INTUITION

1 JULY 2022

# Signs of Life?

*In our "Outlook for 2022" presentation held at the end of last year, one of the core themes that we articulated was the combination of reform and the associated improvement in infrastructure. You will be forgiven for being sceptical on this topic given the growing potholes and persistent loadshedding. But bubbling underneath the surface is a flurry of activity, which we continue to believe will become increasing evident. We are positioning portfolios to benefit from this, even if that benefit might only manifest itself in 12 months' time.*

Michael Porter

In our "Outlook for 2022" presentation held at the end of last year, we identified five core themes that we believed would drive investment performance over the next few years. Two of those themes were "reform optimism" and "infrastructure redevelopment". It is easy to be sceptical in our country. We seem to lurch from one crisis to the next, nothing ever seems to get done, and in fact, things appear to be deteriorating rather than improving. Concepts such as reform and infrastructure improvement seem to about as far away from reality as one can get.

Yet underneath the surface we don't believe this to be the case. Reform continues to gather pace, with several key milestones already evident this year, including:

1. The successful auction of new spectrum for the telecommunications industry. Importantly, that spectrum has already been made available in five provinces as government has met its deadline to migrate from terrestrial to digital broadcasting.
2. Awards of new licenses under the emergency power procurement program, to mitigate loadshedding, as well as progress on projects under the 5th Renewable Bid window.
3. Awards of new generation licenses for power plants under 100MW. This was a key reform last year, but initially there was no activity. Further investigation revealed that operators still had to jump through numerous hoops before a license could be issued. Now some of those hoops have been removed. The result is that two licenses were awarded earlier this month, and more are imminent. Construction on these projects will start within months.

**SPEED READ**

- **One need look no further than growing potholes and persistent loadshedding to understand the urgency for renewed infrastructure investment.**
- **On the surface, it appears as if nothing is happening, but that is not the case. Underneath the surface is a flurry of activity.**
- **Reforms are finally starting to manifest themselves in visible improvement, and key government departments are spending again. This is most evident in roads and electricity infrastructure.**
- **The outlook for industrial companies operating in these sectors is improving, yet they remain neglected by the broader market. We are positioning portfolios to benefit, even if that benefit might only be evident in 12 - 18 months' time.**

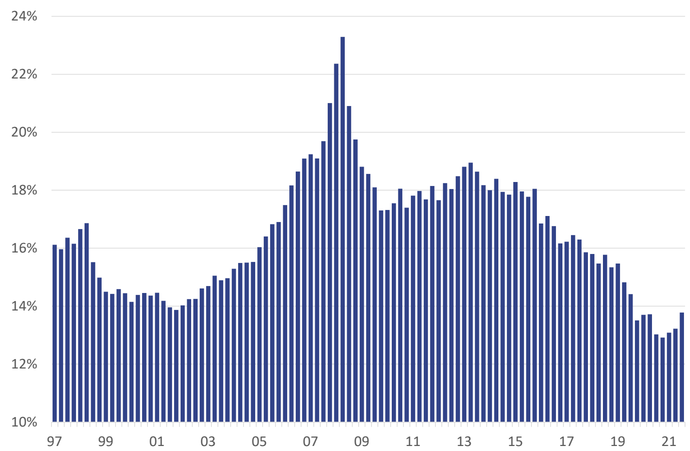
4. Tenders for private sector rail and port participation are out, but this has been delayed by flooding. Transnet has had to prioritise repairs ahead of reforms in the short term. In this respect at least, Transnet has been praised. One line of the key N3 corridor has been reopened since it was damaged due to flooding in April. The other should follow in the next few months.

Part of our job (and a fun and interesting part at that) is to meet and engage with companies and management teams to assess what is happening on the ground. Newspaper headlines are sensational and focus on large issues, but rarely capture incremental changes. We go and kick the tyres, so to speak. In this regard, our engagements over the past month have been encouraging, especially in two key areas:

1. SANRAL. Much has been made in the press of the R17 billion worth of tenders that Sanral cancelled in May due to "tender irregularities." Like others, we were initially dismayed, but our understanding is that the delay is due to procedural issues rather than corruption, and they will be reissued within a few months. Some will interpret this development as Sanral being disfunctional, but that is not the case. These are a small fraction of the projects underway. Anyone driving along the N3 to Durban will see the extent of works between Pietermaritzburg and Cato Ridge. Its bedlam, but the result will be a glistening 4-lane road in each direction. Other road projects are also full steam ahead. Contractors are busy and excited.
2. Electricity. We mentioned in our presentation last year that electricity could be the most exciting sector of our economy over the next 10 years – and that excitement doesn't just stem from the fact that we might actually finally have some electricity. Research suggests that we could spend R1 trillion on electricity infrastructure over the next decade. Reforms are finally feeding into action. Licenses for large projects are being awarded and shovels will be in the ground soon. But the action doesn't stop there. Property developers are rolling out solar to make their properties more self-reliant and municipalities have also been given the green light to procure their own power.

Together with "stronger for longer" commodity prices, this is creating fertile ground for a revival of infrastructure

**RATIO OF GFCF TO GDP**




*We have been "consuming", rather than adding to our infrastructure over the past 12 years. Fixed investment as a percentage of GDP reached a 25-year low during the Pandemic. Data for Q1 this year is the highest in 2 years, and hopefully just the tip of the iceberg.*

*Hopefully South Africa's development will lead to more roads, bridges and core infrastructure.*

spending in our country. It doesn't come a moment too soon. We often highlight the ratio of spending on fixed investment (Gross Fixed Capital Formation, or GFCF) to GDP. The ratio has been declining for years after the binge ahead of the 2010 FIFA World Cup. The data for the latest quarter was the highest since Covid. We believe there is far more to go.

Our discussions with various management teams point to a bustle of activity, the likes of which haven't been seen for 12 years or more. Sceptics will point to government and its inability to follow through. This is always a risk but is mitigated by the large proportion of work that will be driven and funded by the private sector. Furthermore, that can quickly morph into a virtuous cycle of higher investment once the initial momentum gets underway.

> "Research suggests that we could spend R1 trillion on electricity infrastructure over the next decade."

As clients will know, markets look forward, not backward. Yet this potential has yet to reflect in the share prices of companies that stand to benefit – companies such as Afrimat, Barloworld, Hudaco, Raubex and Reunert, to name just a few. We believe this is due to years of skepticism and broken promises from government. Investors simply don't believe that this time will be any different. Consequently, companies are overlooked and valuations languish at historic lows. What is unappreciated is that these companies have survived (and even prospered) in the toughest of times. We are of the opinion that the wheel is finally turning. Consequently, we are positioning portfolios to benefit from this potential, even if it might still take time for that potential to be realised and appreciated.

**Topic:** **Topic to be confirmed**

The next topic for our Insight seminars will be announced in due course.

| **Natal Midlands** | |
|---|---|
| Date: | 15th September 2022 |
| Venue: | Oasis Conference Centre, 72 Main Road, Howick |
| Morning Time: | 10am for 10.30am |
| Evening Time: | 5.30pm for 6pm |

| **Johannesburg** | |
|---|---|
| Date: | 20 September 2022 |
| Venue: | Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham |
| Time: | 7am for 7.30am |

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