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equities@absa.co.za www.absastockbrokers.co.za

Super Group Ltd

Confidence boost from the 'Ramaphosa factor' set to benefit earnings but risks remain

Background

Super Group has three operating divisions: supply chain; fleet solutions; and dealerships. The supply chain division provides a platform for the group's core offerings.

I. The supply chain division has operations in southern Africa, Australia, New Zealand, Germany and the UK. The division has an operational footprint across the entire supply chain, focusing on providing clients with end-to-end solutions. This encompasses the planning and management of all activities across the supply chain including sourcing, procurement, transport, warehousing and distribution of goods and services.

II. The fleet management unit has operations in SA, Australia, New Zealand and the UK. It operates fully maintained operating leases through to pure fleet management services for corporate and government clients and small to medium businesses.

III. The dealerships segment consists of 53 dealerships in SA and 32 in the UK. In December 2014, Super Group acquired Allen Ford, the UK's second-largest independently owned Ford franchise network. It operates 13 franchised Ford motor dealerships and two franchised Kia dealerships. More recently, it acquired Essex Auto in the UK, adding nine dealerships (five Ford ones, two Kias and one Fiat and Mazda).

Our thoughts

Super Group has successfully reinvented itself since 2009 when it almost collapsed. The restructuring that followed started with the hiring of Peter Mountford as CEO in 2010, which has paid off. In 2016, Mountford won the Ernst & Young World Entrepreneur Award Southern Africa.

The company has grown through acquisitions over the years and has increased its European exposure, particularly the UK. It now generates 46% of revenue and 62% of operating profit outside SA. It has grown its bottom line by a compounded annual growth rate of 21.5% since FY10. However, this is a business that is intricately tied to the performance of the wider economy, driven by levels of both business and consumer confidence.

Investment thesis

Macro review

The European and UK markets seem to be stabilising despite the continuing uncertainty regarding Brexit. Europe recently recorded its best growth numbers in almost two decades and there is reason to believe the growth will continue for some time. The Australian economy remains on its steady growth path.

Back home, it is still early days but the ascendency of Cyril Ramaphosa to the presidency signals the return of both business and consumer confidence. Ironically, the recently announced budget seems to have been drafted with global ratings agencies as the most important stakeholder, and we didn't see much that would support economic growth. However, Ramaphosa's state of the nation address indicated that new policies might be crafted to inspire growth through wide consultation with various stakeholders. That's where most of the hope now lies but the economy remains precarious.

Micro analysis

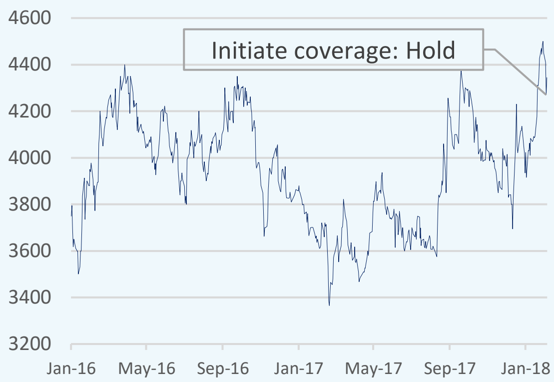
Super Group management says it will focus on improving operational efficiencies and gaining market share. Its premium black economic empowerment ratings should support its quest to expand market share.

Equity Research

Hold

12-month target price	R40.49
Spot share price	R40.24
12-month implied total return	0.6%

Super Group price graph



Source: I-Net BFA

Key statistics

Market cap: R15.7bn

Net debt:equity: 36.7%

Price:earnings ratio: 13.4

Forward PE ratio: 11.9

Dividend yield: nil

Forward dividend yield: nil

Risk: medium

12-month high: R46.70

12-month low: R33.24

Ave monthly volume: 14.6-million

Financial year-end: 30 June

Latest event

Interim results

Date announced: 19 February

Share details

Company: Super Group Ltd

JSE Code: SPG

Sector: Industrial Transportation

Sensitivity analysis				
	Terminal growth	2.0%	4.0%	6.0%
Wacc	10.0%	4 758	6 047	8 626
	11.0%	3 991	4 901	6 538
	12.0%	3 385	**4 049**	5 155
	14.0%	2 493	2 874	3 445
	15.0%	2 157	2 453	2 882

This reflects the sensitivity of our forecasts to assumptions of the terminal growth rate and the weighted average cost of capital (Wacc). The highlighted cell shows our target price in cents.

However, it has lost some margin advantage – a negative impact of its recent acquisitions – but that should be remedied by management's focus on efficiencies.

During the past five years of SA's subdued economic growth, Super Group has managed an average price:earnings ratio (PE) of 13.3 whereas its much bigger and closest peer, Imperial, averaged 11.8. But Imperial rallied in the last quarter of last year to a PE of 18, while Super Group is trading at 13.4. We believe that any upward rerating of Super Group will be driven by the promise of good economic prospects in all its operating markets. Brexit clouds the UK's prospects while SA has a long way to go before any convincing economic growth becomes entrenched. There is also the risk that continued strengthening of the rand will curb growth metrics.

Overall, we think Super Group is trading around its intrinsic value based on our discounted cash-flow valuation. Because of its size there is scope for better growth than Imperial, which we think is overvalued.

Performance Review

RESULTS IN BRIEF	1H18	Change	1H17	FY17
Revenue (R'm)	17 966.3	27.5%	14 094.9	29 873.9
Operating profit (R'm)	1 149.2	10.8%	1 036.8	2 116.1
Operating margin (%)	6.4%	-13.0%	7.4%	7.1%
Attributable earnings (R'm)	543.6	8.8%	499.8	992.7
HEPS (cents)	155.1	7.7%	144.0	288.2

Super Group generated 46% of revenue and 62% of operating profit outside SA for the interim period to end-December. Although the rand strengthened against most of the group's operating currencies, management says it had a negligible effect on the results. Growth in revenue was predominantly driven by acquisitions in the UK and Spain as well as full inclusion of companies acquired in the base period.

Operating profit failed to rise in line with revenue metrics because some of the acquisitions are lower-margin businesses. Net finance costs accelerated 36% to R168.9m as more debt was raised to fund acquisitions and working capital.

Acquisitions spread business risk geographically but come with lower margins

Divisional performances

Supply Chain. Supply Chain Africa revenue increased 7.8% to 4.66bn, held back by subdued business in the fast-moving consumer goods and and quick service restaurant sectors. Operating profit edged up 0.4% to R262m. Supply Chain Europe revenue climbed 60.6% to R1.61bn, propelled by acquisitions. However, operating profit failed to impress with the margin falling to 3.9% from 5.5% as the acquired businesses came with lower margins.

Fleet Solutions. African operations revenue fell 3.4% to R315.6m and operating profit shrank 21.5% to R61.4m. In the UK, performance was helped by the full inclusion of base year acquisitions, with revenue rising 14.3% to 1.6bn. UK margins declined to 30.8% from 31.3% because the newly acquired businesses have lower margins.

Dealerships. South African revenue rose 17.7% to R5.02bn while operating profit shot up 19% to R167m. Again, performance was bolstered by fully including base year acquisitions. The UK revenue climbed 71.3% to R4.76bn, buttressed by acquisitions. However, the UK dealership market experienced steep declines in new vehicle sales of 10.5%, as well as a drop in used car volumes due to fewer trade-ins. Without acquisitions, the UK dealership experienced a 13.5% decline in sales.

Valuation

We expect average revenue growth of more than 12% a year in the short to medium term, which should gradually fall to a sustainable growth rate of 4% in the long run. We estimate that Super Group's adjusted pre-tax operating margin should stabilise at about 8%. Using a discount rate of 12%, we obtain a target price of R40.49/share. That translates to upside potential of 0.6%. Therefore, we rate this a hold, but we are hopeful of improved economic growth from Ramaphosa's presidency which will benefit the company.

Bull Factors

- Ramaphosa presidency signals recovery in business and consumer confidence
- Good geographical diversification and multi-currency income
- Improved growth prospects in eurozone
- Premium black economic empowerment ratings
- Competent management team

Bear Factors

- Rising input costs through increase in fuel levies
- Intense industry competition
- Rand strengthening negates some of the benefits of international diversification

Extract of the DCF model	2017A	2018E	2019E	2020E
Operating profit (R'm)	2 116.1	2 539.3	3 047.1	3 595.6
Net operating profit after tax (R'm)	1 332.7	1 586.3	1 903.6	2 246.3
Working capital changes (R'm)	82.9	(50.0)	(57.5)	(66.1)
Capital expenditures (R'm)	(1 628.1)	(1 872.4)	(1 800.0)	(1 900.0)
Unlevered free cashflows (R'm)	198.2	122.6	553.3	848.8
Headline earnings per share (cents)	288.2	336.7	404.1	476.8
PER (times)	14.0	11.9	10.0	8.4

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