Investment Focus:Bidvest Group

Bidvest is a diversified industrial conglomerate and a cornerstone of South Africa’s economy. Since 2020, the Group has embarked on an aggressive offshore expansion strategy, particularly targeting essential services such as facilities management and hygiene solutions—industries characterized by recurring, non-discretionary demand.

Business Overview

Bidvest oversees adiverse range of asset-light, essential services businesses in two main segments: Business Services and Trading & Distribution. These include seven divisions, one being a 65% stake in Adcock Ingram. The Group's resilient model has achieved a 5-year revenue CAGR of 6.9%, outpacing South Africa's nominal GDP growth.

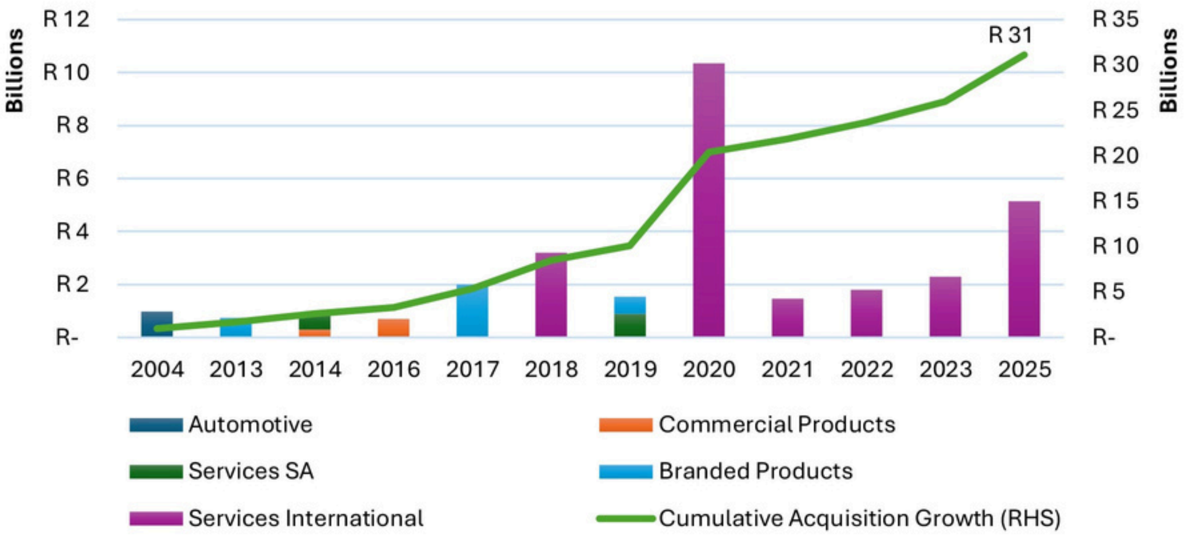
Article Focus

This article examines if the Group’s management incentives align with shareholder value creation, and whether the current return metric used for awarding short-term cash bonuses is appropriate given Bidvest’s evolving capital base.

Bidvest’s Acquisitions Overtime

Priorto 2020, Bidvest's revenue was predominantly driven by goods, with product sales accounting for 62.1% of revenue in FY2019. By FY2024, this contribution had decreased to 54.4%, while services revenue increased from 36.0% to 44.9%. This shift is mainly attributed to offshore acquisitions made between 2020 and 2024, particularly within the Services International division.

BIDVEST ACQUISITIONS OVERTIME



Source: JP Morgan Equity Research, BVT SENS Releases, BlueAlpha Investment Management

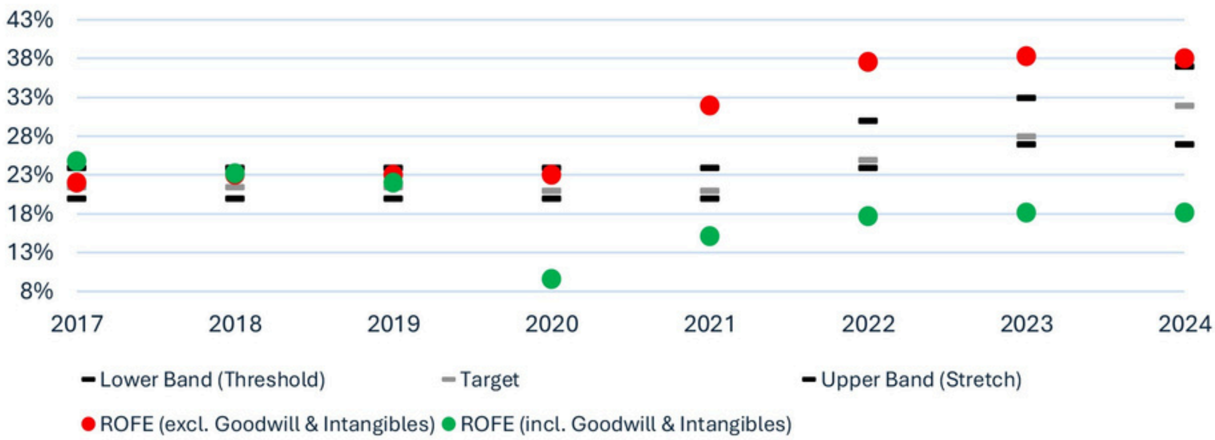
In the decade leading up to 2020, Bidvest completed acquisitions totaling around R10 billion, equal to approximately 15.3% of its market capitalization at the time. By FY2024, this figure had tripled to R31 billion, representing around 40% of its current market cap. Naturally, this acquisitive activity has led to a significant increase in goodwill and intangible assets, which now make up 61% of invested capital—up from 42% prior to 2020.

Return on Funds Employed (ROFE) and Incentive Alignment

Bidvest employs Return on Funds Employed(ROFE)asa crucial performance metric within its short-term incentive (STI) framework. ROFE is determined by dividing trading profit by tangible net operating assets, deliberately excluding goodwill and intangible assets from the calculation. This measure accounts for 30% of the overall STI score used to evaluate senior management, significantly influencing the determination of annual cash incentives.

The chart below compares Bidvest's reported ROFE (based on tangible assets) with BlueAlpha's adjusted calculation, which includes goodwill and intangibles. According to the company's methodology, management met their stretch ROFE targets between 2021 and 2024. However, when returns are calculated on total capital employed, including the assets acquired through strategic M&A, performance does not meet the minimum hurdle.

BIDVEST RETURN ON FUNDS EMPLOYED (ROFE)
[30% weighting in STI Scorecard]



Source: BVT Financial Statements, ESG Reports, BlueAlpha Investment Management

Economic Profit: A Shareholder-Aligned Alternative

Barloworld, anotherSouth Africanindustrial conglomerate, includes Economic Profit (EP) in its Short-Term Incentive (STI) scorecard. EP accounts for 25% of the total score and assesses the value a business generates over and above its cost of capital.

Barloworld's remuneration report shows it missed its economic profit target in three of the last seven years. Conversely, Bidvest consistently met or exceeded its STI targets over all seven years, surpassing stretch targets for four consecutive years. Executives must be accountable for all capital allocated, including acquisitions. Calculating economic profit based on the operating asset base plus goodwill aligns executive incentives with shareholder value.

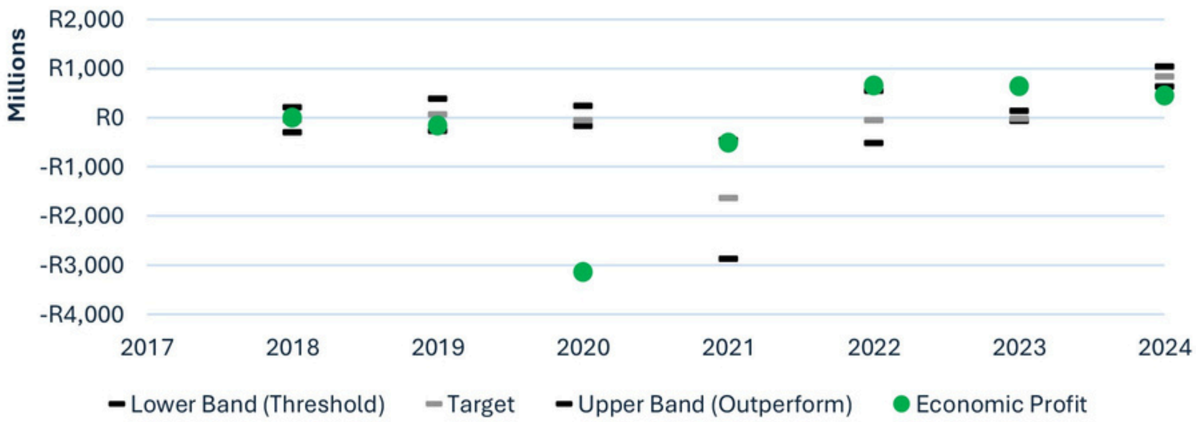
Conclusion

When evaluating executive performance at the Group level, return metrics should reflect the full capital base, including goodwill and intangibles. This is pertinent for the Group CEO and executive team, who are responsible for identifying, negotiating, and executing acquisitions. These strategic decisions result in the recognition of goodwill and intangibles on the balance sheet.

In comparison, divisional leaders generally have limited influence over M&A decisions and should be assessed differently. Excluding acquisition-related assets from Group-level return calculations may misalign incentives with shareholder interests.

At BlueAlpha, a key aspect of the investment approach is to support quality businesses—those that consistently generate economic profit. These companies are capable of reinvesting capital at rates above their cost of capital, thus compounding shareholder value over time. Performance metrics should align with this long-term value creation perspective.

BARLOWORLD ECONOMIC PROFIT (EP)
[25% weighting in STI Scorecard]



Source: Barloworld Remuneration Reports, BlueAlpha Investment Management