Company Research Report
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CEDAR CAPITAL

Equity research | Company Update

The phoenix is rising!

Diversified Holdings

LONG TERM BUY

Bloomberg Ticker	PCL.MV
Reuters Ticker	PCL.MV
Target Price	MWK2 050
Market Data	**4-Feb-20**
Closing Price	MWK1 400
52 Week High	MWK1 400
52 Week Low	MWK1 140
Market Cap (bn)	MWK168
Market Cap (mn)	USD229
P/E	22.5x
P/B	1.08x
DPS Yield	1.86%

MALAWI

PCL surprises…

One of the most interesting and rather surprising things that happened in 2019, was the rally in the share price of Press Corporation Plc (PCL). After years of underperforming on the MSE, the phoenix finally arose from its slumber with the price gaining 90% in 2018 and 22.8% in 2019. As such, 2018 and 2019 saw PCL starting to exert the kind of influence on the market that corresponds to its stature. The company is no longer just a defensive stock but is now also moving up with the rest of the market.

New strategy….

Dr. George Partridge, formerly CEO of National Bank of Malawi, assumed the reigns as Group CEO of PCL in November 2016 and immediately stated his team's major goals as;

(i) turning around the loss making and under performing companies such as Malawi Telecommunications Limited (MTL); People's Trading Centres (PTC); The Foods Company Ltd (TFCL); Press Properties Ltd (PPL) and Open Connect Ltd (OCL);
(ii) strengthening the well performing operations;
(iii) localisation of foreign debt in OCL;
(iv) recapitalisation of undercapitalised units;
(v) establishing technical partnerships in some units and
(vi) Streamlining of operations in all Group companies to improve efficiency and reduce costs, and where necessary, make changes in management.

We will try to evaluate management on these goals, based on the FY18 annual results and the HY 2019 numbers in another section.

However, before we do that, we would like to highlight some of the strategic initiatives that PCL has undertaken in the past three years;

a) Reduction of stake in Carlsberg – now Castel - Malawi

Following the complete disinvestment from Carlsberg Malawi by the Danish brewer; Carlsberg Group, which sold its interest to the Castel Group of France, PCL reduced its interest in the now renamed Castel Malawi to 20% by selling 19% to the Castel Group, who had expressed interest in increasing their shareholding in the brewery. The new major shareholders immediately embarked on an extensive brand rationalization and capital expenditure program which is expected to improve Castel Malawi's efficiencies and output. The initial target was to increase output from 350 000 hectoliters to 1 million hectoliters per annum.

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Why sell and not be progressively diluted? The Castel Group has its own internal shareholding thresholds, below which it would not invest more capital and as such it made sense for PCL to reduce its stake first. At the same time, PCL would not have been able to match dollar for dollar the investment into capex required without raising funds from shareholders, through, possibly a rights issue. This would not have been optimal given that PCL was and is still trading below NAV. In any case, sometimes it makes sense to own 20% of an elephant than 50% of a rat. More positively, the sale unlocked some much-needed cash onto the balance sheet.

b) Farming out of the fibre business

The fibre optic network business was farmed out of the fixed telephony business through the formation of a company called; *Open Connect Limited (OCL)*, which is now the "carrier-of-carriers" for other telecommunication companies. The shareholding of OCL was subsequently restructured with private equity group; Harith General Partners acquiring 60% by injecting USD24.1 million into the business. The new capital was used to clean up the balance sheet and make the company financially viable, with USD5 million said to be earmarked for rehabilitating the current infrastructure base.

Harith General Partners is now the majority shareholder with 60%, followed by PCL which retained 22%; Old Mutual Malawi has 15%; Malawi Government remained with 2.1%; while NICO Holdings and Investments Alliance have 0.92% and 0.23% respectively.

c) What about the serial underperformer?

The supermarket retail business; **Peoples Trading Centre (PTC)** has over the years been the problem child of the group and a serial loss maker. In FY16, the chain was recapitalized, enabling it to sign a franchise agreement with Fruit and Veg City Africa International of South Africa, which facilitated the opening of a Food Lovers Market in Lilongwe. In addition, 4 outlets were converted into Spar Franchises, with a progressive target for 15 Spar outlets. This followed the acquisition of the Spar franchise in 2015. A new management team, led by James Madondo, a retail veteran formerly with Zimbabwe's leading supermarket chain; OK Zimbabwe was also installed. The trading model was reconfigured resulting in the closure of 22 outlets that had failed to make the bar. In FY18, MWK5.6 billion was invested in the unit as working capital, with a portion used for refurbishments and the computerization of the stores.

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d) Going into hospitality…

On 17 May 2018, PCL acquired 10% of Sunbird Tourism Ltd thus, becoming the second biggest shareholder and heralded PCL's entry into the hospitality sector. A further 5% of the hotel group was acquired later, bringing total interest in the group to 15%.

e) Purchase of head office building

In FY18, PCL, through its 100% owned subsidiary, Press Properties, acquired 51% of IndeTrust Holdings; the SPV that owns the Top Mandala Office Building from NBM for MWK1.9 billion. The building now houses the PCL's head office.

Financial matters

It is to be expected that with all the corporate transactions that have been undertaken by PCL, the income statement will particularly be affected in a way that makes analysis of the financials less straight forward. We would like to highlight some of the income statement line items which distort prior year comparisons;

- In FY17, PCL booked a once-off gain/profit of MWK14.28 billion arising from the disposal of 19% of Castel Malawi.
- According to the HY19 financial statements, in FY18 there was a MWK11.8 billon non-recurring gain/profit as a result of the restructuring initiatives of the telecommunications segment with OCL producing MWK8.5 billion and MTL producing MWK2.7 billion.
- There were also once-off costs relating to functional reviews and the decommissioning of the 22 PTC outlets that were closed.

As a result of the FY18 non-recurring gains, the HY19 financials reflected a 40% decrease in earnings, without which the decrease would have been 7%. For the FY19, PCL in a trading statement published in December 2019 advised shareholders that earnings would be lower by as much as 35% as a result of these FY18 non-recurring gains.

It should also be noted that the reported earnings of PCL are made up as follows;

- consolidated results of operating subsdiaries; NBM (51%); TNM (41%); MTL (53%); PTC (100%), TFCL (100%), Presscane (50%), Ethanol Company (66%) and Press Properties (100%) and;
- equity accounted earnings of associates; OCL, Puma Energy; Limbe Leaf Tobacco; Castel Malawi and MacSteel.

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The 15% stake in Sunbird Tourism Ltd is held for long term capital appreciation and is accounted for at fair value through other comprehensive income.

Because of this structure, especially the level of the shareholding in the major contributors to earnings such as NBM and TNM, the level of profits attributable to minorities is high. At FY18, the appropriation for minority interests was 50% of the profits after tax and at HY19, minorities took 75% of the profits.

Valuation implications

The disposals of Castel Malawi and Open Connect Ltd give pointers to the actual values of the businesses which were otherwise hidden as the balance sheet reflect historical cost values;

a) Castel Malawi Transaction

Based on the Castel Malawi transaction, we get an implied full value for the brewer of at least MWK87.6 billion. This means that PCL's 20% stake is valued at MWK17.5 billion. This value does not take into account the capital that has been invested in the business since then.

Castel Malawi Transaction		
Percentage stake sold	19,65%	
Cash Received for the sale of the stake		17 216 000 000,00
Implied Valuation		87 613 231 552,16
Value of the remaining 20% stake		**17 522 646 310,43**

b) Open Connect Ltd Transaction

The OCL transaction, in which Harith General Partners invested USD24.1 million for a 60% stake, gives an implied value for the company of USD40 million. This means that PCL's interest of 22% is valued at USD8.84 million or MWK6.5 billion.

	USD millions
Amount invested for a 60% stake	24,10
Implied Valuation for OCL	**40,17**
Value of the PCL's 22% interest	**8,84**
Exchange Rate (USD: MWK)	736,00
Value of the remaining stake	**6 503 786 666,67**

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Management scorecard

Below we look at the strategic intent statements that management made and the milestones that have been achieved since then.

a) Turnarounds

- **MTL** – according to the PCL's FY18 annual report, the unit undertook a disposal of a number of non-core assets and it is said to have recorded a profit in that year. At HY19, MTL, discounting the previous year's once-offs recorded a marginal profit.
- **OCL** – OCL is obviously work in progress, especially after the capital injection and expunging of all of the borrowings. The unit is said to have produced excellent results at HY19. The shareholder restructuring undertaken by the management in this unit was a bold move.
- **PTC** – success seems to elude the unit despite the recent re-capitalisation and management efforts. At HY19, it was reported that the unit was still loss making and having experienced a 44% deterioration in the loss position. Revenues declined 15%, at a time when borrowings are said to have spiked. PTC is said to need further capital injection and management is evaluating various options. In this business, management could be throwing good money after bad.
- **TFCL** – the foods or fisheries unit, although still loss making had managed to reduce the quantum of losses by 23% at HY19. At production level, tonnage is said to have increased five-fold to 720 tonnes per annum.
- **Press Properties** – the division recorded a profit at HY19 following a capital injection and restructuring.

Although it's still early days, the yields from the management initiatives have been mixed. While the turnaround of the telecom units appears to be on track, a reversal of fortunes in PTC seems elusive.

b) Strengthening of stronger performers

This is difficult to evaluate given that it is a general statement of intent and as such there is not much to say. We, however, highlight the improvement in the ethanol businesses – Ethanol Company and Presscane - which recorded 108% and 11% growth in earnings respectively at HY19. Management now need to consolidate on the improvement to ensure that it is not a one-year wonder.

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c) *Localisation of foreign debt in OCL*

It has been confirmed by management that all of the foreign debt that was sitting in OCL was paid off from proceeds of the USD24 million capital injection and the company is now debt free.

Although the PCL group balance sheet still shows foreign currency exposure of approximately USD27.7 million (MKW20.2 billion), this is sitting at the bank; NBM and is fully hedged.

d) *Strategic partnerships*

Management had previously indicated that there were seeking strategic partners in the fisheries (foods division), the fixed telephone (MTL) and the PTC businesses. Negotiations with equity partners for these units are in progress.

Valuation and Recommendation

We note that PCL is undergoing a massive restructuring, of which results could be mixed. In situations such as these, a lot of money will be spent, but management will win some and lose some. The problem could be that one never knows unless they try. The new management team may deserve the benefit of the doubt in the case of PTC.

As the restructuring exercise is going on, there will be a lot of “noise” surrounding the income statement. We would recommend that long term shareholders pay less attention to the “noise” in the short term and use any price weaknesses as buying opportunities.

We have simplified our indicative valuation by restricting our Sum of the Parts methodology to the listed investments and the implied strike price valuations from the disposals of the stakes in Castel Malawi and OCL transactions shown earlier. From this we conclude that PCL should be trading at **least at MK246.5 billion or MK2 050 per share. LONG TERM BUY.**

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Selected Investments & Subsidiaries				
Company	**Shares in issue**	**Price**	**PCL**	**Valuation of Press Corp Interest**
NBM	466 931 738	525,00	51,49%	126 222 154 745,51
TNM	10 040 450 000	22,10	41,31%	91 664 388 679,50
Sunbird	261 582 580	118,00	15,00%	4 630 011 666,00
TOTAL				**222 516 555 091,01**
Castel Malawi			20,00%	17 522 646 310,43
Open Connect Ltd			22,00%	6 503 786 666,67
Listed Entities plus Castel Malawi & OCL				**246 542 988 068,11**
Press Corporation	*120 255 820*	*1400,00*		*168 358 148 000,00*
Discount to selected entities				**32%**
Minimum Price/share				**2 050,15**
Reported NAV @ 30 June 2019				
Press Corporation				155 389 000 000,00
Premium to NAV				**8%**

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