Wealth Management

Smart Company Analysis

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

Analyst: Orin Tambo, CFA
Email: otambo@Intellidex.co.za

The Company: Omnia Holdings Ltd

Earnings decimated by seasonality but there is room for second-half recovery

Our call

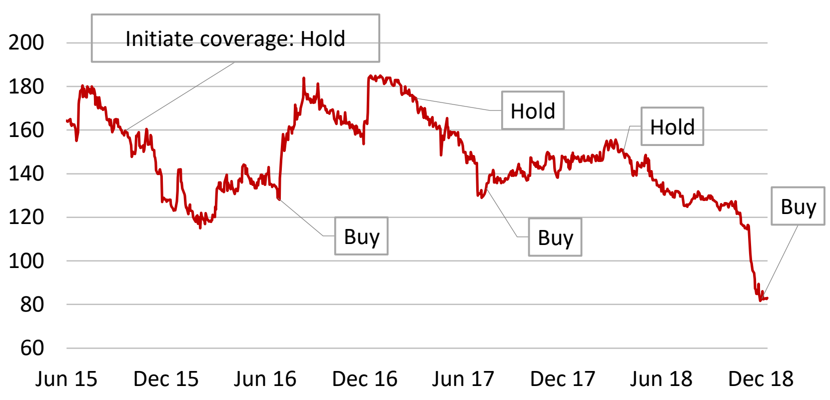
Buy

Intellidex estimate of fair value: ***R92.92***

Spot price: ***R82.80***

Potential move: ***12.2%***

Omnia's share price graph and Intellidex's previous calls



Background

Omnia Holdings is a specialist chemical services provider with interests across the chemical, mining and agricultural markets through three operating divisions: chemicals (Protea Chemicals, Umongo Petroleum), mining (BME, Protea Mining Chemicals) and agriculture (Omnia and Oro Agri).

Sensitivity analysis

	Terminal growth	2%	4%	5.5%
Wacc	8.0%	13 828	19 199	33 162
	10.0%	9 089	11 500	16 053
	11.0%	7 549	9 292	12 313
	13.0%	5 178	6 135	7 602
	14.0%	4 313	5 049	6 131

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.*

Investment thesis

The weak state of the South African economy muddies Omnia's investment case. The group, whose performance is heavily linked to the local mining and manufacturing industries, has seen its profitability deteriorate over the past five or so years. It recently reported an interim loss for the first time since 2009 with all three of its divisions underperforming expectations.

The headwinds facing Omnia are unlikely to disappear overnight. Despite relatively firmer commodity prices, production levels in the local mining sector remain depressed. Many gold and platinum mining companies – Omnia's major clients – are still uneconomical and face closure in the short term. Uncertainty regarding the mining charter and general political uncertainty in the country also continue hampering local and foreign investment in the sector. Although activity in the manufacturing sector is showing signs of recovery, it is still far below levels that would see Omnia's chemicals businesses delivering healthy margins.

Depressed activity in the mining and manufacturing sectors is problematic for Omnia. It causes margin pressures, intense competition and poor-quality order books. The group's chemicals subsidiaries, which were programmed to produce large volumes, also suffer from diseconomies of scale.

Nonetheless, we do not think Omnia's 1H19 results are a true reflection of its profitability. The results contain many distortions which are either once off or will reverse in the second half.

A loss of R37m recorded in the agricultural division is largely due to seasonal factors but exacerbated by adverse currency movements. Omnia ramps up production of fertiliser around May and peaks in December. However, deliveries of fertiliser to farmers begin only at the start of the summer planting season in September/October and peak through December/January. This mismatch between production and delivery cycles often results in high inventory levels, which causes foreign exchange losses when combined with adverse currency movements. However, such losses reverse in the second half when the inventory is sold. Costs in 1H19 also included several once-off items: acquisitions costs, bad debts provision and restructuring costs.

Overall, Omnia remains a competitive business capable of delivering decent value to patient shareholders. The group's competitive advantage is that it doesn't just sell commodities – fertilisers and explosives – but it also applies its intellectual capital and technologies at all key points along its supply and service chains, thereby creating value throughout. This approach effectively locks in clients, which plays a major role in stabilising volumes.

Management is also continuously adapting the group to suit the changing environment. To offset the weak SA environment, it has expanded into international markets. Now, the mining division earns more from markets outside SA than it does from SA. The agricultural division generates more than a third of its profits from outside SA. Omnia is also restructuring its chemicals division where it plans to resize Protea Chemicals and discontinue non-profitable product lines.

We think Omnia should be able to sustain operating margins of between 5% and 7% in the medium to long term. That and other assumptions puts the fair value of the group at R92.25/share, which falls into our buy region.

Analysis of results

Revenue growth of 12% was driven purely by the first-time inclusion of Umongo Petroleum (R559m) and Oro Agri (R279m). Net operating expenses soared by 36%, driven by higher distribution and administrative expenses.

Distribution expenses were up 22% due to higher fuel prices, a weaker rand and the inclusion of new acquisitions. Administration expenses rose 23%, driven in large part by a bad debt provision for a debtor in the mining division.

The agriculture division reported a R37m operating loss (1H18: R111m profit), driven by the delayed start to the planting season and unrealised foreign exchange losses. The mining division reported a 69% decline in operating profit as margins remain under pressure across all its operating markets. The chemicals division's operating profit was flat at R65m.

Net finance expenses ballooned 142% to R218m (1H18: R90m), tracking interest-bearing borrowings and bank overdrafts which increased to R5.37bn (1H18: R2.1bn). These events translated into a headline loss of R140c/share (1H18: 420c/share). A dividend of 75c/share was paid (1H18: 200c/share).

Macroeconomic outlook

Omnia's performance is heavily linked to activity levels in SA's agricultural, mining and manufacturing industries. Its large exposure to offshore markets and products whose pricing mechanisms are linked to international prices also makes the rand a key earnings driver.

In SA, planting is reported to be complete in KwaZulu-Natal and Mpumalanga. Planting in the Free State and the North West was delayed due to erratic rains, but farmers are expected to ramp up following above-average rainfall received during the first 10 days of December. This bodes well for Omnia, which is ready to liquidate its inventory position during the fertiliser period.

The group already has a strong order book with a large portion of orders having been placed prior to the planting season. However, financially constrained farmers are likely to squeeze the group on selling prices.

Activity in SA's mining sector remains glum. Mining output was a positive surprise at 0.5% year on year for October. However, it is still 1% down in the year to date. Load shedding and continuing strike action are likely to ensure there is no significant recovery in the sector in the coming months.

We see manufacturing continuing to recover during the first half of 2019 as investment slowly improves.

Omnia's latest acquisitions – Umongo Petroleum and Oro Agri – are also going to be instrumental to the performance of the group in the short to medium term. Both acquisitions underperformed during 1H19. But we think Oro Agri is a good addition. It brings good intellectual property and its vibrant research and development capabilities are valuable to Omnia. Umongo is too exposed to SA's manufacturing industry.

Bull Factors

- West and east African mining sectors remain attractive
- Medium- to long-term prospects of open pit coal mining remain attractive
- Diversified operations help stabilise earnings

Bear Factors

- The local economy, including the mining and manufacturing industries, are likely to remain constrained in the short term
- Beleaguered mining sector and general political uncertainty to continue hampering local and foreign investment in the mining sector

Key statistics

Share details – JSE Code: OMN
Sector: **Specialty chemicals**

Market cap: **R5.7bn**
Price:earnings ratio: 19.14
Forward PE ratio (FY20): 27.6
Dividend yield: **2.67%**
Forward dividend yield: **3.1%**
Risk: **High**

12-month high: **R160.99**
12-month low: **R118.50**
Ave monthly volume: **1.59-million**
Financial year-end: **31 March**
Latest event**: Final results**
Date announced: **26 June 2018**

RESULTS IN BRIEF	1H19	Change	1H18	FY18
Turnover (R'm)	8 654	12%	7 706	17 372
Operating profit (R'm)	124	-75%	488	1 156
Operating margin (%)	1.4%	-77%	6.3%	6.7%
Attributable earnings (R'm)	(94)	N/A	285	666
Heps (cents)	(140)	N/A	420.0	991

Intellidex Disclaimer:
This research report was issued by Intellidex (Pty) Ltd. Intellidex aims to deliver impartial and objective assessments of securities, companies or other subjects. This document is issued for information purposes only and is not an offer to purchase or sell investments or related financial instruments. Individuals should undertake their own analysis and/or seek professional advice based on their specific needs before purchasing or selling investments. The information contained in this report is based on sources that Intellidex believes to be reliable, but Intellidex makes no representations or warranties regarding the completeness, accuracy or reliability of any information, facts, estimates, forecasts or opinions contained in this document. The information, opinions, estimates, assumptions, target prices and forecasts could change at any time without prior notice. Intellidex is under no obligation to inform any recipient of this document of any such changes. Intellidex, its directors, officers, staff, agents or associates shall have no liability for any loss or damage of any nature arising from the use of this document.

Remuneration
The opinions or recommendations contained in this report represent the true views of the analyst(s) responsible for preparing the report. The analyst's remuneration is not affected by the opinions or recommendations contained in this report, although his/her remuneration may be affected by the overall quality of their research, feedback from clients and the financial performance of Intellidex (Pty) Ltd. Intellidex staff may hold positions in financial instruments or derivatives thereof which are discussed in this document. Trades by staff are subject to Intellidex's code of conduct which can be obtained by emailing mail@intellidex.co.za. Intellidex may also have, or be seeking to have, a consulting or other professional relationship with the companies mentioned in this report.

Guide to recommendations
A buy recommendation is made where the target price is 10% above the current price, a sell when it is 10% below the current price, and a hold recommendation when it is within 10% of the current price. The risk measure is a subjective determination guided by the beta of the share price. We also examine the financial and operating leverage of the business. ©This document is copyrighted by Intellidex (save for information contained in this document provided by third parties which may be copyrighted to them) and may not be distributed in any form without the express prior written permission of Intellidex.

Absa Stockbrokers and Portfolio Managers disclaimer:
This research note is prepared for Absa Stockbrokers and Portfolio Managers(Pty) Ltd ("SPM") by Intellidex (Pty) Ltd, a company registered in South Africa, registration number: 2008/005881/07 ("Intellidex"). Intellidex is an independent company contracted to Absa.
The views expressed in this note are those of Intellidex and/or its analysts and are not necessarily the views of SPM or any officer or agent thereof. The information contained in this communication does not constitute an offer or the solicitation of an offer to enter into any transaction for the sale or purchase of any security, nor does it constitute any recommendation, guidance or proposal to enter into any transaction for the sale or purchase of any security. The information is provided for illustrative purposes only and is not guaranteed. SPM does not represent or warrant that the information contained in this report is true or accurate and no undertaking (express or implied) is given and no responsibility nor liability is accepted by any member of SPM, its employees and agents, or any other person or company affiliated to SPM, as to the accuracy of the information contained herein. Past performance is no indication of future performance. SPM does not accept any liability or responsibility for any loss, damage or expense incurred in relying on the above information or in the use thereof, nor makes any representation as to the accuracy or completeness of the above information. All opinions, estimates and findings contained in this document may be changed after distribution by Intellidex at any time without notice.

This document has been prepared in accordance with local regulations which may differ from the requirements in other jurisdictions. In distributing this research to you, SPM does not hold this out to be impartial (objective) as it may have been prepared by persons who may be exposed to conflicts of interest.

You should be aware that this document might have been originally disseminated by Intellidex to its clients other than SPM. As such, employees and clients of Intellidex and any persons connected with it may have had the opportunity to act upon the information contained in this document. The recipients of this document are urged to seek independent advice with regard to the securities and investments referred to in this document.
.

FAIS Notice and Disclaimer
This brochure/document/material/report/communication/commentary ("this commentary") has been prepared by Absa Stockbroking and Portfolio Management.
Absa Stockbroking and Portfolio Management has issued this commentary for information purposes only and you must not regard this as a prospectus for any security or financial product or transaction. We do not expressly, tacitly or by implication represent, recommend or propose that the securities and/or financial or investment products or services (the "Products") referred to in this commentary are appropriate and/or suitable for your particular investment objectives or financial situation or needs. This commentary is not, nor is it intended to be, advice as defined and/or contemplated in Financial Advisory and Intermediary Services Act, 37 of 2002 ("FAIS"), or any other financial, investment, trading, tax, legal, accounting, retirement, actuarial or other professional advice or service whatsoever ("advice"). All the risks and significant issues related to or associated with the Products are not disclosed herein and therefore, prior to investing or transacting, you should fully understand the Products and any risks and significant issues related to or associated with them. This commentary is neither an offer to sell nor a solicitation of an offer to buy any of the Products, which shall always be subject to our internal approvals and the execution of all requisite documentation.
You have to obtain your own advice prior to making any decision or taking any action based hereon and we, our affiliates, officers, directors, partners, or employees (in whose favour this constitutes a stipulation on behalf of another) do not accept any liability whatsoever for any direct, indirect or consequential damages or loss arising from any use of or reliance on this publication or its contents, and irrespective of whether or not you have obtained independent advice.
Should you be a consumer in terms of the Consumer Protection Act No 68 of 2008, as amended, (i.e. a natural person or an entity with an asset value and annual turnover below R2m), then the above provisions limit and exclude the liabilities which we will have towards you and also place obligations on you.
Absa Stockbroking and Portfolio Management is made up of:
Absa Stockbrokers Pty Limited and Absa Portfolio Managers (Pty) Ltd.
Absa Stockbrokers (Pty) Ltd is a Member of the JSE Equity Market and a Registered Credit Provider Reg No. NCRCP68, Absa Portfolio Managers (Pty) Ltd, an Authorised Financial Services Provider with FSP No 552.
Absa Portfolio Managers (Pty) Ltd trading as Absa Asset Management Private Clients, an Authorised Financial Services Provider, License No. 552