Good Nampak, Bad Nampak

Daniel's Perspectives: 5 March, 2019

At a glance, JSE listed packaging company Nampak looked interesting. Underperforming share price, low PE, discount to Book Value, reasonable financial gearing, 37% of it owned by two respected institutional shareholders of reference.

Sounds good so far but dig deeper and the plot thickens. In fact, it thickened a bit too much for my liking. A few highlights:

1. Earnings is overstated. I estimate the PE ratio is more like 11, compared to the 6,5 in the headlines.
2. It offers a brilliant illusion. I should add entirely legally. The Board formally agreed to dispose of the glass division over a year ago. That disposal has not happened yet, but the financials were re-packaged in terms of what can be thought of as a 'Good Nampak' (ex-Glass with low debt) and a 'Bad Nampak' (Glass with lots of debt). The truth is every Nampak stakeholder has both.
3. What finally brought it home; I noticed a material component of management's financial incentives directly linked to HEPS – headline earnings per share. And yes, you guessed it, HEPS *includes* what happened in 'Good Nampak' but *excludes* whatever happened in 'Bad Nampak'. Also, in case you were wondering, 'Bad Nampak' was significantly loss-making, and yes, management received many millions in non-recourse performance bonus payments in cash as a result.

To dispose of 'Bad Nampak' would have been a challenge in a reasonably healthy South African economy. Selling it given the current reality is a pipe dream. Who are they kidding?

As one of my colleagues' granddad always said: "When looking at a magician, always watch the other hand"

Our work continues…

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