Why Zombie Companies take so long to die

Perspectives: April 11th, 2023

I have often *underestimated* the longevity of stock exchange listed 'zombie companies'. The Britannica dictionary states that zombie means '*a dead person who is able to move because of* ***magic***'.

I eventually realized there is no magic involved in keeping companies alive for longer than I expected. I had simply been demonstrating a failure to show my appreciation for and understanding of *incentives*.

Most stock-exchange listed companies, including those with tiny market capitalizations, are in fact *substantial* business enterprises with a large number of *influential* stakeholders. The list of stakeholders include employees, labour unions, executives, the board of directors, customers, raw material suppliers and *everything* else that goes into the cost of goods sold and operating cost line items, capital equipment suppliers, governments, utilities, auditors, competitors, regulators, corporate advisors, consultants, bankers, insurers, pension fund administrators & managers, corporate lenders, and lastly but unfortunately also least, the institutional and individual equity shareholders – who are often deliberately kept in the dark until it is far too late for them.

Almost all of these stakeholders are *heavily* incentivized to keep a company going for as long as possible. Importantly, there also exists the potential for serious conflicts of interest. For example, the banks who lent money to a zombie company might have a potential conflict of interest with their in-house asset management and life insurance subsidiaries.

Given its already heavily indebted balance sheet position, the writing had probably been on the wall for formerly JSE listed **Tongaat Hulett** since April 2019 when it first disclosed '*significant accounting irregularities*'. Nonetheless, it soldiered on for more than 3 *years* before being suspended by the JSE on July 15th, 2022. In October 2022 it announced it had formally entered business rescue, and the turnaround CEO threw in the towel and departed the scene in

January 2023. At every step along the way, a series of highly paid external 'helpers' were appointed to turn the ship around. In the end, all that money was squandered. As a result, there has been meaningful value leakage from the equity shareholders, who ended up with *zero*.

In most industry value chains, one company's costs are another company's sales, and vice versa. In the 2018 financial year, Tongaat had a market capitalization of R13,2bn, with 40,382 employees, annual sales of R17bn, cost of sales of R13,5bn, financing costs of R1bn, property, plant & equipment worth R14bn, debtors of R4,5bn, creditors of R4,2bn, debt of R9,6bn, a deferred tax liability of R2,4bn, and cash of R2,6bn. In addition, it had spent R1,2bn on replacement capex, and R0,9bn on expansion capex. The external auditors got paid R21mn, technical advisors R19mn, and operating lease payments were R133mn. All in that year alone.

My point is that *any* business, even the tiny ones, are like a mini economy. They are like complex machines operating with all sorts of fixed and moving parts, all interacting with and co-dependent on each other.

The final irony…since Q1 2020 the **Rand** has *weakened* considerably (by 26%) while the US Dollar price of **Sugar** has *increased* significantly (by 140%). Tongaat's huge sugar business *should* have been making a killing.

Our work continues…

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