SHRINKING JSE CALLS FOR SHAREHOLDER ACTIVISM

By Sam Sithole, Tapiwa Ngara and Michael Bennett

The demise in the number of listed companies on the Johannesburg Stock Exchange (JSE) has been well documented, and clearly articulated as a dangerous threat to the ability of domestic companies to rely on South African public equity markets as a credible option to raise capital, grow their businesses and realise value for investors.

This has far reaching implications for the South African economy, particularly as the pressure is most acute for small and mid-sized companies, which should be the engine room of domestic job creation. This is also a structural concern for domestic asset managers who face a fast-shrinking pool of investable options. At Value Capital Partners (VCP) we believe that shareholder activism can play an important role in stemming the shrinking of the JSE.

LOCAL JSE MARKET CONTEXT

According to JSE records, in 1998 there were 669 companies listed on the JSE. By 2013, this had dropped to 375, and during the past decade, the total number of listed companies has decreased further to 275.
Market commentator Paul Miller has recently commented at length on the various underlying structural reasons for the JSE shrinking, and rightly challenged the conventional wisdom that the costs of listing, regulatory framework and challenged economic outlook for SA are the singular causes of the delisting trend on the JSE.

He identified a much wider range of causal factors over the last 25 years, including changes to our domestic stockbroking model, liquidity mismatches, indexation, and investment size as contributing factors to the concentration of interest towards large counters on the JSE, and increasing lack of support for the listings of small and mid-cap companies. Furthermore, in the past year, the recently enacted changes to Regulation 28 of the Pension Funds Act allowing funds greater exposure to offshore assets have also had an impact on domestic asset allocation decisions.

Over the last decade the total market capitalisation of the JSE has increased 83% from R 9.0 trillion to R16.7 trillion. It is, however, crucial to note that the eight largest dual-listed companies on the JSE, namely BHP, AB InBev, Prosus, Richemont, British American Tobacco, Glencore, Anglo American and Naspers, have increased in their collective market capitalisation by nearly 136%. The remainder of the JSE Main Board, excluding these eight large dual-listed companies has decreased in market capitalisation by 9% over this period, while the average issuer market capitalisation has increased from R19.1 billion to R23.2 billion, demonstrating that the decrease in the total capitalisation is driven largely by delistings.

Stated bluntly, given this concerning delisting trend and the additional impact of the weakening Rand, the JSE is slowly losing global relevance. In 2013 the

JSE was the 14th largest listed exchange in the world by total market capitalisation globally, and the largest exchange in the developing world outside of China. It ranked ahead of countries such as Brazil, Taiwan and India and represented 1.7% of US dollar global exchange capitalisation. By 2023 the JSE's global significance has decreased substantially, slipping to 18th place globally, representing only 0.9% of total global exchange capitalisation.

Currently the total combined capitalisation of the JSE at $871 billion is less than 2% of the combined capitalisation of the NYSE and NASDAQ, and less than one third of the size of Apple Inc. alone, whose market capitalisation has increased nearly five-fold over the last decade to $2.7 trillion.

GLOBAL CONTEXT

Whilst stark in relative terms, the JSE is not alone as a shrinking public equity market. Over the last ten years the London Stock Exchange (LSE) has declined from 6% of total global capitalisation to less than 3% today. The total number of companies, excluding investment funds, listed on the FTSE100, FTSE 250, SmallCap and Fledgling indices has fallen by around a fifth in the last five years, from 511 to 412. While, similar to the JSE, the most damage has been seen in smaller companies outside of the large indices, major LSE listed companies such as Shell and British American Tobacco are also known to be exploring changing their primary listings to the US.

Conversely, even though the US has fewer listed companies today than it did 20 years ago, the recent trajectory is less concerning. Since the global financial crisis, the number of domestic listed companies in the US has been relatively stable ranging between 4100 and 4500. Furthermore, the number of foreign listed companies on US markets has increased over this period. At the same time, US equity markets have outperformed almost all major global indices largely driven by a boom in the technology sector.

CHEAP VALUATIONS DRIVING JSE DELISTINGS AND MARKET CONCENTRATION

Against this backdrop, unsurprisingly the JSE is screening cheaply relative to both historical data as well as global peers. On a Price/Earnings basis, the JSE is currently trading on a median LTM multiple of 7.9x, the lowest multiple in the last 10 years, well below the local 10 year average of 11.7x, as well as below current Trailing P/E levels for comparable international markets.

The cheap valuations at which the JSE listed companies trade make them attractive as delisting targets. Analysing JSE market data and corporate announcements related to notable JSE delisting over the last three years for companies with a market capitalisation in excess of R500m prior to the announcement, demonstrates that take-privates by strategic acquirers, both domestic and international, have been the most prevalent causes of JSE delistings since 2020.

Overall, similar to the LSE, the JSE delisting trend has disproportionately impacted small and mid-cap companies. For instance, in 2013 the 40 largest companies on the JSE by market capitalisation represented 83% of the total exchange capitalisation, by 2023 this has increased to 92%. In 2013, the largest dual listed companies comprised 44% of the total JSE market capitalisation, by 2023 this had increased to 67%.

This increasing concentration has compounding effects. Given that the majority of the large local long-only asset managers are either tracking funds or benchmark conscious, their investment strategies are increasingly tilting towards larger companies which are eligible for index inclusion, and therefore more liquid. This has resulted in further relative out performance of the top end of the market spectrum but lower liquidity and weaking valuations for small and mid-cap companies.

A CALL FOR CONSTRUCTIVE SHAREHOLDER ACTIVISM

So what role, if any, can domestic fund managers play in stemming the tide?

Ultimately all stakeholders in our equity capital markets have a role to play in supporting domestic issuers to raise capital and grow the pool of investable options. In South Africa and abroad many interventions have been debated, including further deregulation, changes in capital gains tax (CGT) and other tax legislation and creating other incentives for pension funds and retail investors to invest into smaller listed equities and companies listed on junior stock exchanges.

As a fund manager primarily active in the mid-cap space, VCP strongly believes in the role of constructive shareholder activism as an important ingredient in stemming delistings of companies from the JSE or ensuring delistings realise fair value for public market investors.

VCP deploys the best of private equity principles in the listed space, by acquiring sizeable minority stakes in listed businesses that have an attractive business model but are trading significantly below intrinsic value. As an engaged shareholder, we deploy our directors on the boards of portfolio companies, and work closely with the investee companies' boards, management teams and other stakeholders to unlock value.

We are committed to the long-term success of our portfolio companies and have an established track record of supporting our portfolio companies at critical junctures to ensure their long-term sustainability.

Since inception, key milestones in our portfolio have included partnering with the founding family and key shareholders of Altron to recapitalise the business in 2017, and the subsequent unbundling of Bytes Technology Group plc in 2020 as a separately, dual JSE-LSE listed company, realising significant returns for Altron investors. We have also played a catalytic role in redressing the previously challenged capital structures of PPC and Sun International, two iconic South African companies, and remain committed on the path to unlocking further value for all stakeholders.

Furthermore, we support all our portfolio companies to adopt best-in-class Investor Relations practices. In VCP's recently published Investor Relations thought leadership publication, we highlight that Investor Relations is an essential yet often overlooked discipline in many JSE-listed companies. It plays a crucial role in bridging the information gap between a company and current or potential investors, especially in helping small and mid-cap companies overcome their low visibility to attract a wider following by investors and improve their market valuation.

We welcome the growth of constructive shareholder activism across the JSE, and are proud to have worked with other key domestic asset managers in supporting public companies at critical inflection points in their histories to advance their sustainability as JSE listed businesses.

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Note: Data on which the analysis is presented has been sourced directly from the JSE, with global exchange data sourced from S&P Capital IQ, presented as at 31/10/2023. For the purpose of this analysis, we have considered all primary and secondary listed, active, ordinary shares listed on both the Main Board and the AltX, however including Richemont (Depository Receipts) and Naspers (Class N shares) due to the prominence of these companies to the local exchange. Instruments such as listed preference shares and debentures were specifically excluded from the scope of our analysis. Quoted P/E Multiples are based on system generated data which has not been independently verified by VCP. Median multiples are calculated across the entire exchange, equally weighted.

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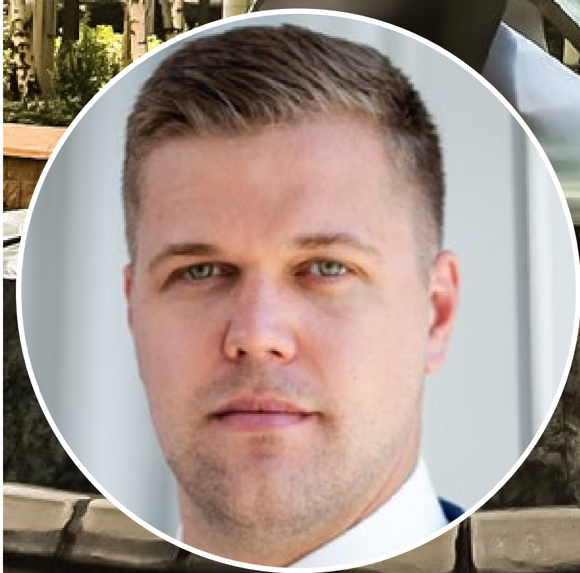

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