OVERBERG MARKET REPORT

Tuesday 10th November 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- This week we take a brief look at a South African company which we have invested in, namely Dis-Chem. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Nick Downing

- The IHS Markit Purchasing Managers' Index (PMI), a composite indicator of private sector business performance continued to benefit from eased Covid restrictions in October, rising from 49.6 to 51, above the expansionary 50-level for the first time since April 2019. The PMI was led higher by the business activity and new orders sub-indices. The forward-looking new orders index regained the 50-level for the first time since July 2018, which bodes well for continued improvement in economic activity over coming months. Andrew Harker, Economics Director at IHS Markit noted "The latest data suggests that GDP could grow again during the final three months of 2020, following an anticipated "mechanical" rebound in the third quarter."

- Although year-on-year vehicle sales data makes for depressing reading, shorter-term figures indicate a strong rebound. New vehicle sales shrank in October by 25.4% on the year but increased by 4.1% month-on-month, contributing to a solid 42.1% increase on a 3-month-on-3-month basis. New passenger vehicle sales were especially encouraging, rising by 18.3% on the month while new vehicle exports increased by 17.9% on the month, exceeding 30,000 units for the first time since February. However, domestic commercial vehicle sales fell by 18.1% on the month after showing signs of pent-up demand in the prior two months. Despite the setback in commercial vehicle sales, the overall data are encouraging. New vehicle sales are expected to maintain their upturn over coming months as domestic demand gradually recovers.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Manufacturing Production: Due Tuesday 10 November 2020. The rate of annual contraction is expected to have slowed amidst the easing of lockdown restrictions with the consensus that it will be coming in at -7.7% year-on-year and 1.4% month-on-month in September compared to -10.8% year-on-year and 3.6% month-on-month in August. The expected improvements are in line with the positive purchasing managers' index (PMI) recorded in recent months.

- Mining Production: Due Wednesday 11 November 2020. Mining production is expected to have continued its recovery from the lows reached during the stricter lockdown levels. The consensus forecast is that the contraction in mining production slowed to -2.1% year-on-year and 1.1% month-on-month in September from -3.3% year-on-year and 6.7% month-on-month recorded in August. The expected rebound in both mining and manufacturing data would indicate positive GDP growth in the fourth quarter.

- Unemployment Rate: Due Wednesday 11 November 2020. The official unemployment rate is expected to have increased to its highest percentage on record in the third quarter. This is expected due to correction of the anomaly which arose in the second quarter as a result of the lockdown which prevented people from looking for work, thus reducing the size of the economically active population (as per the official unemployment definition). The consensus forecast is that third quarter unemployment increased to 31%.

GLOBAL

Contributed by Nick Downing

- A week after posting its largest weekly decline since March, the MSCI World Index rocketed last week after the US presidential election went smoothly, without the social upheavals and riots that many had feared. The post-election day rally beat all previous records. In the US, the S&P 500 index rallied 9.3% on the week, the German DAX gained 8%, the UK FTSE 100 6% and Japan's Nikkei 5.9%. Equity markets like Democrat presidents. Over the past 70 years, US equities have gained by an average 10.6% annually under Democrat presidents and only 4.8% under Republican presidents. Equity markets also like a division of power so that extreme policy tendencies are checked. The Democrats failed to win the "blue sweep", which would have made it easier to push through tax increases, regulatory changes and fragmentation of the tech giants. With the Senate remaining under Republican control, these less "market friendly" policies are unlikely to gain traction. Indeed, the Democrats also suffered a reduction in their majority in the House of Representatives, putting a further check on the party's more extreme policies. While president Trump has yet to concede and seems determined to follow the litigation route, it is highly likely that these attempts will be futile, and that president-elect Joe Biden will ultimately take over. Global markets can also rejoice. Although Biden is likely to remain tough on China and on trade, his policies will be more stable, multilateral and predictable. There will be less policy uncertainty, which markets dislike most of all. The mini bull run in equities has continued into this week following the positive vaccine news from Pfizer and solid earnings results. In the US, companies making up the S&P 500 index are on track to show an aggregate year-on-year earnings decline of 7.5% in the third quarter, far ahead of the 21% decline forecast as little as six weeks ago.

- The JP Morgan Global Manufacturing Purchasing Managers' Index (PMI) increased in October for a fourth straight month, rising further above the neutral 50-level which demarcates expansion from contraction. The global PMI increased from 52.4 to 53.00, with 20 of the 26 constituent countries recording gains. Common themes across countries were improving global trade and recovering domestic and international demand. Moreover, among the PMI sub-indices, the new orders indices were especially strong. As new orders are a forward-looking indicator, there is a strong probability of further improvements in manufacturing activity over coming months. The US IHS PMI strengthened from 53.7 to 54.8 and the Eurozone PMI from 53.7 to 54.8 with Germany's surging from 56.4 to 58.2. Japan's manufacturing PMI remained sub-50 but nonetheless improved from 47.7 to 48.7, while China's increased again from 53.0 to 53.6. While the global economy is undergoing a two-speed "K" shaped recovery with manufacturing and trade enjoying a strong rebound while services remain constrained by Covid-19 and social distancing, this should change once social activity normalises. Pfizer's positive vaccine news has dramatically improved the outlook for a more balanced economic recovery.

NORTH AMERICA

Contributed by Nick Downing

- The unemployment rate continued its steep decline in October, falling from 7.9% to 6.9%, well below the high of 14.7% recorded in April. A total 638,000 non-farm payrolls were created during the month, which would have been higher had the public sector not shed 268,000 jobs. Overall, the private sector created a solid 906,000 jobs, and despite the surge in new Covid cases, 271,000 of these were in leisure and hospitality and 104,000 in the retail trade. The construction sector created 84,000 jobs, the most since 2005. Encouragingly, the labour participation rate also increased from 61.4% to 61.7% as confidence returned to the jobs market. However, a concern is that of jobs lost since the pandemic struck in March, a higher proportion are now deemed to be permanent (3.7 million) rather than temporary (3.2 million). Nonetheless, the overall jobs data is encouraging with the rapid increase in new payrolls expected to add significantly to aggregated personal income growth and household spending. Household spending contributes over two-thirds of US GDP.

- As expected, the Federal Reserve kept its policy parameters unchanged at its November meeting, leaving the fed funds interest rate at 0-0.25% and its monthly purchases of Treasury and mortgage-backed bonds at $120 billion. The Fed considered adjusting the maturity of bonds purchased but since Treasury bond yields are already at such low levels, this was not considered necessary at this stage. Policy makers expressed surprise at the resilience of the economic rebound, especially considering the second wave of new Covid cases but nonetheless cautioned against the considerable risks posed by the pandemic and the decline in personal household savings in the absence of additional fiscal relief. Although taking a “wait-and-see” stance, the Fed remained committed to maintaining its ultra-accommodative monetary policy in place at least until the economy achieves maximum employment and inflation is on track to moderately exceed 2% for some time.

CHINA

Contributed by Nick Downing

- China’s exports beat market expectations for a seventh straight month, rising in October by 11.4% year-on-year, the fastest growth since March 2019. Imports grew by a more modest 4.7%, contributing to a surge in China’s monthly trade surplus from $37 billion to $58.4 billion. Exports to the US increased by 22.5% on the year but imports grew even faster by 33%, which should help defuse trade tensions between the two countries. Exports to ASEAN (Association of Southeast Asian Nations) and to the European Union each grew by 7% on the year. While recognising the substantial contribution which trade makes to its economic growth, China’s authorities are concerned that rising international geopolitical risks and uncertainty over the path of the Covid pandemic may prevent the good times from continuing indefinitely. At its recent 5-year planning session, the ruling party stressed the need to encourage strong domestic demand to reduce the nation’s reliance on international trade. Nonetheless, the trade data bodes well for China’s fourth quarter GDP figures.

JAPAN

Contributed by Carel la Cock

- Japan’s private sector experienced the slowest contraction in output in nine months, according to the latest Jibun Bank Japan Composite PMI, which registered 48 points in October compared to 46.6 in September. Both manufacturing and service sectors saw softer declines as global demand for products and services recovered. Manufacturers reported an expansion in new orders for the first time in two years, while employment levels stabilised in the services sector. Both manufacturing and services reported the highest level of optimism in over two years as respondents have confidence that business conditions will normalise to pre-pandemic levels in the coming months. IHS Market predicts Japan’s economy will contract by 5.6% this year followed by a recovery of 2.2% next year.

EUROPE

Contributed by Carel la Cock

- A resurgence in covid-19 infections has caused the service sector in the eurozone to contract at a faster pace while manufacturing keeps expanding at the fastest rate in nearly three years. The IHS Market Flash Eurozone Composite PMI Output Index fell back below the key 50-level indicating a contraction for the month of October and at 49.4 was the lowest reading in 4 months. The Services PMI Activity Index at 46.2 in October compared to 48.0 in September marked a 5-month low and points to a slowdown in activity even before governments implemented stricter measures on movements. Business optimism in the service sector remains bleak while it also turned negative amongst manufacturers and especially so in France. Germany, with its well-established manufacturing sector, is leading the recovery in Europe, while France saw business activity contract at a faster pace for a second consecutive month. In general manufacturing across the region reported an increase in new orders from both inside the eurozone and from outside, reflecting the uptick in global demand especially from the East. Employment in the services sector is stabilising but deteriorated faster in manufacturing as firms reported a continued reduction in backlogs for orders. Deflationary pressures eased in October although prices still declined. Increased average prices charged in manufacturing were more than offset by falling average service prices. The latest PMI numbers warn of a double dip recession in the eurozone and will put pressure on the ECB to continue to support the economy with loose monetary policy.

UNITED KINGDOM

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- The Bank of England (BOE) left its benchmark interest rate unchanged at 0.1% and vowed to continue with its current asset purchase scheme, expanding the quantitative easing programme by a further £150bn in an effort to boost the economy that has been hit by a second wave of covid-19 infections. The expansion in quantitative easing will bring the total stock of government bonds purchased under the scheme to £875bn. The monetary policy committee committed “to take whatever additional action necessary to achieve its remit” trying to ease fears and boost confidence. Apart from the second lockdown, the country is also still facing uncertainty regarding a Brexit deal. Prime minister Boris Johnson suffered a heavy defeat in the House of Lords when peers voted 433 to 165 this week in favour of removing parts of the internal market bill that would essentially break international law. The US president-elect, Joe Biden, has warned that the bill should not threaten the peace process in Northern Ireland and that a UK-US deal will be off the table if there is any destabilisation in the area. Mr Johnson has indicated that he would press ahead, potentially putting the prime minister and the president of the US on a collision course. Negotiators have until the end of this month to finalise a deal and for the European

Parliament to ratify the deal at their last sitting on the 14th of December. The stakes have never been higher.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- The IHS Markit ASEAN Manufacturing PMI has revealed that despite challenging conditions in the ASEAN economies amid weak global demand, Thailand, Vietnam, and Singapore all saw improvements in their headline PMIs. The region's private sector has been contracting for eight straight months although the latest reading indicated that the pace has slowed. The headline PMI was 48.6 compared to 48.3 in September and showed only a modest deterioration in the production of goods in the region. Myanmar, Indonesia, Malaysia, and the Philippines all reported deteriorations, citing a lack of new orders and a fall in factory production driven by weak global demand. Firms also continued shedding jobs at the same pace as the month before and reported that profit margins remained under pressure due to rising input prices and declining average charges. However, firms are more optimistic about future output in the year ahead than at any point since the pandemic started. The second wave of covid-19 cases in the West could still prove a major headwind for a sustained recovery, especially if the roll-out of a vaccine takes longer than expected. All hope now rests on getting vaccinations administered as expediently as possible.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 0.39	57307
JSE Fini 15	- 30.15	10949
JSE Indi 25	+ 17.86	81679
JSE Resi 20	+ 4.30	51378
R/$	- 8.97	15.38
R/€	- 13.64	18.17
R/£	- 8.34	20.24
S&P 500	+ 9.90	3550
Nikkei	+ 5.00	24839

Hang Seng	- 7.71	26016
FTSE 100	- 17.98	6186
DAX	- 1.16	13095
CAC 40	- 10.73	5336
MSCI Emerging	+ 6.97	1192
MSCI World	+ 6.09	2502
Gold	+ 28.53	1959
Platinum	- 7.29	900
Brent oil	- 35.90	42.4

BOTTOM LINE

Contributed by Gielie Fourie

- DIS-CHEM: Dis-Chem is a leading retail pharmacy group co-founded by Ivan and Lynette Saltzman in 1978 when they opened their first retail pharmacy store in Mondeor, south of Johannesburg. They worked hard and were successful. Dis-Chem listed on the JSE in November 2016. Dis-Chem follows an Everyday Low Price (EDLP) strategy, positioning itself as a discount (Dis-Chem) brand. Today Dis-Chem employs over 1,900 pharmacists, who handles two million prescriptions every month.

- THE FOUNDERS: Ivan Saltzman, a qualified pharmacist, has over 40 years' experience in the retail pharmaceutical industry. Ivan is still involved in the daily operations and decision making of the Group. Lynette Saltzman also has over 40 years' experience in the retail pharmacy industry. Their son, Saul Saltzman (40), has 20 years' experience in the retail pharmaceutical industry, all of which have been at Dis-Chem. He was appointed to the board in November 2016 and is also the alternate executive director to Lynette Saltzman. OWNERSHIP: Although Dis-Chem is a publicly listed company, the Saltzman family have retained majority control of the group. Their 52.7% shareholding is worth around R9 billion. Ivan and Lynette Saltzman receive directors' fees of R13 million and R10 million per year. Lynette heads up marketing for the group. She is the founder and director of The Dis-Chem Foundation, a charity organization. It works closely with registered NGOs to support and improve the lives of poor and struggling communities.

- BUSINESS MODEL: Dis-Chem has four business units. (1) "Big Box" stores in shopping malls. These are destination stores – not located near to the consumer. (2) Smaller format neighborhood stores bringing Dis-Chem nearer to the consumer. (3) The Local Choice (TLC) stores. These are smaller owner-operated franchised stores, also near to the consumer. (4) A wholesale division with four centrally and strategically located distribution warehouses. ORGANIC GROWTH: Dis-Chem's strategy is organic growth, complemented by carefully selected strategic acquisitions. In the current financial year, organic growth will increase the number of Dis-Chem stores to 170, up from 149 stores last year. The TLC franchise stores will increase to 104, up from 91 stores last year.

- GROWTH THROUGH ACQUISITIONS: Dis-Chem also grows by buying businesses that fit in, and have synergies, with its strategy. This year it has announced three acquisitions. (1) Baby City. Baby City sells a comprehensive range of branded baby products. It has a network of 33 stores generating sales of R855 million p.a. Dis-Chem bought Baby City for R430 million after following the company for many years. The seller, Michel Aronof and his staff will stay on. The baby market is big - about one million babies are born each year. (2) Dis-Chem is investigating the acquisition of a community-based pharmacy group. It will expand Dis-Chem's store base. (3) Dis-Chem is in the advanced stages of concluding the acquisition of a strategic interest in a primary healthcare insurance company. None of these acquisitions have been finalised yet.

- BAD PRESS - DISCHEM: Dis-Chem has experienced several incidents of "Bad Press". Earlier this year the Competition Tribunal found Dis-Chem guilty of selling surgical face masks at excessive prices. Dis-Chem was ordered to pay a penalty of R1.2 million. Later Dis-Chem was criticised when it demanded a rent reduction from its landlords. Dis-Chem argued that the Covid-19 restrictions prohibited it from selling 12% of its merchandise. Dis-Chem paid 83% of its rent in April. Since May it has paid its rent in full. Dis-Chem was also criticised for skipping its dividend. It argued that it needed the funds for its acquisitions. In June, Department of Health officials, accompanied by media, barged into a Dis-Chem pharmacy in Alberton to investigate unsubstantiated allegations that Dis-Chem did not follow Covid-19 health and safety standards. Dis-Chem's relationship with trade unions has at times been hostile. It has been sorted out. BAD PRESS - CLICKS: Dis-Chem's experience with the press pales in comparison to the trauma Clicks has experienced with Unilever's TRESemmé hair advertisement, describing African black hair as "frizzy and dull". Cabinet said the Clicks hair advertisement was "profoundly offensive and racist". Henry Ford was right when he said: "The two most important assets not on the Balance Sheet are Reputation and People".

- DIS-CHEM AND CLICKS: Dis-Chem is often compared with Clicks. Let us look at two important metrics – the Price Earnings (PE) Ratio and Earnings Growth: Dis-Chem has a PE Ratio of 26. Its earnings for the six months (five of the six months were Covid-19 "months") to the end of August increased by 16.2%. Clicks has a PE Ratio of 33. Its earnings for the year (five of the twelve months were Covid-19 "months") increased by 13.7%. In both these two important metrics Dis-Chem is the clear winner. No wonder the analysts' consensus has Dis-Chem as a "Buy" and Clicks as a "Sell". Clicks is four times the size of Dis-Chem. The smaller Dis-Chem is experiencing a strong growth phase – its market share is growing year after year.

- SUMMARY: Clicks, a very well-managed company, will have to work harder than Dis-Chem to move the needle. Dis-Chem has the advantage that the founders and directors are big shareholders – they have “skin in the game”. The founder of Clicks (and Pick and Pay), the remarkable Jack Goldin, died in Australia at the age of 75 in 2001. Today Clicks is managed by professional managers. They can move on to a next assignment at any time. Over the past two years, Clicks has outperformed Dis-Chem. Dis-Chem has always been the underdog. Expect this to change. “It’s not the size of the dog in the fight, it’s the size of the fight in the dog that counts”. Mark Twain.

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