Publication: Finweek (English)
Date: 27 Oct 2016
Page: 24

marketplace pro pick

By Dr Andrew Dittberner

CMH

A misunderstood opportunity

Combined Motor Holdings suffers from the market misconception that its business is directly correlated to the economic environment, and new vehicle sales in particular.

Possibly one of the most misunderstood shares on the market, Combined Motor Holdings (CMH) presents an exceptional opportunity at current levels. While the company operates at the sharp end of the economy, there is a misconception that this business is directly correlated to the economic environment, and new vehicle sales in particular.

While CMS is largely thought of as a motor vehicle retailer, it is important to realise that motor dealerships derive a large portion of their incomes from aftermarket servicing, as well as used vehicle sales, as opposed with just new vehicle sales. As such, recent new vehicle sales numbers should not be seen as a leading indicator for CMH's earnings. Evidence of this can be seen in the company's recently released trading update indicating that for the six months ending August, headline earnings per share (HEPS) is expected to be up between 15% and 25%. Those numbers are a far cry from Naamsa's recently published new vehicle sales, which show a sharp decline.

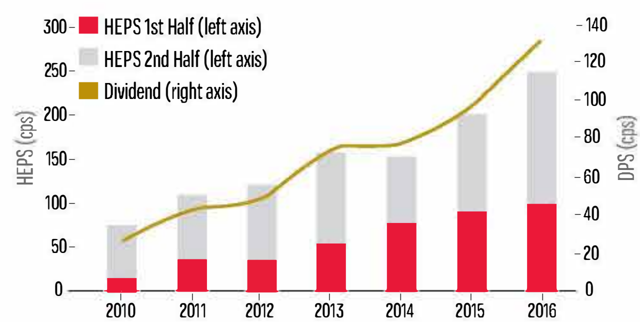
Alongside the dealerships, CMH also owns First Car Rental, a proudly South African car rental company that has been in business for over 17 years. First Car Rental has delivered excellent performance over a number of years, with earnings having enjoyed an average annual compounded growth rate of 28% since 2008. Unsurprisingly, First Car Rental contributed 24% of group operating profits at the 2016 full-year results, released earlier this year. The business proposition of owning First Car Rental is enhanced by the group's ability to sell new vehicles to First Car Rental, as well as selling its used vehicles.

Considering that the purchase price at the beginning of 2010 was R7.95, investors have received their original investment back in the form of dividends and share buybacks.

On the vehicle distribution front, 68% of group operating profit came from this division. Within that, typically 40% comes from parts and servicing, while 35% reflects new vehicle sales and 23% is from used vehicle sales. Thus new vehicle sales typically account for only 24% of group operating profit. The final leg of the business involves financial services, which assist buyers with financing their purchases.

The current economic environment is conducive to vehicle owners either trading down top-end vehicles to purchase more affordable models, or alternatively purchasing used vehicles. As such, used vehicle volumes tend to be counter-cyclical. Evidence of this can be seen from the fourth-quarter volumes in the last financial year, where used vehicle volumes were up 21.3% compared to the same period the previous year. Given the shortage of quality used vehicles in the country at the moment, this trend is expected to continue in the current financial year.

CMH EARNINGS AND DIVIDEND PER SHARE SINCE 2010



From an investment perspective, CMH is a fantastic long-term option. Looking at recent history, since 2010 HEPS have risen at a compounded average annual rate of 22%, complemented by a five-year average return on shareholder's equity of 27.9%. The earnings, which are also of a high quality, are backed by cash flows.

Over this five-year period, the company has repurchased an effective 33.5% of total outstanding shares, while paying R4.95 in dividends back to shareholders. Considering that the purchase price at the beginning of 2010 was R7.95, investors have received their original investment back in the form of dividends and share buybacks.

In 2010 CMH traded on a price-to-earnings ratio (P/E) of 14 times with a dividend yield of 2.4%. Today, I would argue that CMH is far more attractively priced than it was five years ago. Admittedly, the business is highly working-capital intensive; however, the long-term debt is negligible, and cash on hand is R500m, which is substantial for a R1.3bn market capitalisation business. Trading on a P/E of 6.6 times and a dividend yield of 6.8%, if history rhymes, investors will be handsomely rewarded. ■

editorial@finweek.co.za

Dr Andrew Dittberner is chief investment officer of Cannon Asset Managers.