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LISTINGS AND DELISTINGS – *What does it mean for the long-term investor?*

Initial Public Offering (IPO) - The first **sale** of stock by a company to the public.

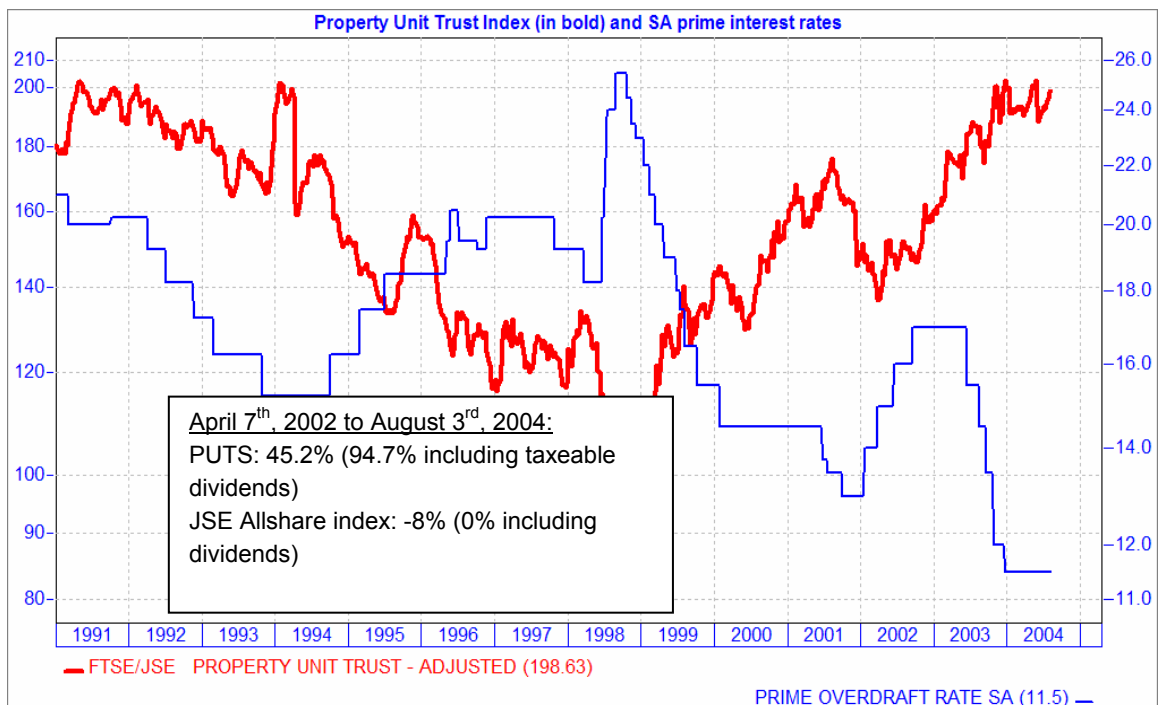
Sale - An exchange of goods, services, or other property for **money**.

Daniel Kahneman PhD won the Nobel prize in Economics in 2002 for his ground-breaking work in the field of behavioural finance. His opinion is that investors are not only irrational, they are predictably irrational. Irrationally priced markets and stocks create opportunities for investors who acknowledge human nature and its cyclical nature.

Our investment process attempts (among other things) to reduce our exposure to the vagaries of human nature. We endeavour to understand irrational asset pricing but we will occasionally get it wrong, so we have to protect our own and our clients' money from ourselves at times!

Participating in an IPO might seem like a good idea, especially when a few of them make traders rich quickly, but in many cases it is a sure road to disappointing investment returns.

Is it any coincidence that pretty much the only sector on the JSE that has enjoyed a new listings boom over the last 2 years is the property sector? Property has been a top-performing asset class, outperforming the JSE Allshare index since 1998 and delivering substantial outperformance in the last 2 years as indicated on the chart below:



Source: I-Net

In the table below it is interesting to note that of the twelve new listings on the JSE since January 2002, seven were in the property sector.

<u>New listings - January 2002 - August 2004</u>						
			listing date	listing price	today's price	% change
1	Capitec Bank Holdings	Consumer Finance	Feb-02	200	700	250%
2	Acucap Properties	Real Estate Holding Development	Mar-02	1000	1290	29%
3	iFour Properties	Real Estate Holding Development	Jun-02	450	655	46%
4	Phumelela Gaming and Leisure	Gaming	Jun-02	50	500	900%
5	Resilient Property Income Fund	Real Estate	Dec-02	500	744	49%
6	Beget Holdings	Venture Capital	Dec-02	20	2	-90%
7	Telkom SA	Fixed line Telecomms	Mar-03	2800	7880	181%
8	MICC Property Income Fund	Real Estate Holding Development	Oct-03	500	520	4%
9	Exxoteq	Oil & Gas Exploration	Nov-03	480	25	-95%
10	Emira Property Fund	Real Estate Holding Development	Nov-03	500	525	5%
11	Ambit Properties	Real Estate Holding Development	Feb-04	200	200	0%
12	Vukile Property Fund	Real Estate Holding Development	Jun-04	500	465	-7%

Source: JSE listings department (modified by the author)

The formation of hastily strung together businesses with a board of directors that no-one has ever heard of, a few glossies and voila, a new stock market listing and sale to the public is nothing new. It is as old as the oldest stock market and indicative of an overpriced market. In our view there have been some questionable new listings in the property sector of the JSE.

In the popular mind (and on CNBC), the stock market and its supporting cast is an industry that helps investors to make money. We contend that it is nothing of the sort – it is an industry like any other; it makes money for itself by selling things at a profit, and like any other industry it derives its profits from its clients: the investors. What it sells is the HOPE of making money. That's why analysts in the US recommend 49 buys for every sell. It's also why strategists almost always expect stocks to go up – they wouldn't have a salary otherwise.

In the international markets we wish to point to two new listings that are of particular interest to us: Naspers listed a subsidiary called Tencent in Hong Kong on June 15th. Tencent provides instant messaging and internet access in China. Shares were priced at HKD3.70 at 21 times its historic 2003 profits (which is not taxed) and 9.3 times revenues. There are no discernable barriers to entry and its listed peers are valued on average price/revenue multiples of 24 times (they don't make any profits). Incredibly, since listing the volume traded is 978mn shares, which is 2 times the free float (ie the number of investable shares), of the whole company! It is in fact nothing more than a giant lottery.

In the US market the world's largest internet search engine, Google, plans an IPO that follows a Dutch auction, whereby potential investors can bid the share up to any value. The latest indications are that this will value Google at a price of between 150 and 187 times the last years earnings.

It is our opinion that both of these listings are attempts by the private owners of these businesses to realise value for themselves (i.e. sell to the public). They are smart because they are capitalising on the hot new trends for investing in China and internet search engines. In effect, the owners are selling hope and pocketing the profit. We are of the opinion that investors will not share in those joys.

Suppose that the merchant banking community really did have access to an investment that would produce consistent above-market profits. These professionals have access to so much capital, why

would they ever fail to take up an extraordinary investment? Quite naturally it follows that the investments that are sold in an IPO are the ones it doesn't want for itself, which is true of every seller.

The exact logic in reverse applies to delisting trends. Management, merchant banks, private equity funds and parent companies raise the funds and buy back large blocks of stock from potentially disillusioned and short-termist institutional investors. This eventually triggers a minority offer and delisting. More often than not these are done with very little fanfare at ridiculously low valuations, often at a substantial discount to net asset value.

Recent high-profile examples are the attempted Mutual & Federal takeover and delisting by parent company Old Mutual, and the currently proposed offer to minorities and delisting of ABI by SABMiller. Our clients own substantial amounts of both of these companies, and have benefited from the attempted buy-outs. Other delistings of quality businesses over the last 2 years include Pepkor, Avis, McCarthy, M-Net Supersport, Energy Africa and Mettle.

Although we are disappointed by the potential loss of access to these companies, our view is that any equity market characterised by the buyouts and delistings of quality businesses is an attractive market to own on behalf of our clients.

When smart and well-informed businessmen are willing to take on debt and put up their own money to buy listed companies, investors should sit up and take note. Equally, when these same smart businessmen are selling their businesses to the public via IPO's, investors should know how to interpret their actions.

Daniel Malan
August 2004