YeboYethu set to give Phuthuma Nathi a run for its track record

By Craig Gradidge, as published in the Business Day on 9 June 2020

Talk to any Black investor who has been investing for at least 10 years and you will either hear regret or joy around Phuthuma Nathi (PN). Regret for not having invested, or having invested too little, or joy at having invested in and holding onto PN for several years. For those who do not know about PN; it was offered to qualifying Black South Africans in 2006. Investors put in R10 equity and there was R40 debt funding. The underlying investment was MultiChoice South Africa. For many investors could not trade PN, although they received dividends annually. Had you invested R10,000 in PN in 2006 and held them until now you'd have earned over R92,000 in dividends and the value of the shares at the time of writing this article is R102,000. It has been a phenomenal success, and only Thembeka Capital has come close to it in terms of return.

Vodacom Ltd (VOD) recently announced its results and surprised the market with a dividend increase and payment. This made me revisit the investment thesis behind its public BBBEE share offer, YeboYethu (YY). YY was initially offered to qualifying Black South Africans in 2008 at R25 a share, as a 10-year deal. The underlying investment was Vodacom South Africa, an unlisted subsidiary of VOD. The original deal delivered solid results with a R73 special dividend in 2018 in addition to the dividends it delivered over the 10 years. These were market beating returns but were somewhat overshadowed by PN in investors' minds.

The current deal has YY investing directly into VOD. Similar to PN, YY started with around 25% equity and 75% debt. The cost of YY debt is around 69% of prime with Vodacom providing over half the debt funding. YY owns just over 114m VOD shares and earns income solely from VOD dividends. These shares are worth R14,4bn with VOD trading at R126 a share. The value of YY's outstanding debt is R9,72bn and it also has a deferred tax liability of around R1,2bn.

A COVID induced boost to YY

Prior to COVID being declared a global pandemic YY was an interesting long-term option for patient investors. It is invested in a cash generative business which was largely ex-growth, but it was funded with cheap debt which was largely manageable. On 15 March 2020 President Ramaphosa announced that schools would close from the 18th and that groups of more than 100 people were no longer allowed. Businesses, including my own, spent the next week scrambling to get staff work-from-home (WFH) ready. Suddenly we needed to order additional laptops, modems and data. A week later the lockdown was announced and WFH became a reality. Markets around the world crashed spectacularly as did the price of oil as demand dried up. The SA Reserve Bank cut interest rates by a full percent and followed that up with another one percent cut in April. Interest rates are down 2,25% year to date.

In-between all this VOD announced results and went against the trend by not only announcing a dividend, it also increased its dividend by 6,3%. It followed trend in not providing any forward-looking guidance to the market though.

The result of this is that YY should save over R200m in interest expense and earn about R50m more in dividend income. The governor indicated that SA should see further rate cuts this year, and the expectation is that many people will have to continue working from home for much longer than expected. VOD is likely to be affected by the economic impact of COVID as people lose their jobs and companies close doors. VOD will also have to deal with the regulator's demand that data costs be slashed. However, VOD's international portfolio continues to show strong growth and contribute to profit growth.

YY looks attractive from a net asset value (assets less liabilities) perspective with the NAV above R65 a share. However, investors would need to factor in a discount to compensate for the higher risk profile, high debt, single company exposure and restricted trading between qualifying Black investors. I would argue that a 30% to 40% discount should apply. At a 35% discount YY would be worth around R43 a share. It currently trades at R25 a share.

Over the past financial year only 1,157,117 YY shares traded. This is 2,2% of the number of YY shares in issue. So, liquidity remains a challenge which is unsurprising given that 68% of the shares are owned by 19 shareholders. These shareholders include strategic partners Royal Bafokeng Holdings, Thebe Investment Corp, and the Vodacom Siyanda Employee Trust. Approximately 73,360 shareholders own between 1 – 100 shares, which I expect is a legacy of the initial YY deal. However, given that YY now trades on the JSE BEE Board, investors can increase their exposure to YY.

YY currently trades on an historic dividend yield of 7,6% which is significantly higher than where PN traded two years into its existence. Given the lower cost of debt and the increased income from dividends, YY looks like it has the potential to give PN a run for its track record. Hopefully more investors wake up to the opportunity before it is too late, again.

Gradidge is co-founder of Gradidge-Mahura Investments and holds the Certified Financial Planner® designation. He is invested indirectly in YeboYethu.