



Monthly Commentary – December 2009

The year is possibly better characterized by what didn't happen as opposed to what did: The world did not enter a 1930s style depression, despite equity markets seemingly priced for this eventuality in late 2008/early 2009; not a single South African bank required a bail-out; Old Mutual did not go bust despite trading at a 70% discount to its disclosed embedded value in March 2009; The Springboks did not end the year as the best rugby team in the world despite holding the World Cup and Tri-Nations trophies and beating the All Blacks three times in a row, pipped to the post by New Zealand after a dismal performance in Europe.

Mean reversion remains the remarkably powerful reality against the emotional pull of fear and greed. While the All Share Index retreated 23% in 2008 (having plummeted 45% from its highs in that year), 2009 produced a 32% total return (29% excluding dividends) and saw the Index soar 56% from the low in March. In US dollar terms, the Index rose 70% in 2009. An investor in the Index over these eventful two years would be somewhat more grey, possibly somewhat wiser, but in almost exactly the same position as on the last trading day of 2007.

The 29% price return of the All Share Index in 2009 was provided by an 81% rerating (from a PE of 9.5 to 17.2) combined with an earnings contraction of some 29%. From here, earnings have to grow by 22% just to reach the long run average market PE of about 14x. Our funds, at a PE discount of around 31% to the market and a dividend yield comfortably above 3% are well placed to weather any earnings disappointments that may or may not be waiting for us in 2010.

Some of the seminal events of 2009 from our perspective, as mentioned in previous reports during the year:

BHP Billiton announced a JV with Rio Tinto for all its Western Australian iron ore production assets. The two companies will market and sell the output from the JV separately to their clients. Billiton expects to pay Rio Tinto \$5.8bn to raise its interest in the JV from 45% to 50%. The JV will require regulatory approval and is slated to realise \$10bn (NPV) from synergies.

In June, **FirstRand** announced that Sizwe Nxasana will succeed Paul Harris as group CEO, in what looks to us like a well-planned, gradual succession. Later in that month, FirstRand hosted an investor update at which the message relayed was quite disappointing. The group pointed to conservative earnings expectations for the second half of the 2009 financial year driven by increases in impairments and bad debts as well as poor performance in various businesses, most notably Private Equity, FICC (fixed income, currencies and commodities) and the SPJI (Special Projects International) portfolio. In a significant change in strategy, FirstRand indicated that they would be significantly scaling back on most of its developed markets businesses and intend to focus more on growing its business into Africa.

Anglo American received an unsolicited and unwanted merger proposal from Xstrata. The board is reported to have taken less than two hours to reject the proposal. Anglo American appointed Sir John Parker to replace Mark Moody-Stewart as chairman. This seemed to ruffle the feathers of some South African politicians who felt entitled to influence the appointment, despite not being shareholders. In compensation they received far more income from Anglo (tax receipts) than the shareholders, who got no dividend for the first time in the company's history.

Just days before its year end, **Sasol** issued a profit warning indicating that headline earnings per share for the year to June 2009 would be down 40% to 50%. This was in sharp contrast to consensus expectations, which were for flat earnings. Once again we could marvel at the futility of forecasting. In the company's subsequent results statement, management took an ultra-conservative stance, cutting the full year dividend for the first time in Sasol's history (-35% to R8.50), slashing the capital expenditure budget, and guiding 2010 earnings further down from 2009's depressed levels.



The latter view (certainly not shared by consensus forecasts at the time) cited their expectation of a \$65-\$70/bbl oil price and a Rand/US dollar exchange rate averaging R7.90/\$ for FY 2010.

Old Mutual: Paul Hanratty's successor as CEO of OMSA is to be Kuseni Dlamini, who comes to the assurer with a good business pedigree but no experience of the life assurance industry at all. We wonder whether this appointment might demotivate veteran senior managers at Old Mutual. Hanratty has been elevated to the head office in London in the capacity of Chief Executive of the global long term savings division. We trust that he will avert the sort of less successful escapades that have hampered the group in recent years.

Mondi: Considerable excitement was generated when the National Treasury permitted the JSE to reclassify Mondi plc in such a way that it can be traded locally just as easily as Mondi Ltd, i.e. without foreign exchange restrictions. The valuation gap between the two promptly narrowed from 22% to 4%. We would be more than a bit pleased if the local listing of British American Tobacco were to be afforded the same favourable treatment.

Standard Bank Group reported interim results to June which clearly indicated that the banking sector is still taking some strain. Headline earnings per share were down 27%, as was the dividend. Of particular concern was a hefty 58% increase in impairments, resulting in an increase in the credit loss ratio (CLR) from 1.31% to 1.84%. This was partly driven by an increase in corporate non-performing loans, where the CLR increased from 0.3% to 1.15%. On a more positive note, Standard Bank remains well capitalised with a total capital adequacy ratio of 14.4%. Tier 1 Capital increased from 10.7% to 12%.

MTN Group: For some time, cellular network operator MTN has been an undisputed market darling. It became the single biggest holding by the average domestic equity unit trust, abetted in this by some gerrymandering of the rules for certain popular indices. The story has been an easy sell – a well managed company in South Africa expanding into the populous and under-served Nigerian market, as well as into Iran (interesting choices of well known bastions of financial prudence and political stability). The problem with these easy-to-sell ideas is that they captivate a large following and many fans seem to be under the peculiar delusion that awareness of the company's prospects is held by a minority. So, the scope for withstanding disappointments becomes very low. Unlike in the past, recent news flow has not been unambiguously palatable to MTN's shareholders. Highly publicised corporate deals failed to materialise, the Nigerian naira weakened hugely against the rand and domestic subscriber numbers actually decreased. These aren't deleterious developments, but the share's 28% underperformance of the JSE since late May has certainly been contrary to consensus predictions.

In these commentaries, we have frequently questioned the value of **rating agencies'** assessments. In July, we were pleased to learn that we are not alone, nor even as earnest about this as some. Calpers, which is the biggest private pension fund in America, announced that it had sued Standard & Poor's, Moody's and Fitch for "wildly inaccurate risk assessments" that were "seriously flawed in conception and incompetently applied". The lawsuit was filed in San Francisco on 9th July 2009. We await the outcome with interest.

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