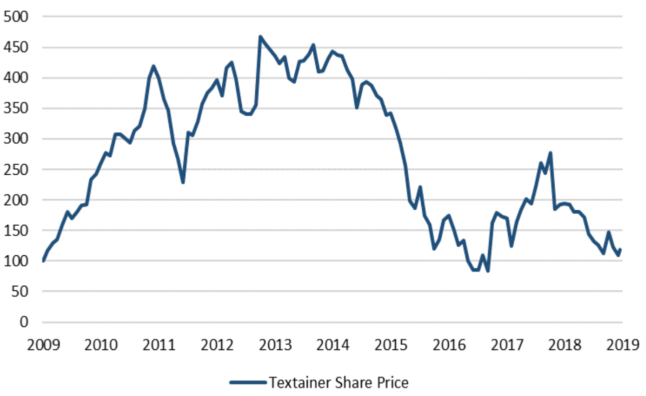
BLUE ALPHA
INVESTMENT MANAGEMENT

# INVESTMENT FOCUS:
## The Danger of Focussing on Share Price (Part 2)

Often, the first thing an investor will look at when considering the “value” of a company is the share price through time. Below are two graphs of a company’s “value” through time. But which one is the correct one to look at? This quarter, we look first at Textainer – a US based company of which SA’s Trencor owns 48%, and then PPC.

Figure 1 shows the stock price of Textainer - this is the graph that everyone gets excited about. You will often hear market commentators say that the share price and the company’s value have fallen by a certain percentage over a certain period. You can see from the graph that Textainer’s “value” has gone from just above 400 in 2014 to 100 in 2019 - supposedly a destruction of value of 75%. Although the stock price movements get all the headlines, it is the wrong metric to look at. Just like PE is a sloppy short-cut to valuation, so is stock price as a representation of performance or a signal of value.

*Figure 1: Textainer Share Price Through Time (indexed to 100)*

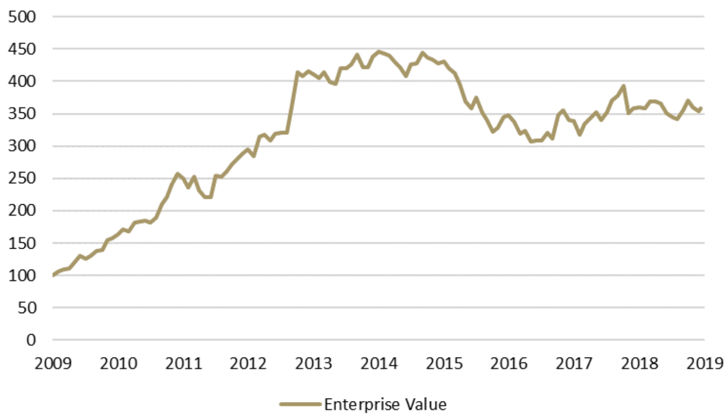



*Source: Bloomberg*

Figure 2 shows the Enterprise Value (EV) of Textainer. EV is stock price times fully diluted number of shares in issue, plus all forms of debt, plus minorities.

Another way to think about EV is to ask yourself - if you engineered a corporate buyout of a company, and settled all stock and debt obligations, how much would you pay? As you can see from figure 2, it makes for a very different picture to the share price, even though it’s the same company.

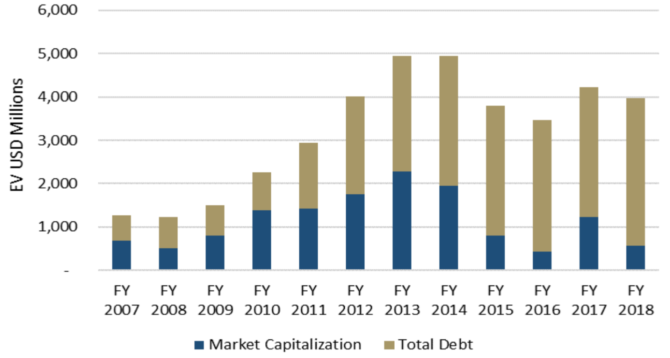
*Figure 2: Textainer’s Enterprise Value (indexed to 100)*




*Source: Bloomberg*

Figure 3 below shows the decomposition of Textainer’s EV into market cap and debt. As a word of caution, we prefer to use gross debt and not net off the cash balance. Cash is typically needed to run the company and cannot practically be extracted. Another form of debt which should be included is off-balance-sheet debt in a subsidiary, where the company effectively has control. In general, it is very difficult for companies to walk away from off-balance-sheet debt or so called “non-recourse” debt. A rare example where this did happen was Netcare.

*Figure 3: Decomposition of Textainer’s EV*




*Source: Bloomberg*

Another way in which EV can look materially different to the stock price is when companies issue new shares. PPC is a good example of this, as they doubled their shares outstanding in 2016 to pay down debt from new expansionary projects that it had undertaken in Africa. This is a good example where non-recourse debt became debt. Surprise, surprise.

*Continued...*

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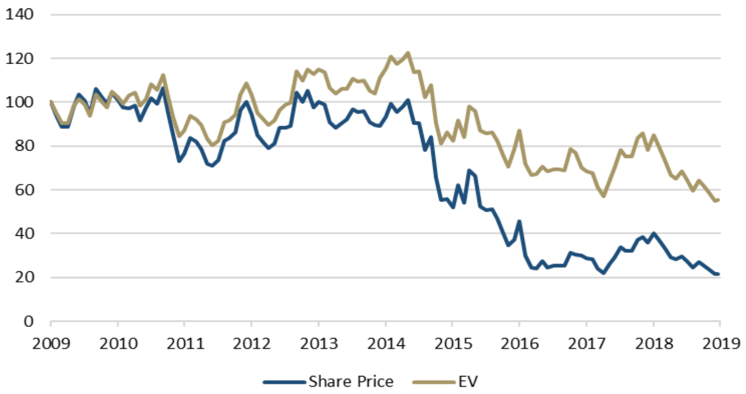
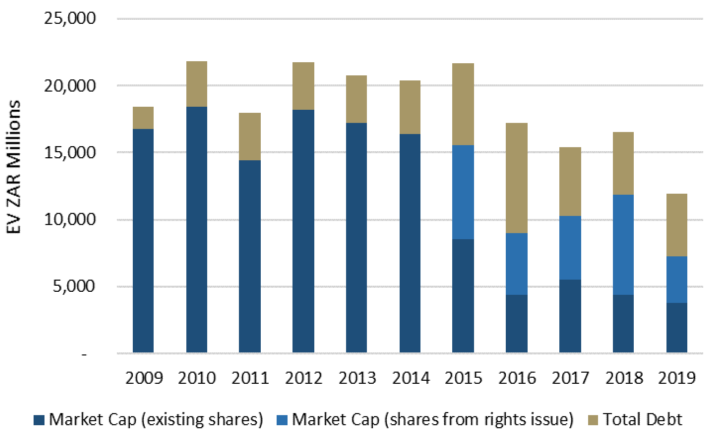
*Figure 4: PPC Stock Price & EV (indexed to 100)*




*Source: Bloomberg*

Figure 5 shows how PPC's EV composition has changed through time. First it added debt for the projects, including some off-balance sheet debt, which most investors ignored. Then it lodged a rights issue. We have split out the new shares. So yes, EV did decline, but not nearly to the extent of the stock price decline.

*Figure 5: PPC EV Decomposition ex-new share issuance*




*Source: Bloomberg*

We noted that the EV composition includes minority interests. The minority adjustment is to reflect that they have rights to a share of the underlying company and you as an ordinary shareholder don't own the business entirely. Most people would use the balance sheet book value to represent the value of the minority's interest, but it is far better to use the value you would need to pay to buy out the minority interest which in most cases would be higher.

Stock price is a short cut that's tempting to use as an anchor of the relative "cheapness" of a stock through time, but its far better to plot the enterprise value to see how the overall composition and valuation of the business has changed.