

Rudi van Niekerk on Intelligent Investing in Crisis Mode: A South African Perspective

Rudi van Niekerk of Desert Lion Capital shared his perspective in an interview for our special event, Intelligent Investing in Crisis Mode 2020.

MOI Global: How do you assess the current situation in South Africa?

Rudi van Niekerk: The South African economy has been in low-growth, muddle-through mode for quite some time now. This is mostly the result of several years of bad policy formulation, government incompetence when it comes to execution, and corruption.

Since Ramaphosa became president in 2018, we've witnessed an extensive and determined effort to expose corruption and rebuild the capacity of the state. Until we see major prosecutions and clear evidence of structural economic reforms, confidence globally and locally towards South Africa will remain low. As a consequence, we are seeing extreme dislocations in the market.

In times of panic, sentiment becomes systemic and correlations tend toward one. The South African market has been hammered by the global selloff. Listed equities, especially in the small- and mid-cap space are trading at multi-decade lows. Never before in my investing career have I witnessed such extreme mispricing in some stocks. [\[more\]](#)

MOI: What is your longer-term view of the opportunity in South Africa?

van Niekerk: South Africa has a lot going for it in the longer run. Generally, infrastructure is excellent for a developing economy. We have a fiercely independent judiciary, and we are going to see some prominent figures donning orange overalls soon.

Ramaphosa is an economically literate politician and his reforms are aimed at growing the economy. He is slowly growing and consolidating his support, meaning he'll have more room to be more decisive in driving structural reforms. We will see massive investment in electricity generation over the next few years. Interest rates are comparably high (risk free rate of around 6.5%) and inflation is under control (around 4%) - there is room for stimulus.

The demographic opportunity in South Africa and the rest of Africa is genuine. With its sophisticated financial services sector and good infrastructure, South Africa is well-positioned to benefit from the longer-term Africa growth story. The base is so low, that any turn in the tide will see massive growth.

Our recent investor trip in South Africa highlighted just how world-class the quality of management and companies in our opportunity set are. My medium- to longer-term view of the opportunity in South Africa is one of conviction, patience, massive volatility, and massive returns.

MOI: Where do you see the largest dislocations right now?

van Niekerk: There are dislocations all around the globe. In South Africa the whole market is cheap, but that doesn't mean that there won't be casualties. So we need to navigate the landscape with some local knowledge. The richest opportunities are in the small- and mid-cap space.

MOI: Would you share your thesis on one or two ideas you find particularly compelling?

van Niekerk: I don't want to give away our whole portfolio but let's touch on two examples:

Balwin Properties (South Africa: BWN) is the largest listed homebuilder in South Africa. Recently they launched their second development sporting the "Crystal Lagoons" concept and they did 25% of annual revenue in just four days of sales. There is a large backlog of middle-income housing in South Africa. The space is tough, but Balwin is managing to stay profitable, generating lower-end of the cycle ROEs of about 17%.

The shares are trading at 3x after-tax earnings and a ~50% discount to book. Sales are running at about 2,700 units per year, but their capacity is 5,000 units per year without significant additional overhead. The conservative base case is that Balwin will generate earnings of R1.50 per share sometime over the next four years. Apply a conservative P/E of 8x and we get R12 per share, which is 4x and a 45% compounded return over four years. [[related](#)]

Another idea is Stadio Holdings (South Africa: SDO). The company is entering the for-profit higher education space in South Africa (college/university), which is massively undersupplied. The management team of Stadio has a long track record of overdelivering on its forecasts. They exceeded the forecasts published in the pre-listing documents for the first three years. Their model and the market opportunity have been proven.

The base case is for Stadio to grow after-tax earnings, albeit from a low early-stage base, at 29% per annum to R500 million in 2026. This is conservative as it is based on 56,000 students by 2026, while Stadio will already have capacity for 100,000 students at that time. The delivery split will be 20% on-campus contact learning and 80% distance learning. Stadio is a disruptive insurgent and will grow rapidly thanks to huge unfulfilled demand, application of best-in-industry technology, no legacy heavy asset base and overheads, and qualifications that are keeping with the times and preparing students for "the world of work".

Stadio shares trade at 55% price-to-book and 7x after-tax free cash flow to equityholders. Remember, this is based on early-stage earnings and severely understates the earning power and growth potential of the business. The balance sheet is basically unlevered. Our conservative base case is to generate a seven-year compound return of 30-35% on Stadio from current levels.

MOI: How do you think about downside protection in a market crisis?

van Niekerk: I only think about the robustness of the businesses we invest in. Markets are going to do what markets are going to do. Especially in emerging markets, you have to understand that you are signing up for higher volatility. If our underlying companies have conservative leverage, are well-managed, and are able to continue being profitable in tough times, then our downside is protected in the long run, regardless of what prices do in the short run.

MOI: How do you spend your time these days?

van Niekerk: I spend more time on meditative walks in nature, without any distractions (no cell phone, music, or podcasts – just silence). I spend less time watching market movements and prices. For the rest, I just do what I always do. Read books. Analyze companies. Reflect and think.

MOI: What does it mean to be a great investor?

van Niekerk: I [detailed](#) my thoughts on this topic in our Q4 2019 letter. The TLDR is: alignment of interests with co-investors; have a well-defined circle of competence and focus; fish in unfished

waters; do the work; be willing to be contrarian as long you know your view is informed; temperament; patience; consistency; humility; constant growth and evolution. If you do this persistently and reliably your whole life, it is highly probable that life will reward your endeavors as investor.

MOI: Rudi, thank you very much for these timely as well as timeless insights.

About the instructor:

Rudi van Niekerk manages the Desert Lion Capital Fund. He is a South African citizen and resides in Cape Town. Desert Lion Capital specializes in small- and mid-cap opportunities in overlooked segments of the South African listed equities market. The investment strategy is opportunistic and follows a fundamental, value-oriented approach. The fund is US domiciled and formed specifically to serve US and other international investors. Rudi is also the manager of Guscora Investments, a permanent capital vehicle incorporated for South African investors with a similar investment approach. Previously he founded and managed Magnum Opus, an investment partnership for mostly family and friends which delivered impressive returns during its lifetime. He has extensive experience in private equity and still serves on the boards of some unlisted companies. Rudi holds a Bachelor of Commerce and MBA degrees from the University of Stellenbosch and is a CFA Charterholder.

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