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Mastering a plastics business

When two private equity funds agreed to pay an additional 10% to buy out shareholders of a small South African plastics manufacturer, it was a win for Prudential's clients and active engagement approach.

On 30 November 2018 came the announcement on the Stock Exchange News Service: Private equity funds Metier Capital Growth Fund II Partnership and MCGF II Investments had agreed to pay an additional 10%, or 220 cents instead of 200 cents per share, to buy out shareholders of Master Plastics, a small South African plastics manufacturer. While this may not appear to be much of an increase, it represented an extra R21 million for all shareholders, including Prudential's clients. This was the result of the efforts by Prudential to obtain what we thought was a fairer price than the R200 million that had originally been offered. It was also a case, one of several in 2018, where we were successful in adding value to our clients' portfolios through active engagement.

Astrapak to master plastics

We were one of Master Plastics' largest shareholders, with a 15% stake, after having invested in Astrapak a few years earlier. At the

time Astrapak, one of the country's largest plastic-producing conglomerates, had just completed a right-sizing initiative, cutting costs and selling off some of its poorer-quality businesses, as well as paying down its considerable debt to nearly zero.

However, its share price had not reflected these substantial improvements and the stock market appeared to have given up on the company after many years of disappointment. We saw the potential at Astrapak and started to accumulate the shares, which were trading at less than half their book value, for our clients.

Then in an effort to realise value for shareholders, in early 2017 Astrapak sold the majority of its operations to a major UK-listed plastics group RPC Group plc for R1.37 billion in cash, representing a 25% premium to book value. This represented a substantial gain in a fairly short period of time. The three small remaining operations of Astrapak were consolidated into the new Master Plastics group, which listed on the JSE's Alternative Exchange (AltX) in May 2017. Astrapak shareholders, including Prudential's clients, received Master Plastics shares from the unbundling.

Cheap valuation for high quality assets

Instead of just selling these Master Plastics shares which had now become a fairly small investment, Prudential started to buy more. From the outset of trading, Master Plastics shares traded at what we again considered very cheap levels of around half of their book value. We tend to find that the stock market undervalues smaller companies when they result from the unbundling of large conglomerate companies into much smaller entities: investors simply overlook the value of the assets remaining because they consider them to be too small and not worth the effort to value, resulting in them selling the shares without understanding what they are worth. At Prudential, however, we are committed to the in-depth analysis required to understand the value of a company, and then we compare this value to the market price. Trading the shares of a company without putting in the effort to understand what a company is worth is a sure-fire way to the poor house!

Our analysis of Master Plastics concluded that two of its three businesses were very high-quality assets which had already invested significant capital for their future expansion and had strong

growth prospects ahead. As a result of this and its attractive valuation, we were confident to buy more shares in Master Plastics.

One of the operations within Master Plastics, Plusnet-Geotex (Geotex), particularly stood out for its rapid growth potential. In fact, it was partly based on our analysis of this business that we believed the 200 cents per share offer from the private equity funds considerably undervalued Master Plastics. Existing shareholders had paid for the recent substantial expansion of its manufacturing capacity, but would not reap the rewards of the likely substantial increase in sales as a result... we felt higher compensation was warranted.

With the Master Plastics share price trading around 140 cents at the time of the buyout offer, the prospect of an almost 50% premium appeared very compelling to many other shareholders. Some 58% of shareholders supported the initial offer, but more than half of this amount included Master Plastics' largest shareholders, the Lereko Metier Capital Growth Fund (LMCGF) Trust and the LMCGF Parallel Trust 1 (which together held 32.5% of the shares). Although technically these are different investment entities to the bidders, they are all private equity funds managed or advised by the broader Metier group.

As journalist Marc Hassenfuss commented in the Financial Mail: "Broadly speaking – and in the spirit of protecting minority shareholder rights – it's very difficult to view these entities as anything but related parties. If the Metier entities were seen as related parties, the LMCGF's trusts would not be allowed to vote. That would change things dramatically."

Actively adding value

At Prudential we also questioned the appropriateness of certain aspects of the offer and shareholder vote, and disagreed with the offer price, believing that even the 50% premium did not represent what the company was truly worth. After much investigation and negotiating, we agreed an additional 20 cents per share with the private equity funds, ultimately benefitting all Master Plastics' shareholders.

The concept of value is at the core of how we think about investing: very often a company's share price can deviate materially from

what it is actually worth, and investing is all about determining what a company is worth and comparing that to where its share price is trading on the market. If you can't determine what a company is worth, your odds of succeeding in the market are no better than going to a casino.

Our investments in Astrapak and Master Plastics are examples of how we actively and consistently try to add value to our clients' investments, no matter the size.

For the full article, please see [Consider this Q1 2019](#).

If you need more information please feel free to contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za