

CAMmunique

CADIZ ASSET MANAGEMENT INVESTMENT UPDATE



MARCH 2020

CORONAVIRUS

A look-through approach to the Global Risk

PROVIDING PERSPECTIVE IN A TIME OF MARKET RISK AND CONCERN

As at 16 March 2020 globally there are currently 173,285 confirmed cases with 6,668 deaths from the COVID-19 outbreak. The number of recovered/discharged cases stands at 77,789, with only about 7% (5,937) of all active cases seen as serious or critical.

If we compare this to the SARS virus of 2003, there were 8,096 confirmed cases with a fatality rate of 9.6%, compared to the fatality rate of COVID-19 of 3.5%, (which is an inflated statistic due to the significant number of cases that are not reported and in which the patient recovers), this means that COVID-19 is more infectious, but significantly less fatal than SARS.

Moreover, the age and health profile of COVID-19 mortality rates is skewed due to the death rate being as high as 14% for people over the age of 80 years and patients with pre-existing medical conditions like cardiovascular disease or diabetes.

WHAT DOES THE COVID-19 OUTBREAK MEAN FOR THE WORLD ECONOMY?

Global economic activity will be impacted by a slowdown in manufacturing which is caused by the closure of factories and workers being absent, as authorities attempt to curb the spread of the virus. With the supply-side of global economy under pressure, the demand-side will also naturally decline due to less travel and tourism. We have already seen sporting events either cancelled or played in closed stadiums with the Bahrain F1 Grand Prix to take place behind closed doors, along with a slowdown in retail activity.

The virus outbreak has also created a fall in global risk appetite as investors move from riskier assets, like equities, into perceived safe havens such as US government bonds, as they attempt to understand the likely impact on company profits in the coming quarters. This has led to a sentiment-driven decline in the world stock markets due to an overreaction in selling. This, however, creates an opportunity for long-term investors to acquire quality companies at fundamentally attractive valuations.

Encouragingly, policy makers have shown a willingness to create further liquidity and provide monetary policy stimulus in the form of interest rate cuts from the US Federal Reserve as well as other central banks around the world. The G20 group of leading economic nations have indicated they are willing to use appropriate measures to support the global economy.

At the same time, oil prices have plummeted to around \$35 a barrel. This selloff follows the news that Saudi Arabia is set to increase production next month as talks between OPEC and Russia to cut oil production, to support the oil price, breakdown. In the medium term, however, a fall in oil prices due to increased supply could be positive for the global economy as this acts as fiscal stimulus for consumers and lowers inflation expectations for central banks.

Nonetheless, in the short-term, the lower oil price has an impact on certain sectors of the economy and will add additional pressure to credit markets. Both of these we will watch closely.



WHAT SHOULD INVESTORS DO?

At present, there is significant concern around world markets regarding the effects the COVID-19 virus will have on global growth. In times like this, market sentiment often runs ahead of fundamentals, exposing investors to unnecessary downside risk.

It is our job to identify which opportunities look attractive, versus which opportunities are attractive. Getting these calls right and staying the course will benefit all of our clients.

Markets have endured a dramatic reassessment of valuations in recent weeks with the fall in both equity prices and bond yields, and while we anticipate that this may continue for some time, we believe that trying to time the market during these volatile times is near impossible.

Our advice to our clients during times like this is to stay calm, ride out the turbulence and markets will correct themselves.

By Adrian Meager | CIO and MD, Cadiz Asset Management

MultiChoice

Enriching lives through entertainment

WHY WE LIKE MULTICHOICE?

With a 30-year track record, MultiChoice Group is one of the fastest growing pay-TV broadcast providers globally. The company's leading local and international sports content has proven to offer a strong competitive advantage. In addition to globally procured content, the business produces locally tailored entertainment to meet their differing customer needs. MultiChoice is a high fixed cost business with a large subscriber base which benefits from economies of scale as more subscribers are added.

WORLD CLASS INFRASTRUCTURE WITH MULTIPLE VIEWING PLATFORMS FOR CUSTOMERS

Providing entertainment to approximately 14 million households across 50 countries in Africa, MultiChoice Group is Africa's leading entertainment company. With world-class technology and well-invested infrastructure, the Group delivers entertainment through Direct-To-Home (DTH), Digital-Terrestrial-Television (DTT) and online video entertainment services. MultiChoice offers a mixture of scheduled television, on-demand features and movie rental services. Dependent on location and product package, viewers can watch local and international content through the DStv, GOtv, BoxOffice, Showmax and DStv Now platforms, however an internet connection is needed to access DStv Now and Showmax.

SOUTH AFRICAN BUSINESS IS HIGHLY CASH GENERATIVE, WHILE AFRICA PRESENTS GROWTH OPPORTUNITIES

The South African segment has entered the mature stage of its lifecycle and has established a strong subscriber base that generates strong free cash flow for the business. Despite the challenging economic environment, this segment has performed well. Disposable income of SA consumers has been under considerable pressure and as a result, some consumers have moved to lower cost subscription packages. Management have and will continue to focus on cost-savings initiatives to ensure margins remain stable in this highly profitable market.

The rest of Africa continues to offer a substantial market opportunity for the MultiChoice Group, with approximately 16 million addressable households. Pay-tv penetration in Africa is significantly lower than that of other emerging and developing countries. As the population grows and the availability to electricity and technological services increases, their footprint in the African market will increase. With MultiChoice already investing significant capital to ensure that they are able to provide pay-tv services to this market, Africa could well become a profitable business as they gain scale by attracting new customers.

SUPERSPORT A KEY ADVANTAGE

Consumer appetite is an important factor to consider when determining the sustainability of a business. The SuperSport business model works for the business as sports-mad South Africans aren't willing to give up their sports viewing and MultiChoice holds exclusivity rights to many major international and local sporting events. Hence, consumers who highly value watching live sports in their homes are likely to remain loyal MultiChoice customers for the time being.

WHAT DOES NEW COMPETITION MEAN FOR THE PAY-TV INDUSTRY?

Although competition from global companies such as Netflix, Amazon Prime and Apple TV+ has increased, the biggest question is whether DStv customers will substitute one product for the other. This is generally determined by the closeness of the competition. MultiChoice has rights to a significant portion of content (exclusive contracts, locally produced scripted and sports) that on-demand media entertainment services like Netflix do not have access to.

Access to broadband internet at an affordable price is also a barrier for competing on-demand services. With an under-developed pay-TV market and very little access to broadband internet in Africa, MultiChoice's satellite subscription and digital terrestrial television infrastructure remains a strong competitive advantage.

INVESTMENT CASE FOR MULTICHOICE

In terms of the Cadiz investment philosophy, we look for quality businesses with low financial risk and capable management, which are trading at an attractive price. MultiChoice has an ungeared balance sheet and generates strong free cash flow. The South African segment is above average quality, with a history of consistently earning return on capital greater than its cost of capital. Although the rest of Africa operations is yet to report a trading profit, this operation is expected to break even in the medium term. Due to the high fixed cost nature of the business, as the number of subscribers increase so should its economy of scale advantage, therefore allowing the African operation to earn a superior return on invested capital.

MultiChoice is a high-quality business with a solid balance sheet that we believe is attractively priced compared to what we believe the business is worth. This discount offers investors the opportunity to generate above market returns over the long-term with low risk of permanent capital loss. We look forward to not only being entertained by great content, but also enjoy a superior return on this investment.

by Kirsten Campbell