CONDUIT CAPITAL

The Financial Mail's biased and misleading narrative is poisoning investors

It's time to tackle attempts at tarnishing our reputation head on

The *Financial Mail* is one of South Africa's most respected and widely read financial magazines. As a young man, I would go to CNA early in the morning to pick up a copy of the magazine and devour it in an hour or two. Such was my thirst for information about South African shares and companies. I thought the quality of analysis and insight in the *FM*, at the time, was great.

I never thought I would one day feature in the *FM*. It was not something I thought possible when we started our investment company, straight out of university, with nothing. Through sheer determination, persistence, a willingness to work extremely hard and an ability to not be afraid of looking wrong when we were right, we built a business from R400,000 in AUM in 2011 to over R6 billion today. Our investments have built wealth for thousands of shareholders, created thousands of jobs, and helped CEO-entrepreneurs create value when few would support them.

Because we have done things differently it has for whatever reason been difficult for people to understand us.

I am disappointed to see what has become of the *FM.* Over the past four years, I and companies in which we have invested, have suffered from biased, incomplete, misunderstood and clearly narrative-driven drivel. This is not for a lack of trying; I have made myself open to the *FM's* journalists and met with many of them. None of my answers, contexts, explanations nor my open door, have been taken into account in their writings.

In particular, certain journalists in the *FM* are obsessed with our investment in Trustco Group Holdings. On 20 February, 2020, the *FM* is out with another (by my count, about 25% of this journalist's writings are smears against us) article that simply feeds on the narrative. Unfortunately, it seems a small cabal of trolls and people determined to tarnish us, for whatever reason (jealously, ego, spite come to mind), are clouding the judgement and analysis of the *FM*. This is highly unfortunate, disappointing and completely unfair to everyone associated with us and our companies.

The article (and all of its predecessors) are filled with innuendo, incomplete facts, carefully selected language, misrepresentation and bias. There appears to be an omission of fact and a lack of understanding at a basic level. Either this means the journalist is incompetent, or the article(s) is written to support a narrative, which brings into question the entire value and impartiality of the *FM*. I hope it's the former, and not the latter, but I have my doubts.

The article insinuates, without providing support, that the announced transaction between Trustco and Conduit is "starting to look worryingly convenient." How it is convenient, other to combine two insurance and investment companies into one, on an arm's length basis as approved by an Independent Board, is not clear.

It is correct that Trustco proposed acquiring Constantia for four times Conduit's market value. Should we as Conduit not accept this offer on the basis it is higher than the market price? Any decent value investor knows that market price and underlying value are two different things, and the ability to understand the difference a major source of outsized investment returns. We did not compound our capital by listening to naysayers when Finbond was 12 cents per share (now R2.45). The idea that price and value are one and the same is ludicrous, and the journalist knows this.

The article says the Namibian local property market is depressed – which it is. Namibia has been in recession for approximately 14 quarters. But the problem in Namibia has not been demand for land, it has been liquidity in the banking sector to fund bonds for property buyers and developers. If Trustco decreased property prices there would not be a flood of new buyers, because the problem isn't prices, its liquidity.

I can only hope the journalist understands that property developments are long-term. It takes years, sometimes decades, to completely develop a major residential or industrial estate. Conveniently, the journalist compares current year figures, when Trustco's biggest development is still at least five years away from breaking ground, to 25 year expectations of future revenues from all properties. This is a basic misalignment massaged to fit the narrative.

The journalist then ridiculously asserts that the transaction creates "accounting capital" rather than real capital. What is the difference? It is not explained. But by deduction any form of joint venture interest, financial instrument, property asset, or claim on asset can be "accounting capital" and not "real capital". Should Growthpoint remove the R116 billion of investment property assets it owns because it's not "real capital"? Do their R3.4 billion in accounting gains from fair value profits in their investment properties over the last two years (when South Africa was in a recession) not count as capital? Why is it different for Trustco?

Scrip funded deals have long been scrutinized in South Africa. There seems to be an aversion to scrip deals – deals that are not paid for 100% in cash. However, there is nothing wrong with scrip deals to acquire assets, and many of the biggest companies in South Africa have repeatedly used their shares for acquisitions. It is normal functioning of the equity market. The acquisition of an asset will always boost the asset base of the acquirer, regardless of whether it's paid in cash, debt or shares. This is a basic point that has nothing whatsoever to do with the fact that Constantia will now own a property development in Namibia that is independently valued by two experts. It's bizarre to assume that in order to create a "real" asset in your books, you have to pay cash.

It is factually inaccurate that the value is set by related parties. The transaction is subject to approval by both boards of directors, who are independently governed in terms of King IV, as well as the board of Constantia and the Prudential Authority. Furthermore, an Independent Board is required to opine on the fairness of the transaction. Finally, shareholders will have to vote on the transaction and the valuation, and we are specifically excluded from this vote. It is nefarious, to say the least, that the transaction terms are set by related parties, and therefore there is something sinister at play. The journalist has not asked any questions whatsoever of any of these overseers, because he will not get the answer he is looking for to support his narrative.

On the valuation of R2 billion for Constantia, it is normal for insurance companies to change hands around the value of their premium (assuming the risks are retained). Where insurance companies are profitable, the multiple to premium can be significant, and where they are not yet profitable, it is unusual to see a big discount to premium value. While we are not proud of the losses generated by Constantia, and we have taken concrete steps to right this ship, the journalist quotes an after tax loss of R582 million for the year to June 2019 – which is not correct – and conveniently fails to mention that R363 million of the loss was unrealized losses on equities – which means they have every chance of showing profits in the next reporting period. Other errors by the journalist: the 2018 valuation of LSH was R6 billion, not R6 million. Freudian slip?

The journalist hammers on the same tired points without any factual evidence, insinuating that some Trustco property assets are at a “heady valuation”, “without too much money actually changing hands.” Why does cash need to change hands in a transaction? Any half rational investor knows deals are done on cash, scrip and debt. The journalist further appears not to have inquired of the independent valuers how they arrived at the valuations, and has not done any analysis on the valuation metrics clearly disclosed on page 50 and 51 of the Annual Financial Statements. If he did, he could see the assumptions behind the valuations and note that the selling price assumed for Trustco land is below market and comparable parcels of land. It is not clear in any event that the journalist has any experience with property valuations in the first place.

The journalist also fundamentally misunderstands the loan from the family (or perhaps does understand it, but portrays it in a way that feeds the narrative). Only 388.4 million shares remained to be issued in terms of the Huso transaction. These shares were to be issued at R4.69 per share, with a share price now at R3.50. The family took a few steps back to take many more steps forward. Clearly this nuance has been missed, and probably on purpose.

Our own analysis indicates the mining operations of Trustco, which we have vigorously tested through independent miners and geological experts, exceeds R10 billion. For this, Trustco has paid the “huge price tag” of R3.6 billion. It is not clear that the journalist has any experience valuing diamond assets, except for touting Trans-Hex which is now in liquidation.

The independent Tellimer Report (https://view.tellimer.com/featured-research/namibian-triple-play-diamonds-demographics-and-development), which hasn’t received a single mention from the journalist, explains in great detail the assets of the company and their valuations. This is a sophisticated analysis – the *FM’s*, is not.

I believe I cannot stand by while the *FM* allows biased, narrative driven reporting to tarnish my reputation and incorrectly influence the public conversation. I recommend all inquisitive minds read the experts opinions, rather than rely on a small cabal with an agenda. I welcome an open debate with the *FM* on their articles in the interests of informing, rather than poisoning, their readership. And finally, I encourage all aspiring investors to ignore what other people say (including me), do your own work, reach your own conclusions, and *think* about what it means to invest in a great company for the long-term. The world would be a much wiser, wealthier and happier place if more people were able to think for themselves.

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