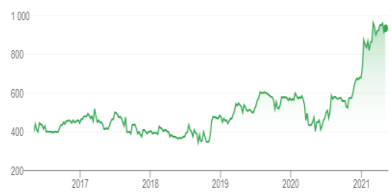
@SmallTalkDaily Research

May 6th 2021

Argent Industrial

Smashes trading update out of the park : upgrade my target value again



Open	910,00	Mkt cap	561,27M ZAR	Prev close	929,00
High	930,00	P/E ratio	4,72	52-wk high	999,00
Low	910,00	Div yield	0,011%	52-wk low	390,00

7-day chg	-3.1%
30-day chg	+3.3%
90-day chg	+7.0%
6 months chg	+61.7%
1-year chg	+132.5%
Year to date chg	+30.1%

JSE: ART Price : 930 cents Mcap: R561m 52wk high/low : 999c / 390c

My last note on Argent Industrial was a 7-page update on January 28th (850 cents) when I commented that this much overlooked micro-cap stock had again made my price target and I was further upgrading my valuation to 1100 cents per share with the comment "watch this space".

The counter has been one of the best performing micro-caps on earnings and share appreciation sense for the past two years. Year to date, the stock is +30.1% and +132.5% on the past year.

Argent Industrial indicated in its morning SENS that HEPS for the 12-months would increase between a range of 54.6% and 74.6% giving an indicative range of 206 cents per share to 232 cents per share. This is a stunning achievement for a micro-cap that has consistently delivered solid earnings growth for the past four reporting periods.

I understand drivers to this HEPS growth was on-going efficiencies and cost cutting at Argent with the work from home angle driving many business units such as DIY (Cannock Gates) and security (Xpanda). The UK operations such as Fuel Proof and Partington did well, though the exchange rate hit the company as the Rand strengthened. Further, the domestic steel shortage and higher prices aided Argent's Phoenix Steel division.

On a 'mid HEPS point' of 219 cents per share, this places Argent Industrial on a historic PE rating of 4.2x for a counter who's previous YE2020 PE was 7.0x.

My 1100 cent January 28th price target now undervalued the prospects of this counter and should FY2022 HEPS even normalise back to sustainable double-digit growth in the mid-20%'s …. *I can justify a price target for Argent a year out of 1400 cents or a return of +50%*. The counter would still (then) be on a FPE of 5.3x.

I maintain my BUY recommendation on Argent Industrial. This will fall on deaf ears to many who only remember the Argent of old rather than what Argent is today. The trading update was solid and the re-engineering, under the stewardship of CEO Treve Hendry the past three years, has certainly delivered the goods.

Anthony Clark
Financial & Industrial Small & Medium Market Cap Analyst
Food Producers & Agriculture Analyst
+27 (083) 300 7009
anthonyc@smalltalkdaily.net
Follow me on Twitter @SmallTalkDaily

Why have I had a BUY on Argent since May 2018?

From Battersea Dogs Home to Crufts in three-years was my report title some two years ago when I issued a buy recommendation on Argent Industrial at 494 cents on May 3rd with a target (then) of 700 cents.

That first target was attained within a year … in January 2020. I then revised my target price to 850 cents. Argent attained that second target value a year later in late-January 2021.

I then upgraded the stock for a third time to a valuation of 1100 cents and at its 2021 high the stock hit 999 cents.

Today it trades at 930 cents on a PE of 7x and a last Net Asset Value of 1746 cents to its last interim results to September 2020.

I'm expecting a healthy uplift in the NAV of the business which is in far better operational and asset shape in May 2021 than it was a few years ago.

Today, I have updated my current viewpoint and opinion on a micro-cap that the institutional market mostly treats as a fleabag mutt but the retail investor sees as its prize-winning hound. That has led me to forecast a target value in 2022 of 1400 cents (+50%).

The share price return of 132% in a year attests to its strong operating performance.

I've covered Argent Industrial for some 20 years. It's been a volatile and colourful ride.

For several years I had an avoid / sell on the counter, which at the time, was the absolute correct recommendation given its weak operational performance, choppy earnings and dire investor sentiment.

Then in late-2018 and into early-2019, I'd heard whispers that there was a new mantra at Argent Industrial.

As Mr Independent Smalltalkdaily Research, I took it upon myself to fly to Natal to meet with the CEO and learn for myself what had transpired.

I spent an entire day with Argent on March 14th 2018 running through the company division by division.

It was eye opening. I was a convert and, in the proceeding, weeks issued a BUY recommendation with the price (then) at 494 cents as at May 3rd 2018.

The company was still headed by erstwhile CEO Treve Hendry on my visit and he is still a hands-on manager of the business.

However, it seemed from my 2019 site visit that the colourful CEO had mellowed and gained a business epiphany. I stated in my May 2019 note "you can teach an old dog new tricks".

Hendry was still as sharp as a bag of tacks but he'd come to realize that wanting to own and build a bigger metal bashing business in South Africa was simply a ticket to problems.

Ongoing BEE issues, unplayable unions and a weak underlying operating environment were all against 'rust belt industries' such as Argent Industrial.

Argent had spent much of 2017 and into 2018 exiting and selling many of its legacy rusty domestic metal bashing and manufacturing businesses and re-inventing itself.

Low margin, capital intensive divisions were sold to focus on the more value-adding, higher margin beneficiation interests both locally and offshore through acquisition.

Today, Argent has 23 subsidiaries of which 9 are offshore.

It is these offshore interests, all via acquisition, that have driven Argent's profits & earnings growth for the past three years. Argent is a near 70% Rand hedge. That may surprise many. That percentage will only rise over time.

I continue to expect that the remaining 14 South African divisions will be rationalized and the lower-margin units sold such as the mining-related and steel companies. I believe further excess property, a long bugbear of the market, will also be disposed.

This was the 'new Argent Industrial' I discovered in my independent-minded March 2019 site visit to their offices in Umhlanga.

From my site visit, it was clear that Argent had been merrily liquidating its South African heritage and using the sizable cash proceeds to buy businesses mainly in the United Kingdom as well as aggressively buying back shares. The company was debt free with net cash.

This was all pretty much ignored by the market whose memories of Argent were of a long past & checkered history. The market had, and still to some degree, has failed to recognize the transformation of the business.

Earnings growth has been impressive, often over-shooting forecasts, and consistency is now much more of an Argent watchword than the earnings volatility of past years.

Interim results to September 2020

Recent earnings for the six months to September 2020, saw HEPS soar +47.1% to 73.7 cents per share from a FY2020 March HEPS base of 133.4 cents per share and this was during Covid-19 period.

A combination of improved business performance, offshore earnings aided by increasing Rand hedge qualities and the benefits of material share buy-backs powered Argent's results again.

The interim results saw a strong contribution from offshore. Like-on-like profits from offshore operations rose to R53,7 million a rise of +48.6% year-on-year.

South African like-on-like H1 2020 interim profits versus H1 2019 domestic profits, slumped -88%. That should normalize in H2 and into Argent's March FY2021 results. In H1 2019, domestic operations made a profit of R16.1 million as comparison.

Improved trading conditions in South Africa, especially strong demand for steel, will have aided Argent's 2H reporting period to March 2021.

Consolidated Statement of Profit or Loss for the period ended	Unaudited 6 months 30 Sept 2020	Unaudited 6 months 30 Sept 2019	Audited year ended 31 Mar 2020
	R 000	R 000	R 000
Revenue	874,086	871,516	1,727,721
Cost of sales	(661,178)	(643,322)	(1,274,361)
Gross profit	212,908	228,194	453,360
Net operating expenses	(149,585)	(168,372)	(319,977)
Operating profit before finance costs	63,323	59,822	133,383
Net interest expense	(7,753)	(7,618)	(14,721)
Profit before taxation	55,570	52,204	118,662
Taxation	(10,840)	(11,927)	(20,748)
Profit for the period	44,730	40,277	97,914
Attributable to equity holders of the			
- Parent	45,353	37,901	96,221
- Non-controlling interest	(623)	2,376	1,693
	44,730	40,277	97,914
Basic earnings per share (cents)	74.3	49.7	130.8
Diluted earnings per share (cents)	74.3	49.7	130.1
Headline earnings per share (cents)	73.7	50.1	133.4
Diluted headline earnings per share (cents)	73.7	50.1	132.8
Dividends per share (cents)	0.0	0.0	0.0
Supplementary information			
Shares in issue (000)			
- at end of period excluding treasury shares	61,021	75,518	61,370
- at end of period including treasury shares	64,567	80,201	64,916
- weighted average	61,021	76,230	73,589
- diluted weighted average	61,021	76,230	73,947

Segmental Review

	Manufacturing	Steel trading	Properties	Consolidated
	R 000	R 000	R 000	R 000
Business segments				
for the 6 months ended 30 September 2020 - unaudited				
Revenue from external sales	601,944	271,955	187	874,086
Inter-segment sales	79,598	47,513	14,875	
Total revenue	681,542	319,468	15,062	
Profit before taxation	34,808	15,153	5,609	55,570
Taxation				(10,840)
Profit for the period				44,730

Segmental Review

	South Africa	Rest of the world	Consolidated
	R 000	R 000	R 000
Geographical segments			
for the 6 months ended 30 September 2020 - unaudited			
Revenue from external sales	606,088	267,998	874,086
Profit before taxation	1,889	53,681	55,570
Taxation			(10,840)
Profit for the period			44,730

Despite stellar results and an on-going improvement in profits, the institutional market simply was not interested. They just recalled the Argent of old. Much of the share price activity has been driven by retail investors.

In the past year, from a 390-cent share price low, Argent recently hit a 52-week high of 999 cents, a level the share price has attained seen since 2008.

Currently, with a share price of 930 cents and a market valuation of R561 million, the stock remains a micro-cap.

However, it's a micro-cap with a much-improved business and a more realistic net asset value (following a major clean up) presently of 1746 cents per share, so the stock is on a discount to NAV of 47%.

Much of that value lies in its highly profitable offshore interests rather than the rusty South African remnants.

What has been more startling is the composition of earnings within Argent.

Through ongoing sales domestically and acquisitions principally in the United Kingdom, of small, niche businesses, Argent at its interim stage 70% or revenue was derived from South Africa but the offshore businesses contributed 94% of Profit before Tax. Much of this was due to the Covid-19 lockdown costs in South Africa in H1 and subdued trading.

Normalized, Rand hedge earnings are around 70% of Argent's profit base.

That offshore component is forecast to increase in FY2021 and FY2022 as domestic assets are offloaded.

At 930 cents a share, the stock is on a historic PE of 7.0x. It's not as cheap as it used to be that easy money has been made in the past 12 to 18 months.

But I remain confident there is further upside opportunity in the stock if my understanding of current developments transpires.

Year-end results will have to be balanced from growth in offshore performance and acquisitions such as Partington, with the fact that as a March year end, the Rand versus the Pound, in FY2020 results were at the worst of the Covid-19 sell-off (R22.31)

In the past financial year, the Rand has strengthened against the Pound by 9% as I write this update note to Argent's March 2021 year end.

Looking into the last couple of months of Argent's FY2021, I believe the company has performed satisfactorily. Covid-19 impacts has led to swings & roundabout effects.

Domestically, a dire shortage of steel has led to windfall profits for the remaining Argent steel trading business.

As the South African economy opened up after the Q2 2020 lockdown, divisions have also performed well echoing what has been detailed by many in the sector on 'pent-up' demand. So, September 2020 to March 2021 should show some improvement on the weak H1 profits reported domestically.

In the UK, as an example, the rise in online shopping has been a win for Partington who manufacturers trolleys and online-order collating products for large online retail warehouses. However, the current economic lockdown in the UK will surely have impacted some of the manufacturing & business product services businesses.

What do I envisage 2021/22 bringing?

Ongoing asset sales of domestic businesses especially in the legacy steel units. These have been volatile and low margin. Excess property, and general metal manufacturing units and allied assets, I also expect to be sold.

Looking ahead, Argent's domestic businesses will be the more value-added consumer focused units such as security closure division Xpanda and Jetmaster pretty much completing the restructuring and exiting of a majority of Argent's metal bashing, low margin businesses.

Argent has been on a rampant share buy-back program the past two years as it utilises its cash from asset sales and improved profitability to acquire and cancel shares. They have repurchased to date 26.2% of the stock.

Its last transaction was on March 8th where it acquired 132,915 shares for a total of R1,042 million. This represented a further 0.21% of the company with the highest price paid of R8.70 a share.

Having repurchased the and completed the first phase buy-back of 20%, Argent's current re-purchase program allows it to buy a further 13.78% or 8,89 million shares.

At 930 cents, despite the share appreciation of the past year and the 7.0x historic rating, the Argent of 2021 is a much better company than it was in 2015/16.

The balance sheet has been right sized, debt expunged, low margin assets sold, major share buy-backs undertaken, all under the auspice of reducing the businesses reliance on the weak South African economy and its operating travails.

At this stage, if my assumptions are correct on trading, asset sales and cash realization, Argent remains an attractive asset to own for investors especially if dividends are resumed in replacement to share-buybacks.

Those dividends given funds on hand and from on-going asset sales (could) be generous.

I thus place a one-year price target on Argent of 1400 cents per share (+50%) and maintain my long-standing buy recommendation.