Merchantec capital

Date 11 November 2022

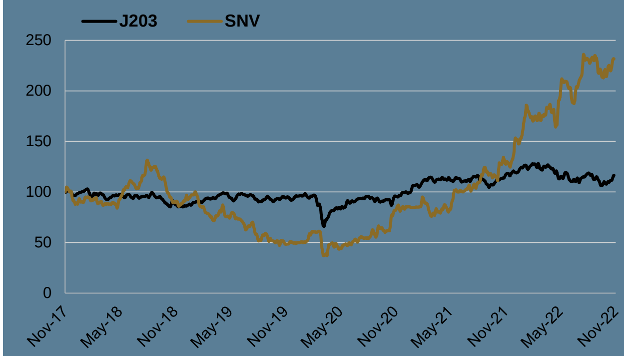
SNV – Santova Limited FY23 Interim Results Equity Update

Valuation: Fairly valued

SNV released interim results on 1 November 2022 for the period ended 31 August 2022

Price (R)			**7,60**
PE Fair Value (R)			**7,30**
DCF Value (R)			**7,65**
Upside (Downside) to DCF (%)			0,6%
DY %			0,0%
Price Performance			**Relative**
	Absolute		**to JALSH**
1 month	6,3%		-2,9%
3 month	-0,3%		0,5%
YTD	50,8%		48,5%
12 month	**High**		**Low**
(SA Rands)	9,24		4,07
No. of shares (m)	138	Price (R)	7,60
NAV per share	6,26	Mkt cap (Rm)	1036
EV (Rm)	993	Price/Book (x)	1,21

Financial Year	2021	2022	2023F	2024F
Turnover (Rm)	442	619	665	693
EBITDA	124	250	276	261
EBIT	97	228	254	239
PAT	70	170	192	183
HEPS (cents)	47,1	126,8	138,1	132,0
Dividend (cents)	0,0	0,0	0,0	0,0
P/E ratio	9,1	5,3	3,1	3,2
EV/EBITDA	5,9	3,8	1,6	1,2
EBITDA margin (%)	28,1%	40,3%	41,5%	37,7%
EBIT margin (%)	22,0%	36,9%	38,1%	34,4%
ROCE (%)	11,5%	24,3%	21,0%	17,0%
ROE (%)	11,8%	24,6%	22,2%	17,5%



RESULTS COMMENTARY

Despite the supply chain issues experienced worldwide and remaining a major headache for both companies and consumers, Santova's focus on excellence generated commendable results.

- Revenue and net interest income for the group during the past six months increased by a strong 13.5% to R319.7m from R281.5m in the corresponding period.

- Operating profit showed promise, rising from R91.2m printed in H1FY22, to R146m in the current year, representing an increase of 60%. Operating profit margin for the period increased significantly to 45.7% (H1FY22: 32.4%).

- HEPS for the interim period rose by 62.4% to 78.1 cents (H1FY22: 48.1 cents). It should be noted that the Group repurchased and cancelled 1.5 million shares during the period, representing 1.1% of the issued shares. The average price paid for the shares in the open market was 733.65 cps. Removing the share buy-back effect, HEPS came in at 77.3 cents for the period.

- No dividend was declared during the reporting period which is in line with the previous period.

OUTLOOK FOR THE NEXT REPORTING PERIOD

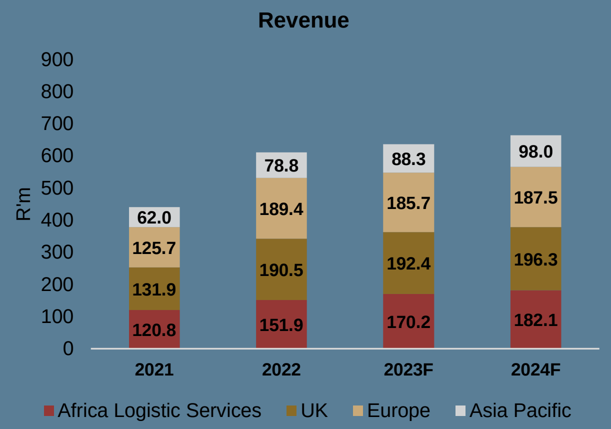
Santova took full advantage of the continued logistic delays and complexities caused by the global pandemic. Although lockdown restrictions have eased in most countries, new challenges caused disruptions for operations during the period. These disruptions arrived in the form of flooding in Durban and Sydney, while storm Eunice had severe adverse effects on sea and air ports in the United Kingdom. Another form of challenge that took place was labour disputes that erupted in major ports such as Felixstowe in the UK and the West Coast ports in the USA.

The shipping industry is well and alive, with 90% of goods transported worldwide being done so by shipping. Around 11 billion metric tons of goods were shipped globally in 2020 according to Statista. A single large container ship can carry more than 200 000 containers per year while the largest container ships can carry around 20 000 containers per load and are about 400 meters in length. China remains the best-connected shipping network according to data gathered for Q1 of 2021.

The congestion at ports worldwide added a layer of complexity to operations, but management's successful navigation through these challenges ensured a strong foundation is in place to take advantage of the situation. The importance of strategic supply chain partners was also highlighted as contribution to the Group's success during the reporting period. Strategic thinking and bespoke solutions made for a wonderful reading of Santova's interim results.

During the year, the operating environment continued to benefit from the implementation of technology which allowed operating margins to improve by 13.3% from 32.4% in H1FY22 to 45.7% during the current period. A decrease in administrative expenses also made a positive contribution to the increase in operating margins with a decrease of 2.5% from R178.6m to R174m during the current year. A commendable decrease considering the current inflationary environment the world is facing. Cash generated from operations during the period increased by R37.3m to R119.4m (H1FY23: R82.1m) while cash and cash equivalents rose to R339.5m (H1FY23: R227.7m), representing a 49% increase.

With the USA being a focus area for the group's expansion, Santova acquired A-Link Freight Inc, a Los Angeles based company that has been operating for over 20 years. The acquisition closed after the reporting period on 21 September 2022. 100% of the share capital was purchased for USD 2.35m and a warranted EBITDA of USD 1.2m for the 2-year period after the effective date of purchase, the second instalment of USD 705k is payable within 180 days of the effective date and the final payment of USD 1m is payable within 2 years of the effective date, subject to the warranty provision. The first instalment of USD 645k on the purchase price is payable on the effective date. With the Rand's continued volatility, the acquisition could just be the perfect opportunity to stabilise the earnings of the group in the future, eliminating some of the erratic movements in the local currency while also breaking into another region.

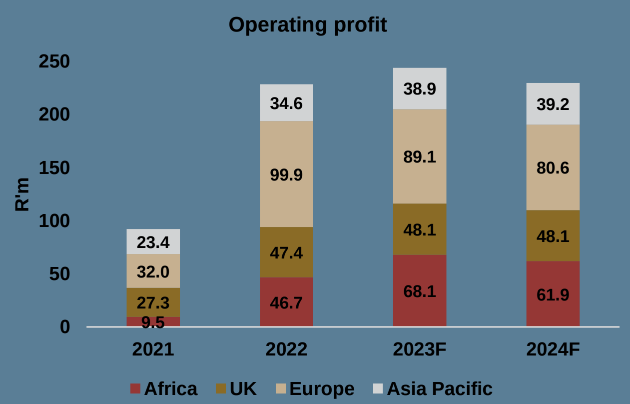


Shipping rates appear to be cooling off while the extreme backlog looks to be somewhat serviced. The Drewry World Container Index (USD per 40-foot container) is a common indicator used to measure shipping rates, and the change therein. A high of USD 9 700 was reported in January 2022, decreasing to USD 4 000 in September 2022. While the drop seems significant and probably is, it is still significantly high from pre-pandemic rates ranging between USD 1 300 and USD 1 600.

A subdued peak season which runs from August to early November is expected mainly due to large customers that already made bulk purchases earlier this year to ensure sufficient stock on hand to supply demand. This can be seen when looking at companies like Alviva for instance which increased its inventory by more than double. On the other hand, smaller customers previously priced out of the market with exuberant shipping costs are re-engaging at these lower prices. Consumer spending during the festive season will also have a major impact on further demand as consumers feel increased pressure from inflation and recession warning indicators.

Management's outlook for the next six months to 28 February 2023 year end is for the unpredictable and volatile trading environment to continue. Inflation pressure will continue to force the hand of central bankers to increase interest rates in an already consumer constrained environment. Shipping costs will likely not decrease further while the Ukraine-Russia war drags on. The war also creates a shortage in the trucker department in Europe and the UK while China's intermittent regional lockdowns will cause delays in manufacturing.

On a Group level, including all regions, we expect revenue for the Group to increase by 7.5% and reach R665m in FY23. We expect the second half of FY23 to be slower than the first six months mainly due to slower demand from consumers and thus lower order volumes. This trend is expected to continue well into FY24 with high levels of inflation, higher energy costs and increased interest rates by central banks. For this reason, we expect revenue to rise by a lower rate of 4.2% to R693m thanks to the addition of the newly acquired A-Link company. Operating profit for H1FY23 made a strong statement. We expect the second half of FY23 to be slightly slower as shipping volumes dry up and pricing power by shipping companies decrease. For FY23, we expect operating profit to increase by 11% to R253.7m and to decrease by 6% to R239m. The decrease in operating profit for FY24 is mainly due to operating profit margins decreasing closer to historical levels. We have considered the acquisition of A-Link in our forecast.



*The newly acquired USA segment has been excluded on the revenue, operating profit and operating profit margin charts and will be included once SNV includes the data in the report at year end.

REGIONAL PERFORMANCE

The Group has operations in **Africa**, **Europe**, **United Kingdom** and **Asia Pacific**.

Looking at the operations in **Africa**, basically represented by South Africa, operations have continued to strive being the provider of sophisticated solutions to global disruptions. The portfolio of customers has continued to grow in size and quality, which contributed to the 52.7% increase in revenue from R63.5m to R96.9m in the current period. Operating profit increased by 352% to R48.1m from R10.7m in H1FY22.

The growth in revenue is noteworthy considering the severe effect of the April 2022 floods and the damage it caused to the Durban infrastructure, the inefficiency with Transnet Port and rail operations. The SA shipping regions also seem to be less of a desirable destination as less shipping lines are available for secure capacity on major trade lanes. This could have a negative impact on prices when securing shipping capacity.

Airfreight activity has picked up during the past few months with volumes increasing by 81.8% to 2 thousand tonnes (H1FY22: 1.1 thousand tonnes). This resulted from customers who run just-in-time inventory models that require urgent stock due to delivery delays.

For the African region, we expect revenue to increase by 12% to R170.2m for FY23 and for the growth rate to slow slightly during FY24 by 7% to R182.1m. Operating profit for FY23 is expected to reach R68.1m, representing an increase of 45.7%, but to decrease by 9% in FY24 to R61.9m, largely due to the return of operating profit margins, decreasing closer to historical levels.

Europe has been the headline on many news platforms due to challenges ranging from significant increased energy costs to the continued conflict in the Ukraine. Although the Europe operations comprise of Netherlands and Germany, the two countries were negatively impacted by the events taking place in Europe.

Revenue decreased by 17.5% during the period from R94.2m in H1FY22 to R77.7m in the current reporting period. NPAT showed some resilience as it increased by 2.7% to R34.8m (H1FY22: R33.9m). The impact of the drop in revenue was partially offset by large forex gains on cash reserves held in USD and lower operating costs. The Netherland's revenue declined by 3.3% to R64.9m after H1FY22 saw a 69.4% increase in revenue over the preceding period of August 2020. The large jump in the previous period was due to more trade taking place through the Rotterdam port because of Brexit. Germany's revenue fell by 52.8% back to pre-pandemic levels. The significant drop came after a fixed term contract to facilitate Covid-19 supplies imports were concluded.

Although 69% of revenue is generated from the Netherlands, with the fixed term contract concluded in Germany, energy cost surging in Europe and the Ukraine conflict dragging on, we expect revenue for FY23 to decrease by 2% to R185.7m, before returning to growing moderately by 1% in FY24 to R187.5m. Operating profit is expected to decrease by 10.8% to R89.1m and a further 9.5% to R80.6m in FY24. The decrease is once again mainly due to a drop in operating profit margins.

On the **UK** front, past all the political turmoil, operations performed well with revenue increasing by 7.7% to R90.8m from R84.3m recorded in the previous period. NPAT made a strong rise of 25.6% to R19.9m (H1FY22: R15.8m), with Tradeway Shipping Ltd, operating in the niche market of exporting used goods to Africa and the Middle East, and SAI Logistics Ltd, who operates in the warehousing business focussed on the e-commerce environment, making meaningful contributions to the success in the UK operation.

W.M Shipping has had a muted 6-month period as some of the customers of the company trading down, specifically the consumer product customers and households. The slowdown in these goods is expected with inflation hitting record highs and the consumer becoming more constrained in the current economic climate.

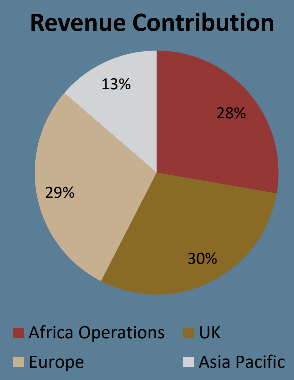
On the other end of operations, the region's airfreight business grew by 12.1%, supported by project work and tailored airfreight products offered to customers. This has in turn increased volumes of products to be shipped and allowed for improved buy-rates negotiating power from the airlines.

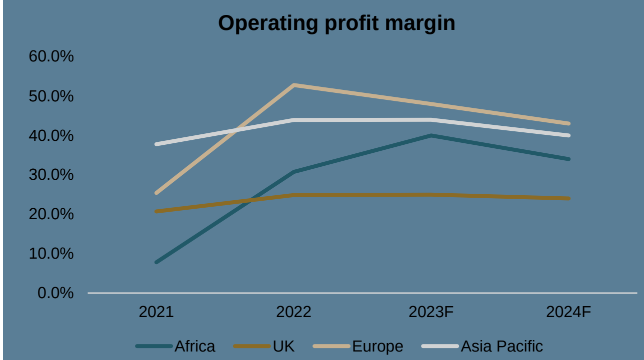
The UK region performed well considering the challenges faced. Revenue is expected to make a 100bps increase to R192.4m in FY23 and to further expand by 2% to R196.3m in FY24. Operating profit is expected to show resilience with a 1.6% increase to R48.1m while FY24 is expected to see a contraction of 2.1% to R47.1m.

Asia Pacific includes Australia, Hong Kong, Singapore, and Thailand. The region experienced strong growth with revenue increasing by 40.5% to R49.7m (H1FY22: R35.3m). The strong performance was primarily from Australia, which had significant growth from long-standing customers. Revenue from the Australian business grew by 58.2% to AUD 1.8m while NPAT climbed 136.1% to AUD 696.3k.

Singapore recovered well after experiencing a difficult trading environment in the prior period. Revenue from the region increased by 24% to SGD 1.3m and NPAT jumped by 319.6% to SGD 584.2k. The improved growth was due to management's focus on securing new clients and providing improved buy-rates.

The Asian Pacific region found its stride during the reporting period. Revenue growth of 12% is expected to reach R88.3m in FY23, while FY24 is expected to be another fruitful year with growth of 11% expected to R98m. Operating profit is expected to rise by 12.1% to R38.9m in FY23 and by a marginal 90bps to R39.2m in the following year. The slower growth rate in FY24 is mainly due to a contraction in operating profit margins.





TECHNICAL ANALYSIS

On a technical analysis basis, SNV has resistance to the upside of between R8 to R8.10 per share, while support is currently at R7.30 with a lower support level between R6.80 to R6.90. We have used a lookback period of 12 months on a daily timeframe.

COMPANY COMPARISON

When looking at a company comparison between Santova and Super Group, SNV's share price increased well over 50% during the past 12 months while SPG's share price is lower by more than 15% over the same period.

DCF Sensitivity Analysis

	Discount rate				
Growth rate	**18,8%**	**19,3%**	**19,8%**	**20,3%**	**20,8%**
0,0%	6,69	6,52	6,35	6,20	6,05
2,5%	7,41	7,19	6,99	6,79	6,61
3,5%	7,77	7,52	7,30	7,08	6,88
4,5%	8,17	7,90	**7,65**	7,41	7,19
5,5%	8,64	8,33	8,04	7,78	7,53
6,5%	9,18	8,83	8,50	8,20	7,92
7,5%	9,81	9,41	9,03	8,69	8,37

VALUATION

Santova is going from strength to strength with another impressive set of interim results. Performance from its offshore operations showed it's worth for the local company during the year and management would be looking to increase its footprint abroad with the new USA acquisition. The Group's streamlined technology-based operating model places it in an attractive position to increase market share and take advantage of the industry's opportunities despite global challenges. We believe that Santova will continue to drive organic growth with its globally diverse portfolio while looking for unique opportunities to expand operations in lucrative regions. Currently, the Group is trading at a ~20% premium to its NAV per share.

Our DCF and relative P/E valuations indicate that the share is currently **Fairly valued**.

With reference to the DCF sensitivity table, we have considered a 3-year forecasting period with cash flows forecast to FY25. Our DCF target price of **R7.65** was derived by utilising a discount rate of 19.8%[1] and a terminal growth rate of 4.5%.

With reference to the relative PE table, we have compared SNV to other logistics businesses in the industry. We have applied a discount of 35% to account for SNV's relatively smaller size. The implied PE of 4.65x places the share at a target price of **R7.30**.

P/E Calculation			
PEERS	**Price**	**Market Cap (R'm)**	**P/E ratio**
Frontier Transport Holdings Limited	4,82	1400	5,38
Super Group Limited	26,77	9148	7,16
OneLogix Group Limited	3,15	705	62,72
Median			**7,16**
			-32%
Santova Limited	7,60	1036	4,85
Discounts			
Company specific discount			5,0%
Size discount			30,0%
Discount applied to weighted P/E			**35,0%**
Adjusted P/E			**4,65**
Total Valuation for Santova Limited			
Adjusted P/E multiple			4,65
Sustainable earnings per share			1,57
P/E Value per share			**7,30**
Implied current gain/(loss)			**-3,99%**

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There are important disclaimers and disclosures which should be read carefully and completely at the end of this document

[1] The discount rate is based on the average implied discount rate obtained from cash flow forecasts for companies with market capitalisations ranging from R1bn to R2bn in our research universe.