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INVESTMENT

A closer look

at great value shares that you've probably never heard of

By Marc Hasenfuss

FOR A VARIETY of reasons, some perfectly good companies on the JSE simply don't get much more than a passing glance from market watchers.

There are a good number of so-called Cinderella stocks that trade in the shadows of more illustrious companies. Typically, Cinderella companies haven't done too much wrong operationally or strategically, but still find themselves relegated to the sidelines.

It's one thing not to be the belle of the ball when the going is good (as was the case between 2005 and mid-2008), but quite another to be neglected – despite having all virtues intact – when the music stops.

Admittedly some remarkably consistent performers on the JSE don't always flirt openly with investors – often reluctant to hold regular investment presentations, not engaging openly with the financial media or offering only the scantiest of commentary on results or corporate actions.

Some companies also labour under misconceptions – sometimes through no fault of their own – that they are plying their trades in sunset industries. Operations – which churn meaningful cash flows year after year – are perceived as dowdy and prospects regarded as musty.

Then some, quite bafflingly, play hard to get. Even though the JSE has regulations to promote liquidity in stocks, there remain instances where the availability – or rather lack of availability – is an issue. This can be a big turn-off – especially for institutions that are looking for large parcels of scrip.

While some companies may prefer to remain low-key, a Cinderella status does carry risks. In this dreary market clime, it's easy to slip from the fringes into relative obscurity.

The prevalent mood on the JSE is one of caution, and one might argue the market's affection is no longer showered on any stock with a half-baked growth story. There's a clamouring for the best known blue chips and steadiest of second liners.

This is typical of a jilted market. Investors go back to the tried and tested in periods of prolonged market jitters – increasing numbers of corporate eyesores (especially among the ranks of the small caps) reinforcing the notion that anything outside the bluest of chips carries undue risk.

Financial service wannabes have fizzled (Blue, Afdawn), the foundations of new building supplies giants have been pulverised (Wearne, AGI, Brikor, African Brick, Kairos) and the best-laid junior mining plans snagged (KCM, Sallies, Pamodzi).

Blue chip counters and second liners do have their ups and downs, but it's rare for the biggest and the best to slump to levels where a strategy is based purely on survival.

But an exaggerated casting out of smaller stocks does mean that some of the lesser-known companies with decent track records and promising prospects are inevitably lumped with the untouchables.

This is good for eagle-eyed buyers who make it their business to spot long-term value. Already we have seen a couple of Cinderellas recently finding their prince when transport conglomerate Imperial recently took a strategic stake in Mix Telematics and bought out logistics specialist CIC Holdings.

One suspects that corporations – acquisitive entities like Imperial and Bidvest (and perhaps private equity players like Brait) – will spot the hidden charms of Cinderella stocks long before the retail investors.

In the pages that follow *Finweek*'s investment writers – Marc Hasenfuss, Marc Ashton and Brendan Ryan – look at 10 stocks that might be out of the limelight... but certainly aren't lemons. ■

CINDERELLA STOCK:

REX TRUEFORM

More popular attractions:
Foschini and Truworths

Lack of liquidity and a cumbersome pyramid control structure have probably kept the punters away from fashion retailer Rex Trueform. Well that, and the fact that the market still gets its kicks from the much larger fashion houses. By comparison, Rextru, founded some 50 years ago, might seem like a dusty old relic – especially considering that the business initially earned its name in the much-maligned clothing manufacturing sector. The thing is that Rextru – unlike other clothing manufacturers – has very successfully adapted its business model. In the late Eighties the Shub family – who have control firmly tied up via African and Overseas Enterprises – made a cursory shift into retail by opening a factory shop in Salt River. Early successes prompted further cautious expansion, and today there are roughly 50 Queenspark stores scattered around SA. Although RexTru has radically altered its operating profile by shifting focus almost exclusively on to retail (only a small in-house manufacturing element remains), the Shub family continues to run the business conservatively. This means a focus on margins and cash flows, but also means the business perhaps lacks an adventurous spirit as regards expansion plans.

PRETTY PONDERINGS

1. A strong (cash flush) balance sheet allows regular dividends no matter the condition of the trading environment.
2. The company has plenty of expansion capacity in its niche (even if roll-outs have at best been slow and steady over the years).
3. Rextru – provided the Shub family wanted a new strategic partner or were keen for a more passive role in the business – could be an attractive acquisition for one of the bigger fashion retailers. Strategic empowerment shareholder Brimstone has already expressed a willingness to sell off its stake in RexTru.
4. Rextru is fundamentally cheap – both on an earnings basis and measured by underlying assets (of which the cash pile represents a large portion).

CINDERELLA STOCK:

TRANSPACO

More popular attractions:
Nampak and Astrapak

Packaging itself is a bit of a Cinderella sector, so it certainly doesn't help your investment image by being the low-key player. Still, Transpaco is one of the unsung performers on the JSE with a reliable earnings record of late, as well as a string of generous dividends. The business is neatly niched across the specialised plastics (carrier bags to film) and cardboard (cartons and cores) markets. CEO Phil Abelheim reckons Transpaco's successes have been built on conservative expansion into strong niches. "We have concentrated on growing our existing legs. Only when we can't grow these legs anymore will we start looking at new options."

Unlike some of its bigger and more illustrious countermates, Transpaco has remained nimble in what has proved a tight market over the last five years – even managing to snap up two relatively large operations from Nampak. Transpaco also has a successful decentralised management structure in place that precludes the company getting bogged down in cumbersome chains of corporate command. Transpaco's recent results to end June confirmed that the business is run "lean and mean" with well-reinforced margins turning a slight drop in turnover into a gain at operating profit level.

PRETTY PONDERINGS

1. The group holds a robust balance sheet and boasts reassuring cash flows (cash flow from operations was nearly R100m in the year to end June).
2. The company has an attractive dividend policy. The share currently yields an enticing 5,6% with the annual payout covered a comfortable three times by earnings.
3. A track record for tweaking under-performing operations. Transpaco bought Nampak's Cape Town-based plastic carrier bag operations in 2006 and has since turned the business into a significant profit generator.
4. Transpaco is ridiculously cheap. Full year earnings of 194c/share put the share on an earnings multiple of 5,7 times. Net cash flow of R59m equates to over 200c/share.

CINDERELLA STOCK:

LITHA HEALTHCARE

More popular attractions:
Aspen, Adcock Ingram and Ciplamed

More market watchers have started paying attention to this company after it flew the AltX coop, in the process shedding its guise as Myriad Medical. The new-look company came about in what was really a reverse listing that brought Litha Healthcare into Myriad. What the Litha transaction did was change Myriad from largely a distribution agency business into a healthcare contender that, in time, will produce its own products (vaccines).

It's a massive change. If Myriad had Litha completely aboard in the half-year to end November, the company would have generated turnover of R470m (instead of R153m) and churned operating profits of R45m (instead of R20m).

Litha – which imports and distributes paediatric vaccines on behalf of Government – is expected to be cash generative and carries minimal debt (which is understandable since R100m was raised in a rights issue for the Litha deal).

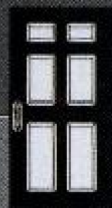
The share price has ticked up nicely (currently running at 115c) but the market may not be fully factoring in Litha's best longer term feature – margin-enhancing manufacturing capabilities.

PRETTY PONDERINGS

1. Litha has an inspired and active anchor shareholder in the form of London-listed Blackstar.
2. Vaccine production at Litha's Pinelands facility could start as early as 2013 – with funding to get the facility to manufacturing status already in place.
3. Besides enhancing Litha's operating margin, there's unlikely to be too much competition for Litha's vaccine plant as barriers to entry are high. So long may the Department of Health back the Expanded Programme on Immunisation by adding more vaccines...
4. Litha could push through 11c/share for the full year to end May 2010 (due for publication any day now). That would put Litha on a forward earnings multiple of around 10 times – a rating that compares well to the historical multiples of its more illustrious countermates Aspen, Adcock Ingram and Ciplamed.

CINDERELLA STOCK:

MASONITE (AFRICA)



More popular attractions:
PPC and DAWN

It's quite possible that there would be a good deal more interest in this specialist building products supplier if its shares were not so tightly held. Between Masonite Corporation (78,6%) and Old Mutual (6,3%) there really isn't much of a free float – especially with just over 7m shares. While institutional investors will find this situation untenable, the retail investor (you and me folks) can still snaffle a decent parcel of shares by exercising a bit of patience. The company has operated in specific niches for yonks, with nary a sign of the corporate action that has characterised other segments of the greater building supplies market. Masonite's areas of speciality are boards (soft and hard), door facings and fibre ceiling panels. It's also a plantation owner. Over the decades (Masonite was listed in 1952) it has had its ups and downs – but recent years have seen some big earnings numbers and been rather rewarding in terms of dividends (ordinary and special). Current trading conditions won't inspire the bottom line, but Masonite can be relied on to keep chugging along profitably even in lean times.

PRETTY PONDERINGS

1. Masonite is well managed, and proof can be found in the fact that gross margins in a tough year to end December were held at 27% – not far from the previous year's 29%.
2. The balance sheet is stout with around R60m in cash on hand (equivalent to around 850c/share).
3. The share price discounts tangible net asset value of 5000c/share by over 20% – a slight on a company with a decent track record.
4. There's been much speculation around why US-based Masonite Inc hasn't simply bought out minorities in Masonite. Masonite Inc got itself into a bit of a squeeze of late, which probably means spare cash for buyouts is not readily available. However, it could be a good time for a local player – perhaps a management consortium – to post a bid for the US company's controlling stake in Masonite.

CINDERELLA STOCK:

PETMIN

More popular attractions:
Exxaro and Pallinghurst

Getting into the South African coal business appeared to be a "no brainer" for many coal juniors in recent years, given Eskom's dire straits and the booming demand on the export market. But cracking the coal space has proved to be a lot tougher than expected as shown by the problems at, among others, SA Coal Mining Holdings, Homeland Energy and HCI's Khusela Coal.

Petmin has moved into the upper end of the junior coal business through the Somkele anthracite mine in KwaZulu-Natal, where it's currently spending R120m to double production. Crucially, Petmin has 600 000t of dedicated export capacity at the Richards Bay Dry Bulk Terminal so it has sidestepped the problem of access to the Richards Bay Coal Terminal.

PRETTY PONDERINGS

1. There's a lot more to Petmin than coal. It owns the operating Samquarz silica mine as well as being a 34,9% JV partner in a potential pig iron project called Veremo. If all goes well, this is potentially a mini-mining house.
2. This company has stayed profitable since 2006 despite the volatility in financial and commodity markets.
3. Management has a great track record. These are the only guys in the past 10 years to make money out of the troubled Grootvlei gold mine on the East Rand, which is currently in the news for all the wrong reasons. Petmin bought low and sold out to Canadian junior Bema Gold at the last top in the gold market several years ago. Grootvlei has gone downhill ever since.
4. Petmin's newly appointed executive chairman is heavyweight mining executive Ian Cockerill, the former CEO of Gold Fields and previously CEO of Anglo American Coal.

CINDERELLA STOCK:

PAN AFRICAN RESOURCES*

More popular attractions:
DRDGold and Harmony

Pan African has underperformed since it first came to the JSE as a dual listing on the AltX in 2007, in addition to its listing on London's AIM bourse.

The JSE listing subsequently migrated to the main gold board while former controlling shareholder Metorex sold off its interest, and the largest shareholder is now Cyril Ramaphosa's Shanduka Resources.

Despite all this and the healthy rise in the dollar gold price over the past two years, Pan African shares have trended south far more than north. Right now they are in deep south territory at around 71c compared with a high of 145c and low of 40c.

There are various reasons for this. The much touted exploration work in the Central African Republic – where management reckoned it had located an entirely new gold field – came to zip.

Pan African's only producing mine – Barberton – is a greenstone operation. Greenstone operations get a bad press because of erratic grades and mining conditions, while Pan African has had major problems with illegal miners. That has been brought under control but at considerable expense.

PRETTY PONDERINGS

1. The Barberton mine is a high-grade operation. That's invaluable in maintaining revenues against the pressure of rising costs and the impact of a strong rand on dollar gold revenues.
2. Pan African offers both growth – there's a possible new mine on the cards in Mozambique – as well as diversification into platinum through the Phoenix tailings treatment scheme.
3. The Barberton gold mining scene is getting interesting. Vantage Gold Fields has just listed in Australia and Galaxy Gold is about to list on the JSE. Who knows what could happen in due course?
4. Pan African has an influential and, so far unlisted, BEE partner in the form of Shanduka Resources, which holds a 26% equity stake, while Cyril Ramaphosa is now the chairman.

CINDERELLA STOCK:
VALUE GROUP

More popular attractions:
Super Group and Imperial

We'd suspect the chaps at Value Group must be perplexed at the market's continued fascination with Super Group – the transport conglomerate that had to go to extraordinary lengths (two sizeable rights issues and the sale of more than a few assets) to curtail its dangerous debt levels. Value never attracted the same hype as Super Group – perhaps unable to mesmerise the market with a debt-funded acquisition spree. But the record will show that Value has hardly put a foot wrong – operationally or strategically – (other than the occasional sniping by *Finweek* around a related party property lease) since listing in the late Nineties. The company has shown encouraging organic growth on its core truck rental business, and acquisitions have been selective and revolved strictly around "wheels" (no hardware stores or financial service interests here). Reassuringly, directors admitted in comments accompanying the year to end-February 2010 results, that various potential acquisitions had been evaluated but did not meet the company's criteria. With the core business still firing on all cylinders, there's no need for a desperate chase – especially when directors predict new accounts will contribute to increased volumes in the financial year ahead and that synergies between business divisions have yielded supply chain opportunities that are generating new revenue streams.

PRETTY PONDERINGS

1. On a historic earnings multiple of around seven, Value's… uhm, good value – especially with management managing to tweak trading margins up.
2. The company's cash conversion rate is most efficient. Cash available from operations at R203m equated to around 100c/share at the end of February 2010.
3. Transport businesses have to re-invest in fleet, but Value's strong balance sheet should allow dividends to be declared without too much strain.
4. While Value has so far trundled along cautiously, major corporate action can't be ruled out. A biggie? Eastern Cape tycoon Tony Cotterell's Kempston empire or the Bolton family's Cargo Carriers?

CINDERELLA STOCK:
JASCO

More popular attractions:
Altron and Reunert

While the "old" Jasco Electronics group has been given an extensive operational and strategic makeover, the company – with a market capitalisation of less than R150m – remains a mere blip on the JSE's Electronic and Electrical Equipment Board. Aside from its core electrical business, the "new" Jasco now incorporates a sizeable telecoms segment, domestic products and security. About two years ago Jasco – sentiment buoyed by a series of acquisitions – appeared to be developing a bit of a cult following. The share pushed to around 450c before the onset of the global financial crisis, which triggered a steady dribbling down in Jasco's price to current levels of around 120c. Delays in telecoms spending have also detracted from Jasco's appeal, although the other operational legs (particularly domestic products and electrical) have performed soundly. Perhaps most important is that Jasco – despite the less-than-favourable operating environment – is not crawling into its shell. There's still a commitment to a strategic goal of becoming an integrated solutions provider to the telecoms, power and security sectors – something that's underscored by the recent acquisition of the Snapper range of plugs and accessories.

PRETTY PONDERINGS

1. Earnings may not be stunning at this juncture, but performance should be put in context. The telecoms segment was hit by delays, while the security arm had 65% of its project list cancelled or delayed. Better days… surely?
2. The business – ignoring "technical" issues in the 16-month period to end June – is capable of producing solid operational cash flows. The balance sheet is stress free.
3. Jasco is trading at a 35% discount to tangible net asset value.
4. Afrocentric Investments is a big backer of Jasco. For those who don't know, some of the prime movers at Afrocentric are Brian Joffe (the founder of Bidvest), beer industry doyen Meyer Kahn and Motty Sacks (of Netcare fame).

CINDERELLA STOCK:

TRUSTCO HOLDINGS*

More popular attractions:
Santam and Glenrand MIB

It's been an inauspicious 18 months for Namibian based financial services group TrustCo since becoming the first and only listing on the JSE Africa Board. The company has slipped from a high of 72c in February 2009 to trade at around 30c/share and appetite is limited for the counter.

With the global financial meltdown still fresh in most people's minds, it's no surprise that investors haven't really had much interest in a company that's perceived as little more than a bitty insurance operation out of dusty Namibia.

This perception wasn't helped when the JSE went through a stage where it prevented SA investors from buying more than R15 000 worth of shares in the company owing to liquidity issues.

Despite its less than spectacular returns, TrustCo has proven itself to be innovative and entrepreneurial in the financial services sector and this has attracted international funders to its business model in the form of the International Finance Corporation (IFC).

For those who enjoy illiquid small cap counters with long-term potential, this might be a stock to consider.

PRETTY PONDERINGS

1. Price to earnings multiple of less than three times historical earnings.
2. A recent investment of $10,9m from the IFC to support subsidiary TrustCo Finance indicates that the company is in good health and will provide a platform from which the company can grow.
3. A unique micro insurance offering that provides free life cover for mobile subscribers upon the purchase of airtime from mobile operator partners means that the group is able to tap into the rapidly growing cellphone market with an innovative financial services offering.
4. Indications from management are that dividends are on the horizon. For a small-cap this is an encouraging sign.

CINDERELLA STOCK:

iQUAD GROUP

More popular attractions:
Investec and Sasfin

It's hard to bet against the enviable track record of the PSG team, and with their new investment vehicle Paladin Capital looking to make a name for itself, it might make sense to take a look at the iQuad Group.

Paladin holds 47% of iQuad with another 8% held by PSG's investment partner Thembeka Capital.

iQuad classifies itself as a "diversified group of specialist financial and business services companies" with the company specialising in a number of niche markets. These include obtaining benefits and refunds from Government departments, interacting with the the Department of Trade and Industry (DTI) around incentive programmes, rebate administration, import and export solutions, strategic consulting as well as VAT, BEE and customs audits.

The company has fallen from its previous highs of R6,20 in 2007 to trade around R3/share, but has remained profitable as well as a generous dividend payer. This seems to have escaped the notice of many punters, with very few shares having changed hands in the last few weeks.

Throw in the fact that dealing with Government departments remains an art only a handful have mastered and iQuad may well be positioned to fill a couple of key areas in the business chain in the coming years.

PRETTY PONDERINGS

1. The proven track record of the PSG investment team, which has been a significant generator of wealth for SA investors in recent years.
2. The recent move of the group's CEO David Edwards to Gauteng to drum up business in a major commerce hub.
3. Attractive dividend yield of just under 7% and a price:earnings multiple of 6,6 times historical earnings.
4. Increased Government focus on the Industrial Policy Action Plan, entrepreneurship and innovative ways to create jobs in South Africa could see iQuad and its underlying business units scoring over the next few years.

**Brendan Ryan holds shares in Pan African and Marc Ashton holds shares in Trustco.*