

Strategic insights and company analysis

28 August 2009

Afrox

Afrox, the gases and welding products group, released earnings for the six months ended June 2009. The result was as anticipated in my recent note. Operating profit of R282m (forecast R270m) is some 37% lower than the R450m of H1 F2008 and earnings came in at R119m (forecast R125m), down 57%, and EPS was also 57% down at 39cps (40cps). So-called headline adjustments were restructuring costs of R23m gross or R17m net. Strictly a cost of doing business the adjusted earnings figure is nevertheless R136m or EPS of 44cps. A dividend of 19 cents is declared, exactly as predicted.

Revenue for the period is down 11% to R2,37bn, with revenue in South Africa down 14% to R2bn. As expected, profits in Africa ops were robust – EBITDA up 34% to R115m whereas South Africa was down 35% to R318m. The spate of capex has resulted in depreciation increasing 23% to R151m. Net finance costs too were up as forecast, to R91m.

As I indicated previously, there is no material deviation from the performance in H2 of F2008 which is a relief given the magnitude of the deterioration then as the real economy nosedived. Cash generated ballooned to R607m from R275m and almost as much cash was generated after working capital for the six months as for all of F2008 (R665m). Debt as a percentage of capital employed reduced to 27% and EBITDA interest cover on net interest paid was a still comfy 4.5x. Cost savings and other efficiencies are being accelerated with an objective of R200m in permanent cost savings.

This is not a bad result in the circumstances and represents the bottom of the downcycle. For now I maintain my estimate of R325m in earnings or EPS of 105 cps for the year ended December, 21% lower than F2008 and 30% below F2007. A dividend of 50 cents is feasible. My estimate for F2010 is EPS of 135cps, up 29%, with DPS at 67 cents. Fair value maintained at R25, 25% above the prevailing price.

Massmart

Per my note last month ahead of Massmart's annual result trading conditions have steadily weakened. This was a 52 week year versus a 53 week year in F2008 so adjustments have to be made but the bottom line is that diluted headline EPS (after adjusting for a net unrealised foreign currency translation loss of R56m after tax or 28cps) came in at 620cps, up 3,7% on the adjusted 597c of F2008, equal to earnings of R1,265bn. My estimate was for EPS of 616cps or R1,257bn. Although the total annual dividend is maintained at 386c (forecast 370c) the final is down 18% to 134c. I called a **SELL** on Massmart recently as I expect earnings to decline in F2010 and for now the rating is rich enough. As I mentioned in my last note, this is a superbly managed business with a superb business model and the business will emerge from this recession stronger than it went into it and will be a preferred place to be once the darkness lifts. Even growth momentum in Shoprite is slowing – earnings growth of 31% for the year ended June translates to 43% growth at the interim stage and 22% for the second half. This may be good in the context of more mature retailers or retailers with different mix and customer orientation but it nonetheless is indicative of stress in the consumer economy. Uncharacteristically, this normally bullish company “expects trading conditions to be challenging in the new financial year”.

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Construction

Both Basil Read and Murray & Roberts reported results this week. Half year EPS was up 37% for Basil Read and we are on track to meet my expectation of 37% for the full year too. Murray & Roberts was to the high end of its own expectations, up 24% to 660cps versus my estimate of 633cps. Of concern though was the dramatic increase in working capital absorption – a R1,7bn swing. Unlike last year and in 2007 there is no forecast provided on 2010 – a telling sign.

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