Stocks ´n Strategy

August 2010

Stocks covered in this issue:

Exxaro	**12312**	**ADD**
Petmin	**252**	**ADD**
Pan-Af	**72**	**BUY**
Group Five	**3640**	**ADD**
Pick n Pay	**4634**	**ADD**
Sycom	**2205**	**FULLY VALUED**
Brait	**2300**	**ADD**
Naspers	**31200**	**ADD**
MTN	**11600**	**ADD**
Anglo American	**29402**	**BUY**

Strategy

Global:

- *Changing facts = changing minds.*

SA:

- *Do we snatch defeat from the jaws of victory?*

Advice:

- *Short term optimism despite a tricky long term environment.*

Strategy

Global

When the facts change, one must change one's mind. The wisest minds on earth cannot agree on the direction of equity markets, and the smartest economists that possibly ever lived are divided on the debate between austerity and stimulus. Perhaps it is just as well that we have the US experimenting with stimulus and the UK & Germany experimenting with austerity, so that the "winning" half is there, in conjunction with robust Eastern economies (that if anything need to be reined in), to pick up the losers of the debate!! Be that as it may, Southern Europeans have to engage in austerity, as they don't have the means for stimulus. It is in keeping with the times that we have yet one more massive economic experiment underway!

Many things have changed in recent times. Basket cases have become examples of fiscal rectitude, while many saints have fallen from virtue. While for many years, equity market earnings yields have moved in line with bond yields, this relationship has also completely broken down in the last 10 years. It has become an environment in which anticipating change has become key to outperformance, and prudence and common sense are vital for risk management.

While the merits of the stress tests on European banks have debate value as to whether or not they were strict enough, the fact is that there's nothing like a light to drive away the dark. We now have a vast improvement in information that substantially reduces the fears of catastrophes surrounding the European banking system. What else has changed? In April 2009, at the G20 summit, global growth for 2010 was forecast to come in at 1.9%. As of June 2010, this figure is now 3.5%.

Of course any recovery that was to follow an event like the Great Recession could be expected to be sharp, especially with the fiscal stimulus applied in the US. It could also be anticipated that when that stimulus ran out, that there would be less pushing it better. That does not however mean that a double dip recession should be considered a fait accompli, far from it! The slowdown in growth that we are seeing now is frankly, hardly surprising. Perhaps it is best said by Kenneth Rogoff "worrisome as the current conjuncture may seem, the

normality of the crisis trajectory to date hardly suggests the need for a panicked fiscal response." The loss of focus brought on by this debate is best summarised by Niall Ferguson "the choice is not between stimulus and austerity; it is between policies that boost private sector confidence and those that kill it ".

The current prospects for equities markets are a balancing act between how the economic stalemate gets resolved and how investors and managers ultimately balance risk versus safety. Both positive and negative forces are vigorously pushing against each other.

Some positives are:

Per Bank Credit Analyst, historically a standard recession corresponds to a 30% drop in the S&P 500, so the recent and sizeable correction reduces stress on share prices. They expect S&P 500 earnings to be around $90, an undemanding PE of 12x. Corporate balance sheets hold record liquid assets, of something like $1.8 trillion, which provides scope for both massive share buybacks and capex. Indeed, given the returns on capex and the lack of capex in recent times, we believe that corporate capex may become an important part of the recovery. Central bank policy is geared towards fighting deflation, and so will remain supportive.

The negatives are:

Slowing growth at a time of weak pricing power and near deflation means that best phase of the profit recovery is probably finished, and expectations for earnings growth may need to be muted. Money and credit growth remain weak in the entire G7 world - so the banking system is clearly not functioning to the point that a money multiplier is emerging again. An example of this is that nine out of 10 new mortgages in the US are being underwritten by Fannie Mae and Freddie Mac. The private sector has simply disappeared. Whether or not it works, austerity will constrain some growth. Although the debt crisis in the eurozone has eased off somewhat, sovereign debt is now a front of mind issue.

The last negative is possibly the most important. Although valuations give equities room to run, markets may well be range bound for quite some time. With demographics in the OECD steadily worsening, household deleveraging can still be expected for quite some time.

SA

The World Cup is over, and it is now back to reality. That reality is a rise in unemployment of 650,000 and politicians with no sense of priority, other than to push hardest for job destroying policies. SA business succeeds despite government, not because of it. The OECD rightly highlighted the need for a stable and competitive currency and more flexible employment markets. In such an environment, local industrial shares (with the exception of the defensives) offer relatively little value, perhaps there is more in Minings and Financials.

We hope that the Reserve Bank will lower real interest rates and start accumulating reserves. The world is awash with deflation.

Investment Outcomes

We retain our view that overall in terms of valuation, equities are probably cheap compared with fixed income or cash. However, since equity markets are desirous of growth, and the risks to growth are many, this relative valuation gap should not be regarded as a one-way bet. Our investment advice is unchanged.
Invest in equity of good relative value high-quality companies with good balance sheets, management and businesses and stable cash flow, which above all are dividend payers. Investors should focus on wealth preservation in this volatile environment. Watch benchmarks such as stability of the US$, Treasuries, and corporate bond spreads. The Fed can pump liquidity into the banks while these indicators show no sign of impending inflation. For monetary policy, the challenge is between tightening too vs. too late. Another bout of asset inflation would potentially sow the seeds for another crisis in a few years time.

Stocks

Resources

EXXARO: - 12312c – *coal to recover shine in interims?*

dil PE(x)	17.5	Ev/Ebitda(x)	7.7
DY(%)	1.6%	Price/Book	3.4
09 FPE(x)	6.5	10 FPE(x)	6.0

EXXARO Final Results FY12/09	% growth	cps FY09	cps FY08
Revenue	9.3%	4192	3835
Derived Pro-rata EBITDA	-1456%	-23629	1743
Headline eps	-31%	728.6	1058.0

The upcoming interims (12/08/10) will probably beat management's expectation with improved demand for coal. Management has decided to some extent to bow to investors' irritation with non-coal assets with signs of action in the base metals area. Based on our valuation

of Kumba (NPV of 35270cps with iron ore long-range at $95/t discounted at 12.25%) Exxaro's holding is worth R30.1bn which puts the coal and other operations, even at FY 09's depressed results, on a 3.5x Ebitda. We accordingly maintain our **ADD** recommendation with a bias towards an upgrade following the interims.

PETMIN: - 252c – *most difficult year in its history*

dil PE(x)	12.0	Ev/Ebitda(x)	4.7
DY(%)	31.7%	Price/Book	1.3

PETMIN 1H of FY 06/10	% growth	cps Rolling	cps 1H10	cps 1H09
Revenue	-56.1%	87	36.6	83
Derived Prorate EBITDA	-52.4%	52.4	13.3	27.9
Headline eps	-28.8%	16.8	8.17	11.48

During 2H09 the anthracite market had been affected by the SA ferrochrome producers mothballing more than 90% of their capacity and the Brazilians cutting production of iron ore, pig iron and iron pellets by 70% almost overnight. The anthracite price accordingly fell below $50/t, but the effect was cushioned by Somkhele securing a four-year off take agreement for 1mtpa at $119/t. As regards 1H10, 1QFY10 suffered from continued ferrochrome plant mothballing, but by the end of the period local market demand was almost at pre-crisis levels and export demand recovered significantly. Somkhele's Ebitda increased by R12m aided by improved cost control. Silica revenue declined 28% to R73m due to a 39% reduction in sales volumes to the metallurgical industry (down 24%) as well as of chert to the metallurgical and construction industries (down 64%). Due to a better sales mix higher margins improved from 26% to 30% and operating profit was only 14% down.

The anthracite outlook for 2H10 has improved significantly with most production for calendar year 2010 taken up at better prices. The silica operation was expected to maintain profitability and increase capex to R17m (FY09: R7.5m) to improve safety and the balance to "secure sufficient production to meet future customer demand." We believe the company has reasonable prospects of fulfilling its strategy and accordingly recommend an **ADD**.

PAN-AF: - 72c – *production survives criminal mining*

Pan Africa Resources Finals Trading Update summary	Upper 2010	Lower 2010	Current Rolling	FY 2009	Fcast fy2010	Fcast fy2011
Growth Range (%)	26%	16%			-20%	9%
Growth 2H on 2H (%)	45%	28%				
Ordinary headlines (cps)	1.1	1.0	0.85	0.85		
Applicable PE (x)	5.9	6.4	84.7	84.7		
I-Net consensus (cps)	0	0		1.0781	0.8596	0.9386
Diluted PE (x)				66.8	83.8	76.7

Headline eps for FY06/10, denominated in GBP, are expected to be between 16% and 26% higher (FY09: 0.85pps). Headline earnings in ZAR terms are not expected to differ by more than 10% (FY09: 12.28cps). Management has said improved grades and higher volumes were the main drivers. Production for the financial year is expected to be 97,000oz despite lost production due to criminal mining. The company's cost profile is close to $600/oz making the operations very lucrative at the current gold price. We also expect an investment decision on Manica and an update on Phoenix Platinum on the 31st of August when the FY06/10 results are released. We maintain our view that the junior producers have not yet fully benefited from the resilient gold price in terms of share price appreciation. Continue to **BUY**: target price 99cps.

Construction

GROUP FIVE: - 3640c – *FY06/10 trading update*

Group Five FY06/10 Finals Trading Update summary	Upper 2010	Lower 2010	Current Rolling	FY 2009	Fcast fy2010	Fcast fy2011
Growth Range (%)	15%	5%			3%	-2%
Growth 2H on 2H (%)	6%	-10%				
Ordinary headlines (cps)	584.5	533.6	566.74	508.23		
Applicable PE (x)	6.2	6.8	6.4	7.2		
I-Net consensus (cps)	0	0		508	525.5	515
Diluted PE (x)				7.2	6.9	7.1

Group Five finals trading statement for the FY ended 06/10 released on the 7th of July notes that fully diluted headline eps (FDHEPS) will be affected by positive adjustments arising from annual pension fund valuations. It expects FDHEPS to be between 5 -15% higher or between 533.6 – 584.5cps (FY09: 508.23c) for a PE of between 5.9x and 6.4x. Had both adjustments not been required, FDHEPS would be between -5% and +5% or 483c - 533c (FY09: 508c) for a PE of between 6.4x and 7.1x. The trading update implies 2H on 2H growth of between -10% and 6%.

The update is just above the I-Net consensus forecast of 15 analysts for FY10, projecting a full year diluted heps of 525.5c implying a 3% growth. Fully diluted earnings per share were affected by impairments relating to the construction materials industry and are expected to be between 40% and 50% (243 to 292cps) lower. As we

noted in the interims, the growth in the Project Opportunity Pipeline (POP) from R73bn to R116bn is encouraging and supports the group's longer term outlook. The group is well placed as a pre-qualified contractor for the government's roll out of PPP building contracts. We expect a slight margin contraction due to the winding up of World Cup related projects. The timing of the resumption in government spending remains a key factor in the medium to long term prospects. Pending the release of results on 10/08/10 we maintain our **ADD** recommendation.

Industrials

PICK N PAY: - 4634c – *Sale of Franklins to Metcash Australia*

dil PE(x)	18.6	Ev/Ebitda(x)	9.1
DY(%)	3.8%	Price/Book	8.2
09 FPE(x)	15.0	10 FPE(x)	12.1

Pick n Pay Stores Finals after Franklins	% growth	cps after	cps FY10
Revenue	-10.4%	10214	11394
Derived Pro-rata EBITDA	-4.7%	474	497
Headline eps	5.9%	226.6	213.9

On 1st July, Pick n Pay agreed on the sale of its Australian subsidiary, Franklins, to Metcash Australia. This will enable Pick n Pay to concentrate its efforts on expanding in markets where it can leverage off its substantial South African base. Hooray! This is way overdue! The market has long had the view that Pick n Pay, will have lost a lot of first mover advantage. This is rot! Anyone following the roll-out of fast food brands in Africa will know that second movers have a simple and effective catch-up strategy "follow the leader". It really is that simple. The leader spends a fortune of time working out the best sites, and then building acceptance for branded retail. Additionally just because Pick n Pay lost the plot strategically, doesn't mean they lost sight of their product. Far from it! They are formidable competitors, and as of right now, we believe they should be re-rated back to the same buy-hold-sell price relatives as Spar and Shoprite. On this basis PIK now becomes our favoured food retailer - for the first time since Imara covered the stock in 2003. Investment in Distribution Centres in conjunction with the SAP implement will bring them up to speed with their competitors. Some commentary has been critical of PnP that it's a less polished business than Spar/Shoprite – but there's the point – there's lots PnP can do to juice earnings. We note in passing that the results for TM Supermarkets of Zimbabwe are still carried in the accounts at nil. Now while TM's last results were shockers, that still seems too conservative. So despite recent share price gains – **ADD**. Market neutral at 4900c.

Property

SYCOM: - 2205c – *initiating coverage*

SYCOM Property Fund		FY10	FY09
SYC	Growth	cps	cps
Net Rental Revenue	6%	182.8	173.2
Net Adjusted Earning	4%	150.4	144.4
Dividend	6%	159.3	149.9
Price/Cashflow		14.2	13.9
Price/Net Revenue		12.1	12.7
Premium/(Discount) to NAV		7%	7%
Dividend Yield		7%	7%
Cashflow	-2%	155.7	158.6

Management is of the opinion that the portfolio has good defensive qualities. Office sector remains challenging, and the group will face a high level of lease expires this financial year. Management has however noticed a material increase recently in the number and quality of enquiries for office space. Results for FY2011 will be linked to the demand for office space, and a possible early re-capitalisation of its investment in Stenham. We expect the share price to retract in the short-to-medium term. The portfolio has shown resilience in the past financial year but the share price has outperformed our benchmark valuation so it is **FULLY VALUED** (i.e. Reduce).

Financials

BRAIT: - 2300c – *on its own cycle*

Brait FY 03/10	% growth	cps FY10	cps FY09
Operating income	12.6%	251.93	223.66
Diluted headline eps	11%	185.6	166.6
Headline eps	11%	175	157

The company has proved to be robust in the difficult operating conditions of recent times, and it has managed to arrest any further decline in earnings from the previous financial year. The decision by the Group to terminate its policy of hedging its South African operations into US$ is a welcome move that was suggested in a previous note. The current PE is significantly higher compared to Brait's historic level which is a strong indicator that the market is braced for

some improvement in earnings levels. There are also strong indications that this is also an internally held view as recent director dealings have seen the purchase of over 500,000 shares, along with comments in the financial results around the fact that the group's profitability is very dependent on the performance of its 2 equity funds and that it had communicated to the market over the last few years "to expect low profitability for F2009 and F2010 due to the fund-to-fund cycle gap". With this in mind and the very attractive dividend yield offered by the share, we adjust our call to an **ADD**.

TMT

NASPERS: - 31200c – *still confident in Tencent growth*

dil PE(x)	22.7	Ev/Ebitda(x)	18.1
DY(%)	0.7%	Price/Book	3.5
09 FPE(x)	14.2	10 FPE(x)	11.7

Naspers Final Results FY03/10	% growth	cps FY10	cps FY09
Revenue	2.2%	7295	7134
Derived Pro-rata EBITDA	15%	1759	1532
Headline eps	7%	884.0	826.0

The decline in Tencent's share price was probably more to do with the fact that markets are still jittery, and the fact that the high growth of Tencent creates some added nervousness that it could be too good to be true and unsustainable as has happened with tech stocks in the past. However management remains confident in the business and its ability to continue growing, and the recent announcements do not appear as though they will have much of an impact. Naspers' investment in additional internet companies in emerging markets means that it now has a strong emerging markets media portfolio, and should a few of these other ventures generate some success the company will be in a very strong position. The Tencent joint venture in India is just one of these that has the potential to do very well. Naspers still presents the most attractive prospect in the media sector as well as for investors looking for a high growth stock, and we maintain our **ADD** call, particularly at the lower price levels following the decline in the Tencent share price.

MTN: - 11600c – *BEE dividend payout its Ayoba!*

dil PE(x)	13.2	Ev/Ebitda(x)	5.9
DY(%)	1.7%	Price/Book	3.0
10 FPE(x)	10.4	11 FPE(x)	9.3

MTN Group Final Results FY12/09	% growth	cps FY09	cps FY08
Revenue	10.6%	5971	5397
Derived Pro-rata EBITDA	3%	2097	2031
Headline eps	-4%	803.2	836.5

In its 15th AGM business update released on 15/07/10 MTN advised that the majority of its markets have continued to show strong subscriber growth. Group subscribers rose by nearly 10% for the 5 months to the end of May 2010 and this growth translated to "sound revenue growth and profitability in the various local currencies". It said it plans to focus more on cutting costs by standardizing systems, processes and technologies. Capex will slow and management will look for ways "to meaningfully improve cash returns to shareholders". The reduced capex makes for a very promising free cash flow outlook. Future growth will be organic and likely to be smaller on acquisitions. This is because management recognises that the sector is maturing with a limited number of acquisition opportunities left within emerging market telecoms. MTN will therefore focus on investor payouts rather than big acquisitions, which is a change from its expansionary strategy. FY09 dividend was 181cps and earnings per share of 791.4c translating to a payout ratio of 23%. Management envisages the declaration of a top up dividend for 1HFY10 as part of a sustainable strategy towards improving the dividend payout ratio. We think this more forthcoming dividend policy will please investors. We are pleased that management has recognised the maturing realities of emerging market telecoms as well as the fact that it is now payout time for shareholders. Accordingly we maintain our **ADD** recommendation.

Snippets

ANGLO AMERICAN: - 29402c – *call update*

dil PE(x)	18.6	Ev/Ebitda(x)	26.1
DY(%)	0.0%	Price/Book	1.7
09 FPE(x)	0.8	10 FPE(x)	0.8

Given price action since our Add recommendation (16 April 2010) and results to date (diamonds and platinum) confirming improved outlook we upgrade our recommendation to **BUY**.

Core Equity Portfolio

Sector	New ALSI	Our Weighting	Holding
OIL & GAS	**4.6%**	**5.1%**	Sasol
BASIC MATERIALS	**38.8%**	**41.7%**	
Chemicals	**0.4%**	**4.6%**	Delta
Forestry & Paper	**1.1%**	**0.0%**	
Industrial Metal	**1.5%**	**2.2%**	Kumba
Diamonds & General Mining	**25.2%**	**27.8%**	7.6 Anglo 7.6 Assore 7.8 Billiton 3.0 Exxaro 1.6 Sentula
Gold Mining	**4.9%**	**5.5%**	2.4 Goldfields 1.6 Simmers 1.6 Gold One
Platinum	**5.5%**	**1.6%**	Northam
INDUSTRIALS	**6.2%**	**13.9%**	
Construction & Materials	**1.6%**	**7.5%**	3.7 Group Five 2.4 Basil Read 1.5 Esor
Gen Industry, Pack, Engineering	**1.9%**	**6.3%**	2.5 Remgro 1.6 Bowcalf 2.1 Hudaco
Electronic & Electrical Equipment	**0.4%**	**0.0%**	
Transportation	**0.9%**	**0.0%**	
Support Services	**1.3%**	**0.0%**	
CONSUMER GOODS	**13.0%**	**5.6%**	
Automobile & Parts Manufacture	**0.0%**	**0.0%**	
Beverages	**6.7%**	**0.0%**	
Food	**1.7%**	**5.6%**	AVI
Personal & Household goods	**4.6%**	**0.0%**	
HEALTHCARE	**1.6%**	**6.3%**	4.1 Adcock Ingram 2.1 Netcare
CONSUMER SERVICES	**8.5%**	**6.9%**	
General Retailers	**4.7%**	**5.0%**	Pick n Pay Hold
Media	**3.4%**	**0.0%**	
Travel & Entertainment	**0.5%**	**1.9%**	Sun International
TELECOMMUNICATIONS	**6.4%**	**0.0%**	
FINANCIALS	**20.2%**	**14.7%**	
Banks	**9.6%**	**3.6%**	Stanbank
Non-Life Insurance	**0.6%**	**0.0%**	
Life Assurance	**4.0%**	**1.8%**	Discovery
Real Estate	**3.0%**	**0.0%**	
Gen Financial & Inv instruments	**3.0%**	**9.3%**	4.1 British American 2.7 JSE 2.4 Pallinghurst
TECHNOLOGY	**0.7%**	**5.9%**	1.7 Simeka 4.2 EOH
TOTAL	**100**	**100.0%**	

Movements: During July the Core Equity Portfolio rose 2.5% while the All Share rose 4.1% (both calculations exclude dividends). ABSA, Clicks and Spar were sold and the proceeds used to buy Pick n Pay Hold and JSE. Since inception in October 2003, the Core Equity Portfolio has appreciated by 282%, while the All Share has appreciated by 213%.

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