many questioning their relevance in the present context.

The starting point for most holding company valuations is a sum-of-the-parts schedule or net asset values (NAV) of the underlying investments. Share prices can either trade above (premium) or below (discount) this published value. At present discounts to NAV are high relative to history and have generally trended wider after high-profile value destruction led to greater scrutiny being placed on valuations, capital allocation, debt levels and costs within structures. Changes to conglomerate regulations and tax treatment of unbundling assets has also led to their lessened appeal.

We would argue that not all investment holding companies are created equal and the unfavourable environment, after a protracted lack of activity, has finally led to the wheels of change being set in motion with several recent positive corporate actions announced. This, coupled with the lacklustre economic picture in SA, makes for compelling selective value-unlock opportunities in our view. Ultimately though the quality of the underlying businesses within these holding companies and their ability to trade through the difficult environment will determine much of the investment case.

In September 2021 we saw rand Merchant Investments (RMI) announce the proposed unbundling of their 24.8% and 26.8% stakes in Discovery and Momentum Metropolitan respectively, with the share price rising more than 14% on the day of the announcement. Subsequently in December RMI announced the disposal of their 30% stake in Hastings which marked another step up for the share price as it further simplified the structure and clarified the investment case. This will leave Outsurance as the only remaining large investment and perhaps finally enable the market to appropriately value an exceptional growth story in the context of the SA environment.

Zeder, after being under cautionary since April 2021 announced the disposal of The Logistics Group in November which makes up over 20% of its NAV. They are still under cautionary after receiving several other approaches interested in acquiring a number of their portfolio investments. This additionally must bode well for the PSG Group already flush with cash after its own restructures, trading at a discount north of 30% and holding several businesses with a long road ahead in terms of market opportunity.

transactions have been announced in some of the larger investments in RMI, Distell and Community Investment Holdings (CIVH) plus there is potentially more to come. This provides an attractive entry point for a holding company trading on a discount of nearly 40%.

It is never easy for management teams to voluntarily shrink the size of their market cap by unbundling or selling investments and returning capital to shareholders. In some cases doing so even threatens the need for the holding company potentially putting themselves out of a job entirely.

Ultimately, though, they are tasked by their boards to maximise shareholder value creation and with access to fresh equity capital being closed off due to its high cost, remaining listed in their current form only serves to add red tape. Hence after being publicly critical at the lack of activity for several years to address persistent discounts, we must acknowledge the management and boards involved.

Though persistently large discounts remain across several of these companies, they are now well placed fundamentally with simpler structures and stronger balance sheets heading into a period where several opportunities could present themselves. We say in the case of RMI, PSG Group and Remgro this represents a portfolio of high-quality businesses now trading on reasonable valuations with the potential for further corporate activity to narrow discounts to group NAVs. Hopefully the above examples serve as an incentive for others.

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