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A time to buy

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Johan started his career at Coronation fund managers in 1998 and was a small and mid cap analyst. He then joined Sanlam Investment Management in 2003 as analyst covering the small and mid cap space. He is currently the portfolio manager of SIM's Small Cap and Growth funds. He completed a Bcomm Economics degree and thereafter his Honours in Economics. He is a qualified Chartered Financial Analyst (CFA).

A lot has been said about South Africa's current political crisis and the economic effects thereof. Even more has been written about the current financial crises globally and the global slowdown in growth. I will not bore you with yet another rehash of the same hypothesis and analysis. What I will say is that no matter what you hear the so called "experts" say, just as they did not see it coming so too will they not see how it will be resolved.

From an investment point of view it is useful to separate what we do know and what we don't. What we do not know is how and when the economic scenario will unfold and what the exact repercussions will be. We do know that economies endure and great companies emerge from periods of uncertainty and economic contraction even more powerful than before. We also know that during times of uncertainty and fear investors who are patient stand to gain significant wealth.

We cannot call when the cycle will turn, but turn it will. In the mean time all that the "experts" do is cause further confusion and volatility. This volatility causes irrationality which when combined with blind fear provides us with fantastic investment opportunities.

So what characteristics do we need to avoid? Well, I would begin by excluding the following companies:

1. Newly formed businesses that are actually just a combination of businesses bought over the past few years
2. Businesses highly geared as a result of poor cash flow and/or too aggressive capital expansion while the going was good (and all the "experts" telling us that things would continue to be good!)
3. Companies whose share prices reflect too high earnings growth expectations
4. Poor quality companies, with poor management teams and patchy track records

In this market we don't have to try and be clever. The market has been indiscriminate in its selling. Fantastic companies, with good earnings potential, strong business models and excellent management teams have been sold off *with* all the lower quality stuff.

It is important to reduce the emphasis of future growth in our valuations and increase the emphasis on the actual value of the company. In other words, the fact rather than the promise.

Some examples of companies that we feel fit the above criteria are:

Aspen, excellent track record, good earnings growth potential and truly a world class business. It is now trading at a similar price to last year. Also look at Enaleni.

Pick n Pay, one of SA's best businesses now trading at the same price as in early 2006 and at PE's last seen in the late 80's. This business should continue to grow its earnings in this environment and actually benefits from high inflation. Also look at Shoprite.

Advtech; schools and education are sectors that exhibit both growth and defensiveness. Advtech has been sold off with the market and is trading at the same levels as in early 2007. Also look at Adcorp.

Afgri, after many years of decline, agriculture is recovering. SA has just harvested a massive crop, maize prices remain high and Afgri has recently come through a difficult trading period and restructured significantly. It is now trading marginally above book value, an extremely low PE and a dividend yield in excess of 8%. Also look at Zeder.

These companies should continue to grow their earnings despite the environment, they will pay excellent dividends and will come through this period even more dominant.

I have also heard some "experts" saying that you should stay in cash and wait for the cycle to improve. This is only true if you need the liquidity within the next 5 years but then equity investments are not an option anyway. It may also be true for those of us who can time markets and economies as well as share prices perfectly and consistently. I have yet to meet such a person.

For the rest of us long term investors this comment is absurd. Money market funds provide a return of about 12% (before tax) with inflation currently topping 13% and including tax you are losing money. Property may look attractive (based on historic yields and capital appreciation) but the best time for property is gone. Vacancies will increase, price growth will slow and escalation growth will slow.

Bonds may be an option but given our stubbornly high inflation I would suspect that a lot of good news regarding lower future interest rates has been priced in.

This leaves equities which have proven over and over to be the best performing asset class over the long term.

There will be lots of bad news and lots of "experts" telling you what will transpire during these times of crisis. All I can say is that most of these "experts" will be wrong. Perhaps one or two may prove right but we have no way of knowing which. There is too much uncertainty in the world to bog you down with trying to predict the future. What we can say for certain is that the cycle will turn again. In the mean time I'm happy to keep buying these high quality bargains and pick up my 5 to 8% dividend yields.
