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For Your Perusal

Highlighting Interesting Investment Research

Defending Against Eskom and Wealth Shedding

It has been 22 years since Eskom was awarded the prestigious Power Company of the Year in the Financial Times' annual Global Energy Awards. This award was for technical excellence in plant production, maintenance and operation while producing some of the cheapest electricity on the planet. Eskom has gone from being a significant structural tailwind for the South African economy to a considerable hindrance.

Load-shedding is undoubtedly a firm handbrake on the economy. The recent trading updates from Mr Price, Woolworths and TFG highlight the impact of load-shedding on the retailers' operations, with not all stores having backup power to allow for continued trading. The ability to continue to trade also comes at a hefty cost, illustrated by Shoprite having to spend R500m on diesel. Astral has also provided a dire update, with load-shedding being the primary culprit, placing upward pressure on costs and the price of chicken. The mining industry, which has carried the South African economy over the past few years, is also suffering from the interrupted electricity supply, which constrains production. Not a single industry is immune to the plight of load-shedding. Foreign investors are concerned about the impact of load-shedding on economic growth and, consequently, have been net sellers of South African shares for the last eight years.

Whether being impacted directly by not being able to operate a business or through second-order effects like inflation, the impact of load-shedding is devastating. South Africa will likely experience another 18 months of level 4-6 load-shedding as 5 out of 12 of our new power generating units are out of commission and undergoing repairs. Investors cannot ignore this and need to position investment portfolios to protect against Eskom and grow their investments at a reasonable rate to protect their long-term purchasing power.

Fortunately, the breadth of the investment options available to South African investors provides the flexibility to protect investment portfolios from Eskom's woes.

Source: Independent Securities Research

Direct offshore investment

The best way to protect a portfolio is to move capital directly from South Africa to an offshore investment account where the capital can be invested in various global investments, including shares, bonds and real estate. Investors will need to use their single discretionary allowance or foreign investment allowance to move funds abroad.

Global ETFs via the JSE

While JSE listed offshore focused exchange-traded funds (ETFs) may not be the most optimal route for all investors, there are many offshore focused ETFs that investors can easily buy using rands in local accounts. These ETFs provide foreign exposure to various developed and emerging global markets. Furthermore, investments into global sectors such as technology, healthcare and real estate, as well as themes like ESG and infrastructure, are easily accessible via a JSE stockbroking account.

Global single-stock ETNs via the JSE

Investing indirectly into foreign-denominated instruments can also be achieved on the JSE via exchange-traded notes (ETNs). A variety of globally focused ETNs provide investors with exposure to the price movement of a handful of mega capitalisation shares that are listed on the US stock market. Exposure to companies like Apple, Amazon, Coke, Netflix, Berkshire, Tesla and Visa can all be obtained via these JSE-listed ETNs.

Rand Hedges

Investing in rand hedge shares listed on the JSE is also an option available to investors. Investing in companies that derive most, if not all, of their revenue and earnings from global operations is an effective and constructive method to build global wealth within South Africa. A well-diversified portfolio of quality stocks can be constructed within the rand hedge theme. Companies that stand out are global tobacco giant British American Tobacco (BTI), which has a low P/E and a high dividend yield, while luxury goods maker Richemont (CFR) continues to see growth, selling primarily across Asia and Europe. (The P/E ratio provides an indication of the valuation of a company and for context the long-term average of the JSE is around 15x. A lower P/E ratio is generally considered better.) Within the food services sector, Bidcorp (BID) operates in over 20 countries and continues to provide long-term stable growth. Technology giant Prosus (PRX) derives most of its value from high-growth investee companies in emerging markets, particularly China. These companies will have their idiosyncratic risks, but Eskom is not one of them. There are also several good options to invest in property companies that are listed on the JSE yet only own properties in Europe. These include Sirius (SRE), Mas Plc (MSP) and NEPI Rockcastle (NRP). Each of these companies boasts an attractive dividend yield in prime currencies without their properties being subjected to load-shedding.

Power plays via the JSE

The means to protect an investment portfolio, as illustrated thus far, are all defensive plays which avoid load-shedding risks. There are, however, offensive options where investments can be made in companies that will benefit from load-shedding. There is a limited selection in this case, but there are companies who are benefiting by solving the energy shortage problem. Reunert (RLO) is one of the few listed companies in South Africa with products and services that will enjoy increased demand due to Eskom's inability to provide stable electricity. Reunert provides end-to-end renewable energy and storage solutions for households and commercial customers through different divisions within its applied electronics segment. Reunert has a compelling investment proposition as it benefits from both load-shedding and the structural push into renewable energy.

South African Banks

In what may be a counterintuitive investment opportunity given the broad economic headwinds, South African banks benefit from the increasing investment and financing requirements from corporates, industry and individuals looking to move off the Eskom grid. Nedbank (NED) is a good example and has issued renewable energy bonds where the proceeds from the bonds are used to help finance solar and wind projects. The bank is also actively providing loans to large industrial companies that are self-generating or supplementing their electricity needs with renewable energy. South African households can also access loans to purchase and install solar power.

Given the six options provided above, hope is certainly not lost in the face of the Eskom calamity, and investors have many viable options to protect their investment portfolios from wealth shedding.

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