

# Walking *Giants*

by Paul Bosman

TJ Strydom titled his recent publication on the history of Capitec Bank '*Stalking Giants*'. This is with reference to the tiny start-up operating among SA's very large established banks.

Our funds have held large positions in Capitec for a long time, but over the last six months we increased exposure to two of its bigger peers. Our aggregate exposure to Nedbank and Standard Bank went from 4.5% in the Granate BCI Balanced Fund and 4.4% in the Granate BCI Flexible Fund to 9.1% and 8.4% respectively.

## Giants on the move

We believe these giants can make for good investments when they walk – and very good investments when they trot. Their pace is tied to the level of economic activity in South Africa. This is especially true for Nedbank, which generates almost all its profit in the local market.

In the decade between 2003 and 2013, SA's real GDP expanded at a compound annual growth rate of 3.4%. Over this period, the total return from an investment in Standard Bank and Nedbank would have been 15.8% and 18.1% respectively. The next decade was far more challenging in SA, and we only managed compound annual GDP growth of 0.5%. Over this period, the return of Standard Bank was still a reasonable 10.6%. Nedbank delivered a lower 6.0% return, but still protected the value of your money in real terms. Making this more noteworthy is that Nedbank delivered this return despite a derating relative to book value from 1.6 times to 0.9 times.

If our economic growth accelerates over the next few years, these banks' profits should grow significantly, pulling their share prices much higher. If this is combined with an upward rerating of their share prices relative to book value – a likely outcome in a growth environment – these investments could generate very high returns.

## But what if the giants don't trot?

We will most probably still earn a good return, consisting of a dividend and inflationary growth. The current dividend yields on Standard Bank and Nedbank are 6.6% and 7.1% respectively. Adding inflation to this still achieves our funds' benchmarks.

Capitec will keep stalking these giants, whether they walk or trot. We think this whole party moves faster than inflation, but there is a reasonable chance it could move at multiples of inflation. Potential for a real party.

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