



Monthly Commentary – November 2009

“The taller they are, the harder they fall”.

I played rugby for most of my school years, and was always smaller than average for my age. This had its advantages, none of which was having to tackle much bigger players. Coach after coach including Nick Mallett¹, in his first ever coaching job, invoked the quote above, to limited effect. The chances of bringing down someone twice my size by encouraging his kneecap to come to an abrupt halt against my face seemed low. Unfortunately, I had not yet learnt a technique demonstrated by James Dalton playing in my old position of hooker in the opening game of the 1995 World Cup against Australia², namely to build up good momentum and then aim your cranium squarely at the bigger player’s scrotum, forcing him to yield instantly. So I can’t say that I know for sure that the bigger they are, the harder they fall. What is clearer is that the higher a share’s rating, or an investment’s proclaimed promise, the greater the likelihood of a big disappointment. We’ll take a look at two topical examples:

MTN

For some time, cellular network operator MTN was a 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. But news flow has not been overly kind to MTN’s shareholders recently. Highly publicised corporate deals failed to materialise, the naira weakened hugely against the rand and domestic subscriber numbers actually decreased. These aren’t deleterious developments, and yet MTN’s rating relative to the overall market has plunged 60% in 2009. It has fallen so hard that we have begun to take an interest. Superior earnings have cushioned the blow from de-rating, and in total return terms MTN has underperformed the market by 29% in the past few months.

DUBAI / Murray & Roberts

We first mentioned Dubai in these monthly commentaries in November 2008, when we learnt that property developer Nakheel had suspended the Trump Towers project, in which Murray & Roberts held a 50% interest. Just a few months prior, M&R had been trading on a PE multiple of over 23 and in March 2007 it was on a PE of 37. Apologists for these ratings invoked a bizarre new metric: price to order book. Pity some orders were cancelled. M&R is currently on a PE of 7. Although we missed the worst of the fall, we accumulated a position too early, as value investors often do.

Almost a year to the day after the extravagant opening party for Sol Kerzner’s³ Atlantis Dubai hotel, the world’s most lavish hotel by some standards, the emirate announced that it was essentially defaulting on loans. The FT wrote: “Of all the glitzy emirates on the western shore of the Gulf, Dubai is easily the brashest. With the grenade it has just lobbed into the capital markets by calling for a six-month creditor standstill for its flagship Dubai World holding company, it is effortlessly living down to that reputation. Dubai’s action looks like either a serious misjudgment or, more likely, a breathtaking cock-up.” (FT, 26 November 2009). An inglorious side effect of the decision to delay repayment of a \$3.5bn bond of Dubai World’s Nakheel property subsidiary is that the world’s biggest Islamic bond (“sukuk”) is now in default. There are many facets of this decision that are difficult to understand: the loan could easily have been repaid, given the successful recent issuance of new bonds; the announcement came just before four days of religious holidays; the Abu Dhabi authorities have thus far remained silent. Investors are left to surmise on political one-upmanship by the much wealthier Abu Dhabi emirate.



The effects of the apparently ill-conceived announcement have been severe. The costs of Middle Eastern debt rose sharply, as did the costs of insuring this debt. Saudi Arabia and Qatar must be peeved by their neighbour's actions. As usual, the rating agencies provided no warning at all, but downgraded much of the region after the fact.

So, Dubai's rampant ambitions have been badly dented. Yet, financial markets appear to have over-reacted. Dubai never did have oil or fiscal savings and it has financed its curious projects with high leverage for a long time. We think the corporate sector is being scolded by Sheikh Maktoum (who has replaced leading businessmen with members of his family) and the Abu Dhabi authorities. Whoever sanctioned the announcement badly underestimated the financial markets' reactions (similar to Anglo American and Old Mutual passing on dividends earlier in the year). We expect that Abu Dhabi will step up to the plate in exchange for some political gain, and that this episode will pass. Those who previously excused M&R's high rating on the prospects for Dubai projects may never be vindicated though.

The city with the tallest building has indeed fallen hard. Nick Mallet may be smiling wryly.

Some company news during October:

ABSA (held) had its CEO, Maria Ramos, appointed to the board of Barclays, its controlling shareholder. Maybe she knew this was coming when she appeared to delegate so much of her work at ABSA.

Old Mutual (held) provided a third quarter update. Its cash and FGD surplus rose and its US bond portfolio's unrealised losses decreased. We remain comfortable shareholders as the price: embedded value remains attractive.

CFR (Richemont) (not held), has weathered the economic storm much better than previously, partly through good cost control. Johan Rupert is assuming the CEO role. Alas, we sold this one too early.

ABIL (not held) conceded that the Ellerine's acquisition is still putting severe strain on the business. The dividend was maintained at the cost of a lower dividend cover.

Liberty Holdings (not held) is still experiencing a poor lapse rate but investment earnings were up and the group was profitable in the third quarter. Embedded value was static on the previous quarter. Stanlib suffered net outflows of R4bn in the quarter.

Rowan Williams-Short

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¹ Nick Mallet went on to play for Western Province and South Africa, as well as to coach South Africa to a record winning streak of 17 consecutive test match victories. He currently coaches Italy.

² South Africa beat Australia 27 – 18 in the opening match and went on to win the 1995 World Cup, beating New Zealand 15 – 12 in the final after extra time. SA regained the World Cup in 2007.

³ South African born Sol Kerzner has developed several famous hotels, including Sun City and the Lost Palace in SA, the Atlantis resort in the Bahamas, the Atlantis in Dubai and most recently the One and Only in Cape Town.