OVERBERG MARKET REPORT

Tuesday 9th February 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Last week we invested in Grindrod (JSE:GND). We look at the rationale behind our decision for this investment. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The IHS Markit Purchasing Managers Index (PMI) increased for the fourth consecutive month to 50.8 in January up from 50.2 in December. The January reading signalled the sharpest increase in output in over four years. However, the rise in activity mainly supported the completion of outstanding business, as firms struggled to find new work due to the Covid-19 pandemic. The IHS Markit South African PMI is a composite single-figure indicator of private sector business performance. Any reading above 50.0 indicates an overall improvement in the sector and a reading below 50 a decline. The latest expansion was mostly driven by an increase in private sector output that was notably the fastest since December 2016. While some businesses linked this to a rise in new orders, the upturn also supported efforts to fulfil outstanding work. The outlook for the forthcoming year for business activity picked up from December, as firms remained hopeful of an easing in Covid-19 restrictions over the course of 2021. Nevertheless, continued lockdowns, load shedding and inflationary pressure will continue to weigh on business activity in the private sector in the medium-term.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Werner Erasmus

- Mining production, due Thursday 11 February. Lockdowns both domestically and abroad, as well as the recent bout of load-shedding are likely to have hampered mining production in December. As a result, mining production is expected to have declined in December by 6.2% year-on-year and 7% month-on-month.

- Manufacturing production, due Thursday 11 February. Manufacturing production for December is expected to have declined 1.2% year-on-year. The momentum of the recovery in the manufacturing sector has been showing signs of slippage. In November, it showed a worse-than-expected decline of 3.5% mainly due to a resurgence of infections in many of South Africa's trading partners and the introduction of tougher economic restrictions. In December South Africa was also hit with its own second wave, introducing renewed level 3 lockdown regulations.

- State of the Nation Address (SONA), due Thursday 11 February. While South Africa continues to battle the Covid-19 pandemic, the SONA is anticipated to outline the administration's economic plans and progress for the year with regards to reforms of state-owned entities, the electricity sector, network industries and the infrastructure rollout as well as a recovery plan.

NORTH AMERICA

Contributed by Nick Downing

- Non-farm payrolls increased in January by 49,000 while the unemployment rate dropped from 6.7% to 6.3%. However, the numbers were disappointing as the fall in the unemployment rate is attributed to a reduction in the number of people actively seeking jobs. The labour participation rate dropped marginally to 61.4% as more job seekers became discouraged and dropped out of the labour market. This contrasts with last year's pre-pandemic participation rate of 63.3%. Meanwhile, combined December and November payroll numbers were revised lower by an aggregate 159,000. The leisure and hospitality sector remained the source of most job losses, shedding 61.000 in January after losing 536,000 in December. The best jobs producing sector in January was Professional/ Business Services, although of the 97,000 jobs created 81,000 were temporary which indicates continued reluctance on the part of employers to make full-time offers. However, the average number of weekly hours worked increased from 34.7 in December to 35 in January. An increase is often a precursor to rising employment activity. Most economists predict the winter employment lull is temporary and should gather momentum as the weather improves, vaccinations are rolled out and social distancing restrictions are lifted. Additional fiscal stimulus should also boost hiring activity. Nonetheless, there is a long way to go. Of the 22.36 million jobs lost in March and April last year, 9.94 million are still unrecovered. This point is not lost on President Joe Biden, who latched on the disappointing payroll report to motivate his proposed $1.9 trillion Covid relief package. He said, "It's very clear our economy is still in trouble."

- President Biden has initiated discussions with the Republican party on his $1.9 trillion stimulus package but the counter proposal from across the Congressional aisle has been watered down to $618 billion. Democrats, having gained control of both houses of Congress after winning the Georgia Senate elections in January have the option of Budget Reconciliation, which allows certain tax and expenditure legislation to be passed by a simple majority. If bipartisan agreement appears out of reach, Biden may opt for budget reconciliation which would fast-track the stimulus and keep it intact. The growing likelihood of additional stimulus has pushed inflation expectations higher. Financial markets expect consumer inflation, as measured by the breakeven rate between conventional 10-year US Treasury bonds and similar maturity Treasury Inflation Protected Securities (TIPS), to average 2.2% over the next ten years. This is the highest breakeven rate since 2014. There are concerns from some quarters that the government may be providing too much stimulus. Former Treasury Secretary Larry Summers cautioned that the stimulus plan may trigger "Inflation pressures of a kind we have not seen in a generation, with consequences for the value of the dollar and financial stability." A report from the Brookings Institute predicted that the $1.9 trillion plan would lower the unemployment rate to 3.2% by early 2022, lower than the pre-pandemic record low of 3.5% but on the other hand, the Congressional Budget Office warned that without additional stimulus, a return to full employment would allude the economy for the next decade.

- The Institute for Supply Management (ISM) manufacturing purchasing managers' index (PMI) slipped from 60.5 in December to 58.7 in January but remained close to historic highs and well above the expansionary 50-level for an eighth straight month. According to the survey report, "The manufacturing PMI continued to indicate strong sector expansion and US economic growth in January. All five contributing subindexes were in growth territory." According to Tim Fiore who oversees the survey, "The manufacturing PMI corresponds to a 4.4 percent increase in real gross domestic product (GDP) on an annualised basis." The upbeat data corroborates the earlier IHS Markit manufacturing PMI released a fortnight ago which increased from 57.1 in December to 59.2 in January, its highest since the data series began in 2007.

JAPAN

Contributed by Carel la Cock

- Japan's private services sector contracted at a faster pace in January compared to December. The Jibun Bank Japan Services Business Activity Index fell to 46.1 in January from 47.7 the month before as rising covid-19 cases at the start of the year impacted output and new order flows. The latest figure brings the consecutive monthly contractions (sub-50) in the service sector to a total of twelve and recorded the fastest contraction since August. Surveyed respondents also pointed out that demand from abroad for Japan's services fell markedly at the start of the year. Despite subdued new orders and output, employment levels have remained stable for the past four months. Skilled labour in technology and the digital sector were in demand but largely offset by increasing retirements and voluntary resignations in other sectors. The overall business expectations measure for the next twelve months remained positive pinned to the hope that the pandemic will end this year and see an improvement in both domestic and international demand.

EUROPE

Contributed by Carel la Cock

- The latest flash estimates reported by Eurostat shows that the eurozone economy contracted by 0.7% quarter-on-quarter in the fourth quarter. The economy gave up some of the gains made in the third quarter, following the worst contraction in modern times caused by the covid-19 pandemic. Compared to the same quarter the year before, output fell by 5.1% in the fourth quarter impacted by the resurgence in covid-19 infections and the mitigating measures taken. The economy contracted by 6.1% for the full year compared to 2019. The eurozone has been hit hard by the second wave of infections and has experienced worse economic growth than some of the bloc's peer group. The US for example grew by 1% quarter-on-quarter in the fourth quarter, while China surged ahead 2.6% over the same period and recorded growth of 2.3% year-on-year for 2020. The US is expected to make a full economic recovery by mid-year while economists expect the eurozone to only return to pre-pandemic levels by the middle of next year. However, the quarterly contraction in the eurozone was milder than most economists expected, putting it ahead of the European Central Bank's 2.2% contraction and 1.2% contraction predicted by a Reuters poll. Some ascribe furlough schemes and better than expected exports and investments for the welcomed upside surprise. Amongst individual nations, Italy felt the impact of the latest restrictions more acutely, seeing GDP fall by 2% quarter-on-quarter and 8.8% year-on-year for 2020. Only Spain reported a worse contraction of 11% year-on-year for 2020. Germany (-5%) and France (-8.3%) reported slightly better year-on-year figures for 2020 while both Germany (+0.1%) and Spain (+0.4%) eked out a gain in the fourth quarter. Most analysts expect that the eurozone will show another slight contraction in the first quarter of 2021 and that higher transmissible variants to the covid-19 virus and delays in the rollout of the vaccination are major headwinds for economic growth this year.

UNITED KINGDOM

Contributed by Carel la Cock

- The Bank of England (BOE) kept its benchmark rate unchanged at 0.1% but indicated again that negative interest rates could be a possibility should the economy fail to rebound in the second quarter of this year. The Bank expects the economy to contract by 4% in the first quarter, but to rebound in the second half of the year boosted by consumer spend, assuming savers will spend up to 5% of their savings once restrictions are lifted. However, it remains contingent on a successful vaccination roll-out. The market responded to the news by selling off UK gilts seeing the news as hawkish and driving government borrowing slightly higher. Most analysts do not expect the BOE to cut rates to below zero, believing that the economy will show signs of a recovery before the BOE will be in a position to cut rates. The BOE is investigating the best way to tighten monetary policy assuming it would not sell any of the accumulated £895bn in assets purchased in the various asset purchase programs until interest rates have risen to at least 1.5%, giving comfort that there will remain ample liquidity for the foreseeable future.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- Manufacturing conditions in South East Asia have improved at the fastest pace in nearly three years. The IHS Markit ASEAN Manufacturing Purchasing Managers' Index improved to 51.4 in January from 50.8 in December. Both new orders and factory outputs saw their strongest recoveries in over two years, recording solid gains at the start of the year. However, a further lengthening of delivery times by suppliers has put some cost pressure on manufacturers and has seen another month of reduced staffing-levels, although at a slightly lower rate. According to IHS Markit economist Lewis Cooper, "Overall, the latest PMI data are welcome news for the manufacturing sector, indicating that a recovery is finally underway. Conditions remain uneven at the national level, however, as stricter lockdown measures stifle demand in some countries. But, if current restrictions are successful in curbing virus case numbers, the sector as a whole should see further growth as the vaccine is rolled-out and measures are loosened across the board."

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 9.51	65059
JSE Fini 15	+ 2.71	12386
JSE Indi 25	+ 12.17	87381
JSE Resi 20	+ 9.10	62814
R/$	- 1.26	14.88
R/€	+ 0.13	17.93
R/£	- 1.75	20.44
S&P 500	+ 4.25	3915

Nikkei	+ 7.08	29388
Hang Seng	+ 7.67	29319
FTSE 100	+ 0.98	6523
DAX	+ 2.49	14059
CAC 40	+ 2.42	5686
MSCI Emerging	+ 8.41	1399
MSCI World	+ 3.93	2795
Gold	- 5.27	1795
Platinum	+ 6.32	1137
Brent oil	+ 14.56	59.34

BOTTOM LINE

Contributed by Gielie Fourie

- GRINDROD: Grindrod is part of South African history. Grindrod was established in November 1910 by Captain John Grindrod as a clearing and forwarding agency and a marine surveying business. It survived two world wars and the Great Depression to become one of the most prominent shipping companies in Africa and the world. In 1986 the company listed on the Johannesburg Stock Exchange (JSE). In 2006 Grindrod was named the top shipping company in the world.

- MAPUTO PORT: In 2007 Grindrod invested in the Maputo Port Development Company – it owns 25% of the company. Today, the port manages a throughput of 16 million tons a year. Grindrod's investments in dry-bulk and car terminals at the port added significant value to the company's logistics offerings. To augment its shipping service, Grindrod entered the rail sector in 2009. It now offers a full suite of rail services, from locomotive manufacturing and line operations to track construction through interests located in South Africa, Mozambique, Zimbabwe, Zambia, Congo Brazzaville, the DRC, Sierra Leone, and Ghana. It operates a shipping service between Maputo, Beira, and Mauritius.

- ENTER REMGRO: A big change came in 2011 when it entered a R2 billion equity raising transaction with Remgro to support the group's strategic development of capital projects. Remgro owns 22.7% of Grindrod - it has board representation through Pieter Uys and Willem van Wyk. The Grindrod Family still owns 10% of Grindrod - they have board representation through Walter Grindrod. With Remgro and the Grindrod family on board, governance and management oversight is sound.

- DISCOUNT TO NET ASSET VALUE (NAV): Grindrod was trading at a big discount to its NAV. Often the discount was in excess of 50%. Grindrod has been a disastrous investment for Remgro. There was pressure from shareholders, especially Remgro, to unlock value. One way to unlock value, is to sell noncore assets. In 2018 Grindrod spun off the Shipping Division. Grindrod Shipping listed separately on the Nasdaq and the JSE (JSE:GSH). Grindrod (GND), now much smaller, remained listed on the JSE. UNLOCKING VALUE: The smaller Grindrod still trades at a significant discount to NAV. The NAV is R12.34, while the share price is R4.90 – a discount of 60%. Over 109 years Grindrod has accumulated a substantial portfolio of businesses that did not really fit together. To further unlock value, Grindrod is selling its remaining noncore assets, especially its investments in agriculture. These investments made no sense – Grindrod is not an agricultural company. It has sold its substantial holdings in SENWES Agri and NWK Agri. Also for sale are valuable agricultural land in KZN, and Grindrod Bank. The expected proceeds are around R3 billion. Some businesses were simply discontinued. This will leave Grindrod with no debt on the balance sheet. Once the noncore assets are sold, Grindrod will be left with valuable assets in ports, terminals, warehouses, ships, trains, and specialist logistics. Much of its income will be generated offshore.

- CORE BUSINESS – FREIGHT TRANSPORT AND LOGISTICS: Grindrod will now be able to focus on its core business, which is transporting and handling freight by (1) rail and (2) its four ships. Rail transport includes transporting containers, new vehicles, and exporting coal, iron ore, copper and citrus, through Maputo. Grindrod provides a rail service to many sub-Saharan Africa countries. The shipping service transports and handles freight between Maputo, Mauritius, and Beira. To this end they have bought two extra locomotives, 54 extra carriages and a fourth ship. Its logistics services include tailormade warehousing and distribution facilities.

- SUPPLY CHAIN SOLUTIONS: Grindrod provides specialised and integrated supply chain solutions for exporters and importers in the global movement of liquid bulk, dry-bulk and containerised cargo, from “pit-to-port” for mining companies, and from factory to port for manufacturers. Grindrod continuously invests in assets across its business operations with specific focus on dry-bulk and bulk liquid commodities, containerised cargo and vehicles. This is further enhanced by the Grindrod network and facilities present throughout southern and sub-Saharan Africa.

- FREIGHT, SECURITY, SALES AND LEASING: Typical cargo types include FMCG (Fast Moving Consumer Goods), steel products, ferrochrome, vehicles, CKD (Complete Knock-Down) components, sugar, bulk cargo, any specialised cargo, even refrigerated cargo. Special services include container packing and unpacking. Security is important. Facilities are monitored 24/7 via a sophisticated CCTV network, with control rooms linked to emergency services and private armed response companies. The Sales and Leasing division specialises in buying, selling, and leasing second-hand, general purpose and refrigerated shipping containers, as well as converting second-hand containers into accommodation (site offices, spaza shops, etc.).

- RÖHLIG-GRINDROD: The Röhlig-Grindrod division offers its customers total operational and management control over their shipments through worldwide clearing and forwarding, import, export, and project cargo services, by sea, air or over land. Röhlig-Grindrod's integrated information system provides customers with complete shipment tracking, from order placement to final point of delivery.

- BARRIERS TO ENTRY: Barriers to entry into this business are high. Grindrod has a wide moat around it. Firstly, it is capital intensive. Secondly, it owns 25% of the Maputo Port Development Company, locking out competition. Thirdly, it has the backing of Remgro. Fourthly, Africa is unsafe due to high crime rates and terrorism. The safety of staff is a top priority. Grindrod has 109 years of experience of how to operate in Africa. Grindrod operates in 24 countries, mainly in sub-Saharan Africa and South East Asia, employing more than 4,700 people.

- SUMMARY: With a market capitalisation of R3.4 billion, Grindrod is now leaner and meaner - a shadow of its former self. The value unlock will wipe out all debt on the balance sheet. Profits and dividends will increase. The discount to NAV will narrow. We expect strong cash generation, followed by a rise in the share price within a year. Realistically, the share price could double – from R4.70 to around R10.00. The current PE is 8; the dividend yield is 2.9%. The Covid-19 pandemic had a negative on operations. The intention of management is to return surplus cash to shareholders, either via share buybacks or dividends. We are convinced Grindrod will be a profitable addition to our clients' portfolios.

Disclaimer