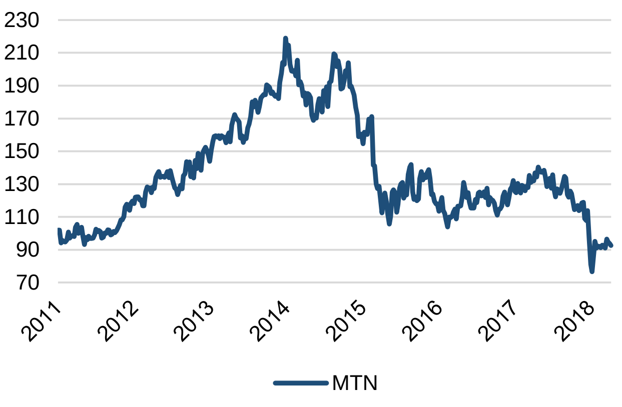
INVESTMENT FOCUS:
The Danger of Focussing on Share Price

When considering a company for investment, too many investors focus on what share price has done through time. If a stock sees large price declines, many investors would then conclude that it's now cheap. However, it's more useful to understand what drives share price movements, rather than looking at them in isolation. This quarter, we look at MTN – a stock that has fallen nearly 40% over the year – to better understand what drove its derating and whether it was justified.

Over the year, MTN has had several issues that have contributed to a re-rating. These include earnings downgrades of -14% from the beginning of the year, slow growth locally, and concerns over both 1.) Nigerian allegations of $2 billion in back-taxes owed and 2.) a fine of roughly R800 million levied by the Nigerian Central Bank – who allege that MTN repatriated funds to South Africa illegally. The Nigerian allegations came out in August 2018, coinciding with the sharp price declines since. For the year, MTN's share price has lost 36% of its value.

Figure 1: MTN's Share Price



Source: Bloomberg

What's in the Price?

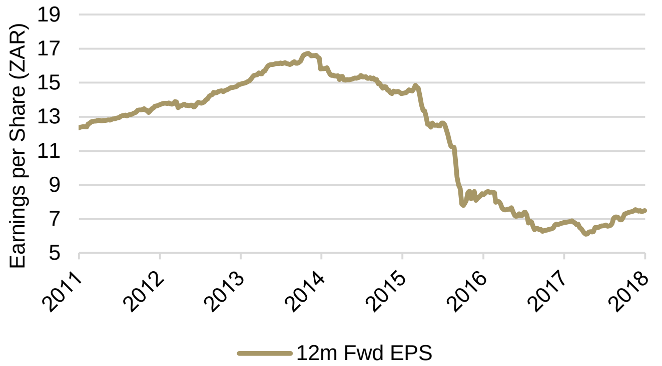
We can decompose price into PE and Earnings to better understand what actually drives the price.

$$Share\ Price = \frac{Price}{Earnings}\ x\ Earnings\ (EPS)$$

Figure 2 highlights MTN's earnings, which have been the predominant driver of price for MTN. Earnings peaked in 2014 and have steadily declined since. In this way, you understand that if earnings halve, one should expect price to halve as well.

In MTN's case, 12-month forward earnings declined by 55% from its peak in 2014. In turn, price has fallen by 57% over the same period, suggesting that this decline was justified. Over the full period, falling earnings have destroyed 40% of MTN's value.

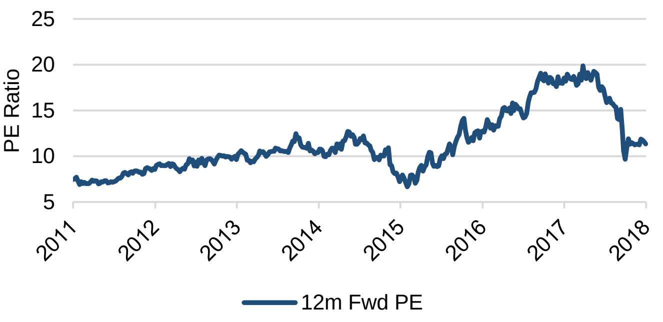
Figure 2: MTN's Earnings



Source: Bloomberg

As in figure 3, MTN is trading at the same multiple as it was for much of 2013 to 2014. The sharp re-rating of its multiple from 2015 into 2018 was unexplained (which is also why we didn't own it over this period), peaking in March and then de-rating to 11.3x by year-end. From 2011, re-rating has contributed 52% to price movements, but since October 2014, this has only been 3% attributable to rating.

Figure 3: MTN's PE



Source: Bloomberg

Earnings Drive Returns

Over the long run, the bulk of returns tend to come from earnings growth. While it's easy to look at a company like MTN, after a nearly 40% decline in price, and call it cheap – investors will be much better served figuring out whether share prices are supported by compounding earnings, rather than focussing on share price in isolation.