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Monthly Market Review

Wednesday - **05.04.2023**

REVIEW OF STOCK PICKS FOR MARCH

VUKILE VKE (1255c)

Recommendation: Maintain Buy
Report date: 02 Mar
link to report

1H of FY03/23 results:

Despite a challenging macro backdrop, Vukile reported a pleasing set of results for 1H23.

Highlights

– Gross property revenue **increased by 5.8% from R1.7 bn in 1H22 to R1.8 bn in 1H23**
– Basic earnings per share increased to 108.65 cps (1H22: 88.15 cps).
– **Headline earnings declined by 15.8% to 61.57 cps** (1H22: 71.31 cps) due to the decrease in operating profit before finance costs and impact of additional shares issued. In addition, pre-acquisition dividends received from Lar Espa– a of c. Euro6.6 m was accounted for as a reduction of the carrying value of the investment as opposed to investment income
– The group's **NAV per share increased by 6.6% to R19.10 per share for 1H23** (R17.92: FY03/22), due to positive performance in net property income and favourable exposure to a weaker Rand
– The group's direct property investments amount to R32.7 bn at 1H23 (FY03/22: R30.8 bn), located in South Africa and Spain
– Gross **dividends declared increased by 16.8%** to 47.32 cps for 1H23 (1H22: 40.56c)
– Total **FFO of 80.8 cps**

Investment Case

We like Vukile due to its significant interest in Spain, with almost 54% of assets held there. Given the headwinds from the current loadshedding crisis in SA we believe diversity of income from offshore portfolios should help mitigate some of these risks.

The SA leasing activity is focused on township and rural retail portfolio (shopping malls and other retail centres) - a strong target market that has good growth prospects and has proven to be defensive during difficult times as can be seen from the 1H23 results. The group is focused on second-tier tenants – 11 of the top 20 store footprint expansions in the past 3 years have been from second tier nationals. There is a big focus on Spain, with c. 54% of assets held there. The property in Spain is valued at c.R16.2bn, and SA at c. R14.6bn.

Price/FFO (funds from operations) at 9x is well below 5 year average of 15.1x and FDY of 8.5% is attractive. No offices. LTV is 43% - this is higher than its SA peers but considered acceptable given that higher levels are the norm in Spain.

EQUITES EQU (1537c)

Recommendation: Buy
Report date: 02 Mar
link to report

Equites delivered a strong set of results for 1H of FY02/23, amidst the challenging macro backdrop. This was driven by strong demand and low vacancy rates in both the SA and UK markets. In South Africa, there has been record levels of demand for warehousing space in the past six months. This has been driven by growth in ecommerce and supply chain optimization as more companies look to increase inventory on hand amidst global supply chain issues.

Equites was able to capitalize on this well due its large land bank. The other advantage for Equites is that the bulk of its tenants are considered blue chip A grade, ranging from the likes of Shoprite and Foschini Group in SA to Amazon and Tesco in the UK. These companies also have long term leases, ranging from 10-20 years, which provides more certainty for equites in terms of rental income. Equites is a REIT we like as it offers a favourable expected forward dividend yield of c.11% and stability due to its long term leases with blue chip companies. Current dividend yield is 10.7%.

STOR-AGE SSS (1295c)

Recommendation: Buy
Report date: 02 Mar
link to report

Stor-Age is focused on the self storage sector of the commercial property market and operates through SA and the UK.

Highlights for FY03/22 and 12 months ended 31 Aug 22

In South Africa total occupancy increased by 28 700m² year-on-year ("y-o-y"). On a same store basis to 31 August 2022, the average rental rate increased by 6.7% y-o-y, while the average occupancy increased by approximately 6 300m² or 2.0%. In the UK total occupancy increased by 28 900m² y-o-y. On a same store basis to 31 August 2022, 3 the average rental rate increased by 10.8% y-o-y, while the average occupancy increased by approximately 1 000m² or 1.3%.

Investment case summary

5 year CAGR in Funds from operations of 14.6% with net property income up 16.7% in FY03/22. Currently portfolio comprises 55 properties in SA valued at R4.9bn and 40 in the UK, under the brand Storage King, valued at R5.3bn. Despite fast growth, gearing (LTV) is super low and expansion continues with pipeline of 14 properties in UK and SA. 7.9% DY on top of 5 year FFO CAGR of 14.6%

EMIRA EMI (1010c)

Recommendation: Buy
Report date: 02 Mar
link to report

Emira's portfolio is mostly based in SA, but it continues to expand offshore in the US to improve diversification. The portfolio includes office, retail and industrial with a new element of residential. While Emira does have some exposure to office, this is relatively small in comparison to retail.

Results for 1H23

– Directly held portfolio revenue increased by 16.3% to R840 m compared to R722 m for 1H22
– HEPS increased by 30.3% to 74.66 cents compared to 57.29 cents for 1H22
– Net asset value per share increased by 10% to 1 694.6 cents compared to 1 540.5 cents for 1H22
– Distributable earnings increased by 15.0% to R379 m compared to R329 m for 1H22
– Dividend declared increased by 17.4% to 66.43 cents per share compared to 56.59 cents per share for 1H22
– The current dividend yield is 16.3%

EXXARO RESOURCES EXX (19098c)

Recommendation: Hold
Report date: 16 Mar
link to report

The average benchmark API4 RBCT export price of $271/t for FY 12/22 was 118% higher than the $124/t for FY21 resulting in a 161% increase in the average realised export price for Exxaro of $261/t (FY21: $96/t). The iron ore price also boomed and crashed but has been quicker to recover (no doubt in line with steel) than coal. As is usually the case, cyclical stocks are priced for the expected downturn in their respective commodity prices and Exxaro is no exception. We do, however, believe the consensus forecast of maintained EPS for FY 23 is too optimistic and accordingly recommend a HOLD at this stage as a double-digit dividend yield on the current price is still likely.

Highlights for FY 12/22

– Final dividend of 1 136 cents per share, down 39 cents per share from 1 175 cents per share
– Revenue up by 41% to R46bn (2021: R32.8bn)
– Net operating profit up by 67% to R16.2bn (2021: R9.7bn)
– AEPS up by 11% to 5 713 cents (2021: 5 128 cents)
– HEPS up by 28% to 6 016 cents (2021: 4 683 cents)
– Final dividend lower by 39 cents per share to 1 136 cents per share (2021: 1 175 cents per share)

GEMFIELDS GML (395c)

Recommendation: Hold
Report date: 27 Mar
link to report

Gemfields reported a strong set of results for FY22, showing record revenue and strong growth in EBITDA. The return of cash to shareholders via dividends, and commitment by management to do so on a consistent basis is a positive signal for investors.

Despite the excellent results, it is worth noting that Gemfields in recent months were forced to evacuate staff from Nairoto Resources in the Cabo Delgado province of Mozambique after insurgency attacks at a nearby village. It is encouraging to see there has since been no impacts on the main operations at Montepuez Ruby Mining. This is a risk we are closely monitoring – Gemfields is however working closely with government and police to mitigate this.

Consensus of two analysts has a Buy recommendation with a target price of R7.92 and is looking for a 12 month FPE of 5.8x. We believe there is still further upside from current levels, but investors should be cautious of the risks to the investment case due to the recent increase in insurgency attacks in Mozambique. For now, however we do not believe it poses a significant risk to Gemfield's main operations. Our recommendation is to HOLD.

MASTER DRILLING MDI (1420c)

Recommendation: ADD
Report date: 28 Mar
link to report

Master Drilling continues to operate in countries, too numerous to mention here, in South, Central and North America. Africa remains the key area for the group, but it is also active, and looking to expand in Scandinavia, Australia, and India. Management emphasizes its commitment to safety with innovative risk management technology as well as innovations in related areas. Given the healthy pipeline it seems as though another year of growth is in view. While the stock is now on a PE of 6.0x and DY of 3.4% and we maintain our ADD recommendation, mining stocks in general, are awaiting sufficient revival in commodities demand before resuming uptrends.

PEPKOR HOLDINGS PPH (1744c)

Recommendation: Buy
Report date: 28 Mar
link to report

Investment case

– Pepkor is a leader in the discounted clothing market space and has shown strong growth in market share and earnings over the past five years
– Pepkor's share price has derated over the past few months and now offers value at current pricing in comparison to other clothing retailers
– Well positioned to benefit from the recent trends that has seen consumers down trade from expensive brands to discounted value for money offerings
– It is trading at an attractive FPE of 10.5x, which falls below its average of 14.9x over a five year period, indicating it is relatively undervalued
– Earnings growth over the next five years is expected to be ahead of its peers
– The business has strong cash flow generation – the bulk of sales (c.80%) is generated from cash which is favourable during tough times

Consensus views

Consensus of 6 analysts has a Buy rating with a target price of R23.80 and is expecting long term earnings growth of 10% for a 12m FPE of 10.5x, which falls below the average of 14.9x over a five year period – indicating it is relatively undervalued.

PICK N PAY STORES PIK (4250c)

Recommendation: Buy
Report date: 28 March
link to report

Investment case:

– The share price has derated significantly and now appears relatively undervalued in comparison to SHP
– A lot of investment has been made into the Boxer brand which is expected to be a big growth driver for Pick n Pay going forward, with sales expected to almost double over the next five years
– The business has been focused on disciplined cost controls to help protect margins and earnings
– We expect recovery in the long term once inflation falls and the loadshedding crisis begins to abate
– The risks to the investment case are the current power crisis and high levels of food inflation which, if not contained, may cut into food retailers' profit margins this year

Consensus views

Consensus of 8 analysts has a Hold rating with a target price of R58.67 and is looking for long term earnings growth of 13%, placing the stock on a 12m FPE of 13.6x. This falls below the average of 17.3x over a five-year period – indicating it is relatively undervalued.

ALPHABET GOOGL ($104.36)

Recommendation: Buy
Report date: 28 Mar
link to report

Investment case:

– Continues to invest in advanced technologies to keep the business competitive in long term
– Return of capital to shareholders and stock split is positive – share repurchase amounted to c. $50bn was completed in FY21; stock split of 20 for 1 executed in July 2022, bringing down the share price and making it easier for retail investors to invest in
– Strong cash flow generation, ROEs, and balance sheet
– Cost cutting drive should help boost the bottom line and keep business competitive
– Relatively undervalued – trading at a 12m FPE of 19.6x

Consensus views:

Consensus of 50 analysts has a Buy rating with a target price of $125.37 and is expecting long term earnings growth of 17.7% for a 12m FPE of 19.6x, which falls below the average of 24.1x over a five-year period – indicating it is relatively undervalued. The implied upside is c 19%

ADOBE ADBE ($380.08)

Recommendation: Buy
Report date: 28 Mar
link to report

Investment case:

– Earnings are projected to grow by 12% per annum over the next three years – this has not been fully accounted for in current pricing
– The valuation is attractive at a FPE of 23.3x; ROEs are average while PEs are at close to their 10 year lows
– PEs appear too low given consensus forecast earnings growth over the next three years
– The company has a strong credit rating of AAA

Consensus views

Consensus of 36 analysts has a Buy rating with a target price of R393.10 and is expecting long term earnings growth of 15.5% for a 12m FPE of 10.5x, which falls below the average of 14.9x over a five year period – indicating it is relatively undervalued.

STANDARD BANK SBK (17487c)

Recommendation: Buy
Report date: 28 Mar
link to report

Standard Bank Group managed to grow EPS by 9.7% per year, over three years. This robust earnings growth drove returns higher for shareholders. Earnings growth and robust capital levels supported higher dividends for FY22. This strong performance has resulted in the group being ahead of plan in terms of delivering on its 2025 commitments. Revenues, strong average balance sheet growth and margin expansion were boosted by higher interest rates. Revenue growth was well ahead of cost growth which supported strong positive operating leverage and a decline in the cost-to-income ratio.

Highlights

– Headline earnings of R34.2bn for e FY22 up 37% on FY21
– ROE improved to 16.4% (FY21: 13.5%)
– Net asset value grew by 10% and with a common equity tier 1 ratio of 13.5% (FY21: 13.8%)
– Final dividend of 691cps which equates to a final dividend pay-out ratio of 60%
– The group's credit loss ratio was broadly flat at 75 basis points (FY21: 73 basis points)
– The South African franchise delivered headline earnings growth of 26% and ROE improved to 15.2% (FY21: 12.5%)
– The Africa Regions franchise delivered a robust performance and now comprises 36% of total earnings. Headline earnings grew by 36% and ROE improved to 21.0% (FY21: 18.2%)

Consensus Views

There is an overweight rating by 11 analysts with a target price of R202.97 and long-term growth rate of 13%. The stock is looking at a 12-month FPE of 7.2x which is lower than the 5 year average of 8.8x implying that the stock is currently undervalued. The implied upside is 18%.

ABSA ABG (18460c)

Recommendation: Buy
Report date: 28 Mar
link to report

The group recently good sets of results for FY12/22 despite the challenging environment with global and local uncertainty. ABSA has revised its GDP growth prospects for South Africa to below 1% for the 2023 due to the sharply heightened electricity load shedding. South Africa contributes 87% of group's earnings.

Highlights

– EPS: R24.78 (up from R21.40 in FY 2021)
– Revenue: R85.1bn (up 10.0% from FY 2021)
– Net income: R20.6bn (up 16% from FY 2021)
– Profit margin: 24% (up from 23% in FY 2021). The increase in margin was driven by higher revenue
– Non-performing loans: 6.09% (down from 6.16% in FY 2021)
– Declared a full year dividend of 300 cents per share up 65%
– ROE improved to 15.6% from 14.6%
– NAV per share grew by 4% to 16255 cents

Consensus Views

There is a Buy recommendation by 11 analysts with target price R227.18 and long term 10.9%. The stock is currently looking at a 12- month FPE of 6.2x which is lower than the 5 year average of 7.2x suggesting that the stock is undervalued. The implied upside is 25%

THUNGELA RESOURCES TGA (20600c)

Recommendation: Buy
Report date: 28 Mar
link to report

As the largest exporter through Richards Bay Thungela stands to benefit if and when the Transnet tender for repair of its 180 to 200 locomotives is awarded and successfully executed. The locos have been idled owing to a dispute around their repair with the Chinese supplier and this has been the single biggest factor in the decline of coal exports from 73mt in 2018 to 50.3mt in 2022.

FY12/22 results Highlights:

– Profit of R18.2 bn
– Adjusted operating free cash flow of R18.1bn (FY21:3.1bn) and net cash R14.7bn
– Final cash dividend R40.00p s taking full year dividend to R100.00ps. R13.8 bn returned to shareholders for FY22
– Secured access to R3.2bn in credit facilities; liquidity buffer raised to R8.2bn to reflect liquidity needs following Ensham acquisition and heightened levels of uncertainty related to Transnet performance
– Export saleable production 13.1mt (FY21: 13.9mt)

The stock is looking at a 12 month FPE of 2.3x based on the consensus forecast of R90.95. Due to the lower coal price, however, this is unlikely to be achieved. While the coal price (see graph below) may level out it will be much lower than the $236/t realised and not much above the current $130/t. Coal prices have been affected by the excess gas inventory in Europe, but this is likely to be worked out early in the next northern winter. The tight energy situation should again lead to a firmer coal price.

Meanwhile, however, the consensus forecast of c R80ps for FY23 is likely to be in excess of a more probable R70ps. Production is also forecast to be lower at between 10.5 and 12.5mt for FY23 although management is optimistic that Transnet will improve in the short term. The outlook is therefore for much lower 1H Heps followed by some recovery in 2H, possibly boosted by a contribution from the Ensham acquisition. Longer term of course it's all about the reinstatement of Transnet's missing locos so, in the meantime, holders might consider reducing ahead of likely pressure on the share price in 2Q and 3Q 23.

Eli Lilly and Co LLY ($350,74)

Recommendation: Buy
Report date: 28 Mar
link to report

The pharma group, which has an outsized impact on the healthcare index performance, should do well in current market conditions. Big Pharma is focused on research into Alzheimer's disease, obesity and oncology, all of which are experiencing new groundbreaking treatments. Eli Lilly is on the forefront of this as it is waiting for approval for its drugs, *Donanab* and *Tirzepatide*, which are set to bring advances in the treatment of Alzheimer's and obesity respectively.

On the regulatory front, the split control of Congress has further diminished regulation risk around price control and that is a favourable development for the industry group. Due to a strong product pipeline and resilience in potentially recessionary markets, Eli Lily is set to fare well this year.

Consensus of 22 analysts has a buy rating with a target price of $375.23, implying potential upside of 12.49%.

AstraZeneca AZN (£69.91)

Recommendation: Buy
Report date: 28 Mar
link to report

Due to a low level of discretionary spending, low manufacturing costs and Alexion's integration, AstraZeneca has a robust pipeline and is set to deliver solid quarterly reports. The company is expecting 30 Phase 3 trials this year, making it one of the leaders in innovation. These developments position AstraZeneca for solid revenue growth this year. Among the top-performing drugs are the cancer treatments Tagrisso, Evusheld, Lynparza and Imfinzi.
Looking ahead to 2023, the company said it expects revenue to rise excluding COVID-19 medicines. Total revenues from COVID-19 medicines, including AstraZeneca's vaccine, are expected to decline in 2023. In a statement, CEO Pascal Soriot explained that the group is on track to achieve "*industry-leading*" increases in turnover "*through 2025 and beyond*", adding that AstraZeneca's goal is to deliver at least fifteen new drugs before the end of the decade.

Analysts forecast sales growth of 13% with a core EPS growth of 12%, including $3 billion sales in Lynparza revenue trajectory. FY12/2022 results were supported by 25% and 33% growth in revenue and EPS, with the company's indication to raise gross margins. Alongside higher internal EPS estimates, equity analysts are largely pricing in new potential 2023 catalysts, forecasting a multi-billion-dollar peak in oncology sales. Aside from the usual pharma risks, oncology is a small molecule portfolio risk due to the US IRA healthcare reform as well as the US drug price reform.

Consensus of 30 analysts has a buy rating with a target price of $78.10, implying potential upside of 16.59%. It currently has a 12m FPE of 17.9x, which is below the average of 19.9x over a five year period indicating that it is relatively undervalued.

Afrocentric Investment Corporation Limited ACT (534c)

Recommendation: Buy
Report date: 28 Mar
link to report

AfroCentric currently holds 71.3% of the Sanlam Life subsidiary, AHA, and, after the Proposed Transaction, AHA will be a fully owned subsidiary of AfroCentric. The Sanlam Group will become a strategic and controlling shareholder in AfroCentric (with 55-60%) and thereby have alignment with other AfroCentric Shareholders in the future strategy of AfroCentric and AHA.

The Asset for Share Transaction will facilitate a structure whereby Sanlam Life will hold shares at a listed AfroCentric level and not at the level of its subsidiary, AHA. This will facilitate improved alignment of interest between the Sanlam Group and AfroCentric, potentially supporting further investment from the Sanlam Group, development of bespoke healthcare solutions through the cooperation of the Sanlam Group and AfroCentric teams and potential integration of the Sanlam Group and AfroCentric products.

Further investment from Sanlam Group in AfroCentric would enable integration of AfroCentric into the ecosystem of the Sanlam Group, AfroCentric will gain increased access to the wider Sanlam Group distribution network and AfroCentric's client base will benefit from access to the overall Sanlam Group product offering. Operating in a niche market, being backed by Sanlam and having competent management are factors that, among others, will see Afrocentric performing in the foreseeable future.

Valuation approach and results

A sum of the parts valuation of AfroCentric as well as an AfroCentric Share was performed based on an aggregation of the:
Pharmaceuticals Segment (the DCF was applied as the primary valuation approach and capitalisation of maintainable earnings as a secondary methodology to perform the valuation of this segment).
Services and Other Segment (the DCF was applied as the primary valuation approach and capitalisation of maintainable earnings as a secondary methodology to perform the valuation of this segment).
Head office (the head office and corporate function was valued using a capitalisation of maintainable earnings as a primary valuation approach).

Afrocentric has shown tremendous growth over the past 5 years and has boasted consistent quality earnings, a growing profit margint, a positive earnings trend and accelerating growth. It also has a relatively low PE ratio compared to its peers, meaning that it is undervalued and has more potential for growth.

In undertaking the valuation exercise above, a valuation range of R5.60 to R6.70 per AfroCentric Share, with a most likely value of R6.27 per AfroCentric Share on a control basis has been determined.

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