REMGRO – Narrowing the discount

Remgro is one of South Africa's most successful investment holding companies (holdco). The unbundling of British American Tobacco for R55 billion in 2008 and RMB Holdings for R23.9 billion in 2020, illustrates its quality management team's ability to deliver sustainable, long-term earnings and dividend growth. Earlier this year, I wrote about Remgro's tactical move into the exciting, high-growth, fibre internet market, via CIVH, targeting townships and lower LSM areas. More recently, in its full-year 2022 results, many of Remgro's larger investments showed a strong recovery, albeit off Covid-19 lows. Headline earnings per share (HEPS) improved by 125%, the dividend by 67.7% whilst its intrinsic net asset value (INAV), jumped by 20% to R213 from R177 in 2021. This article will cover the large discount to INAV, the main drivers of the recovery including the deal to take Mediclinic private, the Distell transaction with Heineken, an update on CIVH and the Rand Merchant Investment Holdings (RMI) transaction.

Nick Rogers

Firstly, what is intrinsic net asset value (INAV) and why do investment companies tend to trade at a discount thereto? Aristotle, the Greek philosopher, coined the saying, "the whole is greater than the sum of its parts". In Remgro's case, the current share price is trading c35% below management's valuation of their investment portfolio of R213 per share. This is partly because Remgro invests in both listed and unlisted companies where traditional measurements of performance, such as sales or gross profit, are not meaningful criteria for evaluating the performance of holding companies. Instead, management uses headline earnings and INAV as alternatives. Listed valuations are straightforward. For instance, the value of its 44.6% stake in Mediclinic is simply the number of shares held multiplied by the closing share price on the JSE. For unlisted investments, Remgro applies the accounting principles of IFRS 13 or Fair Value Measurement. This is open to interpretation and complicated (in no order) by:

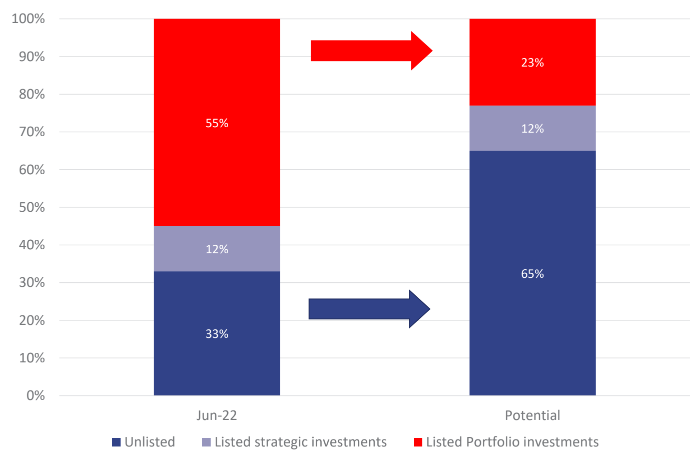
1. Accounting for substantial capital gains on the future sale of an underlying asset.
2. The difficulty in quantifying the negative impact of management fees when listed shares could be bought directly and years could pass before a company with huge potential becomes 'ripe' for sale.
3. Unlisted investments often being illiquid (one can't sell immediately) requiring analysts to apply an illiquidity discount.
4. Free cash flow generated by valuable investments often being used to subsidise struggling businesses to help it recover to full value in time, rather than paid out to shareholders.

SPEED READ

- **Remgro's share price currently trades at a c35% discount to its intrinsic net asset value of R213 per share (R177 in FY21) implying upside potential should it merely revert to its long-term average discount of 18.7%.**
- **Remgro will increase its stake in Mediclinic from 46% to 50% as it joins forces with Mediterranean Shipping Company (MSC, who will hold the other 50%) to delist the company from the JSE to unlock future value.**
- **Despite Heineken's acquisition of Distell, Remgro intends to elect to receive Newco shares for its Distell shares (31% owned) and retain exposure to the fast-growing spirits market.**
- **1 Remgro share bought on 1st June 2020 for R100.59 was worth R136 on 4th Nov 2022 (a return of 37% if dividends are included.) However, including returns from all the corporate activity and those associated dividends results in a total return of 107% (or an equivalent share price of R208 per share.)**

Thus, a discount is necessary, but the extent of the discount varies over time due to sentiment and the perceived performance or quality of its underlying investment portfolio. At present, the discount is unusually wide, suggesting that there is room for strong returns should management be able to convince the market that a narrower discount is warranted. There are also many exciting unlisted companies inside Remgro that investors would otherwise not have access to. To unlock the discount, management must continue to maintain a good balance of young, growth-orientated companies alongside well-established, cash-generating companies, where the tempo of growth is orchestrated by highly experienced, decentralised management teams. They are paid to patiently monitor and allocate financial capital to ultimately realise the optimal value of each investment at the optimal time. Remgro also calculates its discount consistently and transparently and places governance and ESG at the core of all decisions, leading by example.

LISTED VS UNLISTED CONTRIBUTION

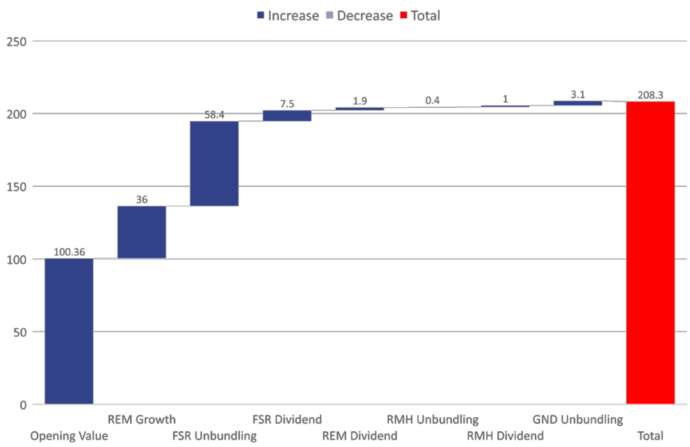


Part of Remgro's strategy to narrow the discount to INAV is to decrease the percentage of listed investments in favour of those that are unlisted which should create demand for its shares as Remgro will be the only vehicle through which those unlisted investments can be accessed. Furthermore, it will give management more freedom to realise value away from the daily scrutiny of the market.

Post Covid-19, pressure has been building from shareholders to 'close' the discount in many SA holding companies. Examples include PSG (now de-listed) and Naspers/Prosus (which are trading above 40% discount to INAV). The low-hanging fruit is often realized by selling down or unbundling the listed companies when management feels that they can no longer add value. Remgro's management is at pains to emphasize that it's not just about delisting assets for the sake of it, but rather making investment decisions which support value creation first and foremost. Why increase the unlisted exposure going forward? It is often far easier to create value via direct management of a company due to the enhanced ability to alter strategy quickly - be it decision-making or cash injections - to optimise profits.

Let us therefore assess management's recent track record. On the 1st of June 2020, one share in Remgro would have cost R100.59. On the 4th of November 2022, that same share was worth R136.01 – a return of 37% if you include the dividends received over that 29-month period. That is a solid return, by any measure, but it only tells half the story. Remgro has undertaken significant corporate activity over that period, unbundling its investments in RMB Holdings, FirstRand and Grindrod. The value of those shares received, plus the dividends accruing on those shares, pushes the total return from Remgro to 107% (or an equivalent share price of R208.28). This unlocking of value is the main attraction of holding companies.

VALUE UNLOCKED SINCE JUNE 2020



Remgro has boosted its total return to shareholders by unlocking value through the unbundling of its investments in FirstRand, RMB Holdings and Grindrod."

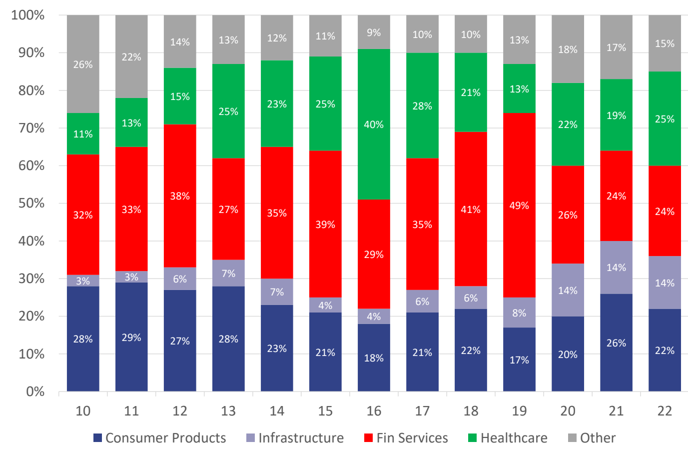
Lastly, let's look at a few highlights within the 4 primary sectors:

1. Healthcare (25% of NAV) is a great example of strong board representation in a listed company to drive the changes required. Mediclinic (46% owned by Remgro) has been a drag on earnings after being hit by the Pandemic. Having largely returned to normal operations and with HEPS rising 88% to R1.27 billion (vs R674 million in 2021), the time was ripe for Remgro to unlock value in the company. Remgro and MSC Mediterranean Shipping Co. will each own a 50% stake and delist Mediclinic from the JSE. With operations in Switzerland, the Middle East, the UK and

SA, it remains a great Rand hedge asset and Remgro's management understands the business extremely well.

2. Financial Services (24% of NAV) has always represented a significant proportion of REM's NAV (49% in FY'19). In 2022, Remgro received R3.96 billion from reducing its stake in FirstRand to 2%. Remgro also received a direct interest of 7.7% in Discovery and 8.6% in Momentum Metropolitan via the RMI unbundling. Going forward, RMI's assets, in which Remgro holds a 31.6% stake, will consist mainly of its 89.1% investment in OUTsurance.
3. Consumer Products (22% of NAV). One of the high-profile deals in this segment is Heineken's acquisition of Distell (31% owned). Rather than selling out to Heineken, Remgro has opted to retain its shares in the merged entity, thus retaining its exposure to the fast-growing spirits market, as evidenced by its 226% profit growth (albeit off a Covid-affected base) for the last financial year.
4. Infrastructure (14% of NAV). A successful rights issue raised cR2 billion, the proceeds of which was used to reduce CIVH's debt and increase Remgro's stake to 57%. The turnaround from a loss of R435 million last year to a profit of R47 million this year bodes well as does the merger with Vodacom's fibre assets, which has now been approved by ICASA. Vodacom, SA's largest telecoms company, will acquire up to 40% of the newly formed MAZIV, which holds the potentially lucrative Vumatel and Dark Fibre Africa investments. Regulatory approval is expected in January '23. Remgro is happy to dilute its holding, as part of the deal, as Vodacom will inject an additional R6 billion to boost the infrastructure required to facilitate fibre connectivity to underserved rural areas. Remgro has also recently unbundled its entire 25% shareholding in Grindrod, having already separated and sold Grindrod Shipping for R1.2 billion. The timing of both exits has been great, and the cash will be used to fund future investments.

COMPOSITION OF NET ASSET VALUE



The contribution to Net Asset Value by Financial Services has halved post the unbundling of FirstRand and RMH whilst the Infrastructure-related contribution is growing thanks to CIVH's exciting fibre opportunity."

In conclusion, as management focuses on narrowing the discount to INAV, the implication is that the share price will rise further. Investors may well need patience due to the current global and local headwinds and the fact that management has addressed most of the low-hanging fruit. Given that dividends from its investment portfolio are expected to recover to pre-Covid levels, Remgro's balance sheet is looking strong which puts it in a healthy position to continue with its strategic goals. We are happy to add Remgro to portfolios and continue to back this quality management team as they seek to unlock further value over the long term.

Heineken purchased Distell, but REMGRO remained a shareholder in the merged entity providing exposure to spirits revenues.

Topic: **The World in 2023**

The world and financial markets have lurched from one crisis to the next over the past few years.

Will 2023 be any different?

Join us as we look ahead to what the new year may hold.

Natal Midlands	
Date:	24th of November 2022
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	6th of December 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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