

It's not just AI; the old school economy still works too

At the moment it feels like the whole world is just focused on AI and the “Magnificent 7” group of companies. Since we wrote about ChatGPT in January 2023, so much has already happened in this space. ChatGPT has competition and every computer advertisement tells you to download some form of AI assistant. In ten years from now, AI will be so integral to what we do, we will not even remember its humble beginnings in 2023/24. Yet life goes on and we still operate in an old school economy, whether we like it or not. We need roads, dams, and buildings, and issues like rodents and pests are unlikely to disappear. There are investment opportunities in companies that use AI to drive growth but who still operate in the “basic economy”. This issue highlights two such examples.



**Willie
Pelsner**

Over the past few weeks, the investment team has concluded research on two “old-school economy” companies which we feel might warrant inclusion in offshore portfolios. What is “old school”? It is easier to make a few comments on what I term “new school” and hopefully at the end of the article after mentioning two companies’ operations, you will share my old school view.

New school for me lies somewhere in the new technological developments that start perhaps with the internet-of-things (or perhaps the internet itself as it evolved) followed by ChatGPT and its related concepts and ending now with AI (artificial intelligence) – the new buzzword. There is much debate as to whether AI is actually new. I recall using Neural Networks during my Econometric studies to try and build integrated economic models to forecast economic growth. I must admit, the “new” AI is 1,000,000,000,000 times (add or delete zeros as you wish) more advanced.

I believe that in ten years’ time, the AI that is a part of everyday life will be as far evolved from today’s AI as today’s internet is from the internet of the very early days. By 2034, it’s very possible that the fusion of quantum computing and AI will have kicked off a new era of supercomputing and scientific discovery.

Quantum computing has the potential to vastly speed up some of the computations used in AI algorithms. An example would be quickly solving optimization problems that would take far longer using classical computers. This

SPEED READ

- **The development of AI is steaming ahead. New technology, computing advances and the use of mega-data have already caused a share price explosion in AI-related shares. The new acronym used refers to those as the Magnificent 7 – all companies benefitting from super microchip developments.**
- **AI is here to stay, and advancements will certainly benefit not just these companies, but all of us through at least productivity gains and efficiencies.**
- **Harvard House is of the opinion that companies that operate in what we call the “old school economy”, i.e. the basic economics around transport, construction, water, hygiene, pests, etc. still have a place in portfolios.**
- **Two examples are Vinci and Rentokil Initial.**

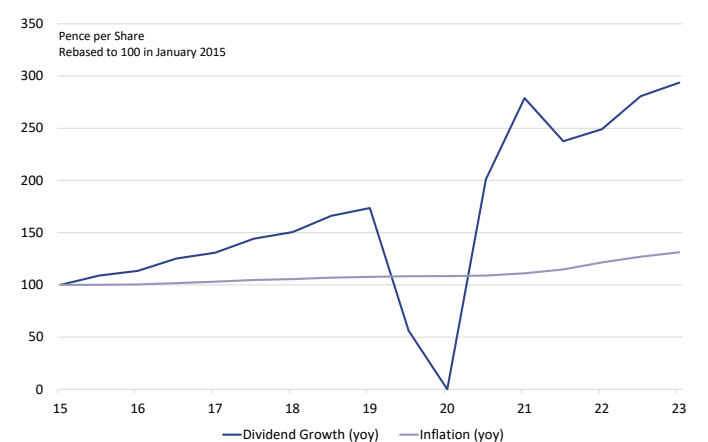
has already led to advances in drug discovery and material sciences, as well as the efficiency of route planning by delivery companies such as DHL. Within 10 years, accessibility to quantum computing technology will have increased dramatically, meaning many more discoveries and efficiencies are likely to have been made.

This sounds like a lot of hype - trust me, it is not. Just go and ask ChatGPT a question and see what you get. It is real and if your autonomous car takes you to the “computer” doctor for an initial diagnosis, remember this part of the article.

I have referred to a car in the previous paragraph. Even if it is driverless, you still need a road to travel on, for tolls to be paid as you pass under the gantry, to park in an AI-assisted garage, where you have been guided to the right bay, etc, etc. Catch my old school drift? There is plenty of old school “technology” that we just can’t get away from. Think about a company like Afrimat with its aggregates, for example. We still need those for basic infrastructure development, and I am not only thinking about South Africa. We need roads, rail, airports, dams, and power grids. We need building materials to build data warehouses to house these super AI computers and the data they generate. As mentioned, two companies that operate at a grassroots level or in the old school economy have popped up on our radar. One of them (this article will not delve into all the detail) will sort out pests. You guess wrong - it is not the maker of DOOM.

Rentokil Initial started in 1903, but only consolidated all its operations under this name in 1962. Rentokil focuses on pest control. Including Terminix (the US company it acquired in 2022), it operates in more than 90 countries, and is the market leader in many of those. Initial offers a wide range of services to meet today’s growing expectations for hygiene, specialist services in air care, waste management and ancillary services. Why add an “exterminator” to portfolios? In short, they have a strong operating platform in a highly fragmented and global market. Pests are everywhere and the risk of an outbreak can sink one’s reputation overnight. So, it is a service where you don’t want to scrimp on the budget. That makes the business model defensive and counter-cyclical, which in turn drives very strong cashflows and a growing dividend stream. The other company offers investors exposure to roads, airports, trains, energy and even the Stade de France. Who can forget that stadium and the nail-biting one-point victory

RENTOKIL: ACTUAL DIVIDEND REL TO INFLATION



Despite missing its dividend in 2020 due to Covid, Rentokil has grown its dividend by 200% since 2015, well above inflation, which has risen by a cumulative 32% over the same period.

for The Boys in Green! The company is called VINCI, aptly named after Leonardo Da Vinci, an artist, scientist, and engineer, and stands for the humanism, inventiveness and technical resourcefulness with which the company identifies itself.

VINCI, the brand, was created in 2000, however the core operational businesses of concessions, contracting and energy has been in existence since the 19th century. The company’s roots are in France when the company was tasked in 1890 with building and managing the sewer system in Marseilles. Today the brand is a banner which brings together 4,000 companies and 280,000 employees across the world. (Vinci was even involved in the building of the Gariep Dam in South Africa).

VINCI designs, finances, builds and operates, under public-

Concessions	
Autoroutes	Finances, designs, builds and operates motorways in France. With a network of 4,443 km under concessions, VINCI is France’s leading motorway concession holder.
Airports	This division is the world’s leading private operator in this sector. It manages 72 airports across 13 countries in Europe, Asia and the Americas. They develop, finance, build and manage airports, leveraging their investment capacity and know-how in optimising operational performance, modernising infrastructure and steering their environmental transition.
Highways	Like Autoroutes, but outside of France. They finance, build, operate and maintain motorways, bridges, tunnels, urban roads and toll services over a 4,100 km network in 15 countries.
Railways	The division manages high-profile infrastructure projects in France, designing and developing transport infrastructure that meets the highest standards of safety, comfort and reliability. Vinci manages the 1 private High Speed Line infrastructure in France as well as Urban Rail in France.
Stadiums	VINCI manages a network of four stadiums built by the Group in France: the Stade de France in Saint-Denis, the Matmut Atlantique in Bordeaux, the Allianz Riviera in Nice and the MMArena in Le Mans.

private partnerships, transport infrastructure and public amenities that contribute to economic development. These concessions are shown in the table above.

The Energy division, which incorporates a division called COBRA IS, helps with energy sufficiency as the need to modernise and refurbish buildings, infrastructure and industrial production sites increases to make them more reliable, energy-efficient, and sustainable. It relies on a network of 1,900 agile, innovative and locally rooted business units that extends across 57 countries. Vinci Energies through its brands like OMEXOM, Actemium and Axians, operate transport and energy infrastructure equipment from design to operations to ensure stable and consistent electricity supply whilst also developing sustainable and renewable energy like solar farms.

Construction is a theme that forms part of our global and local investment strategy. This is a sizeable portion of their operations, but really co-exists alongside the other operations described above to ensure that they can deliver holistic and complete solutions for clients. The unit is structured around three complementary pillars – Major Projects, Specialty Networks and Proximity Networks in both France and abroad. Finally, there is a very small division that manages real estate and whose focus is increasingly turning to “new energy” residential buildings.

The following three examples of contracts awarded during 2023 will probably help us all to get a feel for the nuts and bolts of VINCI’s operations, but as mentioned earlier there are about 4000 business, so the examples are endless.

- VINCI Airports, concessionaire of 6 airports in the Dominican Republic since 2016 through its subsidiary Aerodom, has just been granted by the Government of the Dominican Republic a 30-year extension of its concession contract, originally scheduled to end in 2030. Under the extended concession contract, from 2030 to 2060, VINCI Airports will be responsible for financing, operating, maintaining, developing and modernising the airports under concession. VINCI Airports will notably build and operate a new passenger terminal at Santo Domingo airport and continue to implement its environmental action plan, including expansion of solar power plants and deployment of wastewater treatment plant as well as waste sorting centres.
- Following an auction by the National Electricity

Agency (ANEEL) of Brazil for around 6,000 km of new electrical transmission lines divided into nine lots, Cobra IS - through its Brazilian subsidiaries - was awarded three lots to build almost 1,600km of new electricity transmission infrastructure.

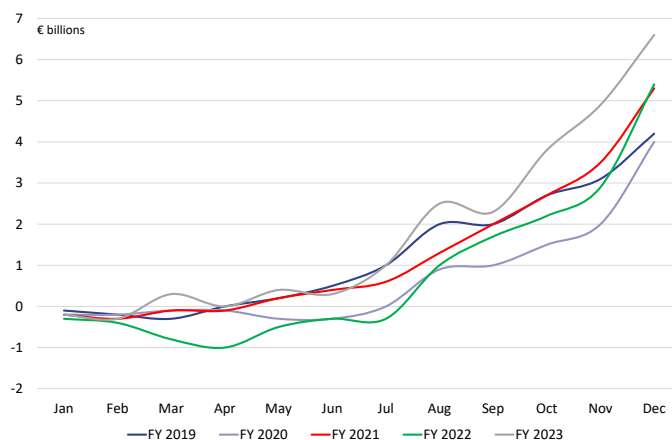
- The German Ministry for Digital and Transport has awarded VINCI Concessions three contracts under the Deutschlandnetz Regional programme to develop ultra-fast charging stations throughout the country. The investment associated with the three contracts amounts to approximately €200 million – subsidised in part by the concession-granting authority – and covers 828 charging points at 106 stations in the Berlin, Hamburg and Leipzig areas. VINCI Concessions, through its subsidiary that specializes in electric vehicle charging infrastructure in Germany, will be tasked with acquiring land, installing the stations and operating them for 12 years.

“VINCI: an old school economy company transforming their operations into the new school economy for the benefit of all participants.”

Why is VINCI on our list of companies to invest in?

1. An old school economy company transforming their operations into the new school economy for the benefit of all participants. Hopefully the examples and other detail on what keeps VINCI busy, speaks to my interpretation.
2. I have not come across many companies with a Free Cash Flow profile like VINCI’s. The nature of their contracts and the associated escalating income streams (built-in protection from inflation) has huge benefits

CUMULATIVE FREE CASH FLOW OVER A YEAR.”



Cumulative cash flows have accelerated annually, and even the impact of Covid is hardly noticeable.”

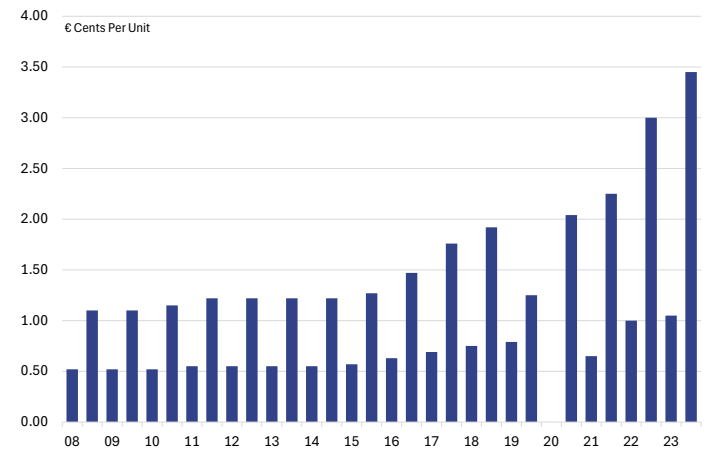
from a revenue perspective. The chart highlights the cash-generative nature of the business.

3. Diverse income streams. Ten years ago, the company relied heavily on the profits from Autoroutes Concessions (more than 70% of total). Strategic initiatives and planning have led to new divisions of Energy, Airports, other concessions, and Construction - which now combined generate more profit than the Autoroutes segment. Furthermore, the profit contribution from the various divisions is evenly spread. This reduces volatility and has benefitted Vinci enormously, especially during crisis periods like Covid. It took a long time for some concession operations like rail traffic to see a return to pre-covid volume numbers, but weakness there was offset by growth elsewhere in the company.

4. Right dividend profile for the HH investment philosophy

Although VINCI and Rentokil Initial might not be as sexy as the Magnificent 7 (a term used in the financial press for the seven tech giants that dominate US markets), I believe that the advantages and continual development of AI will

SEMI-ANNUAL DIVIDEND



Consistent and increasing dividends helps with long term wealth creation.

find an application in companies such as these, leading to increased productivity, innovation and additional income streams. Then we might as well repeat points 1 to 4 again; and so the cycles continues.



A VINCI railroad in France.



Our next Insight seminar will be held in March, and will focus on why our investment philosophy places so much importance on income.



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Topic: **Why our obsession with income?**

Natal Midlands

Date: 14 March 2024

Venue: Oasis Conference Centre,
72 Main Road, Howick

Morning Time: 10am for 10.30am

Evening Time: 5.30pm for 6pm

Johannesburg

Date: 12 March 2024

Venue: Rosebank Union Church, Cnr
William Nichol and St Andrews
Road, Hurlingham

Time: 7am for 7.30am

Cape Town

Date: n/a

Venue: ABRU Motor Studio, Lourensford
Wine Estate, Somerset West

Time: 5.30pm for 6pm

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