Worried about the health of SA companies? Let's look at the data - Fin24 29 August 2019

I have always found the human brain to be a fascinating thing. In school, we had a pupil that was extremely gullible. He'd come to school 100% healthy, but from time to time, his friends would play a prank on him by telling him that he didn't look healthy at all.

Lo and behold, before the day was done, he would be sick in bed at home, "recovering" from his illness. The prank was so convincing, that he actually started to feel sick.

I have attended several presentations by some of the most prominent fund managers in the industry in the last four months and one topic that dominated most of these presentations, was local companies, or the so-called 'SA Inc.' theme.

The golden thread tying these highly paid and highly qualified expert opinions together, was that South African companies in general are starting to reflect cheaply. Then there is another group of individuals who, much like the friends of the gullible pupil I went to school with 30 years ago, reject these well-researched opinions and, more importantly, tries to convince others that local shares will eventually become worthless and that now is the perfect time to sell it all.

Based on the abovementioned conflicting opinions, I decided to compare a number of local sectors to their international peers this week. I specifically compared a number of local companies' financial ratios with companies listed on the MSCI All Country World Index (ACWI). The assumption can be made that South African companies can be compared to some of the world's largest companies, and the results were quite interesting.

Local banks are not that cheap

While local banks make for excellent quality shares and boast a much higher return on equity (ROE), higher growth comes at a price. Even with the exclusion of Capitec – which trades at a higher historical price-to-earnings ratio (P/E) – local banks' average price-to-book ratio (P/B) is currently trading almost 50% higher than their international peers' P/B.

When we compare P/E forecasts, local banks are currently still enjoying a premium rating of 25% compared to their international peers.

In short, local banks are high-quality banks, but it may not tickle the fancy of all value seekers. Relatively speaking, Standard Bank still seems like the best option compared to other local banks.

More of the same with local insurers

No different to local banks, there isn't much relative value hiding within local insurers and with the dark NHI cloud hanging over most of them, it's definitely an area that investors shouldn't jump into without patience, and before doing some thorough homework. When looking at all local insurers, Momentum Metropolitan Holdings does seem to be the cheapest option at this stage.

Local healthcare may be moved out of ICU soon

There are good reasons why local healthcare companies have been under pressure in the past few years, but relative value is now starting to emerge in this sector. Relatively speaking, our P/Es are fairly low compared to ACWI healthcare companies' P/Es and aside from the fact that their ROEs are somewhat lower than their international peers' ROEs, one has to wonder if roughly a third of the valuation can be justified. Value seekers can definitely start to consider Mediclinic and Netcare shares in this sector.

Local general and food retailers are starting to enter bargain territory

Following a week of downgrades (Pick n Pay) and poor results (Shoprite), I know it's going to be difficult to convince people that bargains are starting to emerge in our local retail sector, and make no mistake, this still makes for a very challenging environment and doesn't come without risks.

But relative valuations compared to ACWI companies are starting to bring forth the question: How much cheaper can these companies become? Woolworths' debt levels may be on the relatively higher side, but they appear relatively cheap, while Truworths is starting to look better by the day.

Local telecommunications companies are getting louder

The global communications sector, in its totality, has been crowned the fourth-best performing sector in the world this year, but local telecommunications have yet to join the international party.

A lack of growth is the main culprit, yet again, but with a P/E of 13 relative to ACWI's average of 19.5 for this sector, people are starting to wonder why. Vodacom's ROE, for example, is the same as the ACWI sector average, but its expected P/E, P/B and debt levels are trading at roughly half the levels of the international sector average.

Don't just listen to people who are trying to tell you that SA companies are not looking healthy at all. Clearly, when we examine the relative data at our disposal, what they are saying is simply not true.

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