

# How many JSE-listers do you think beat the last downturn?



By [Dr Adrian Saville](#)

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Of the more than 1,000 companies surveyed in our research, just a handful of JSE-listed companies managed to sustain and grow earnings between 1997 and 2013. We call them the 'exceptional exceptions' and they are quite an eclectic mix of shares - from Mr Price to Wilson Bayly Holmes-Ovcon; from EOH to Famous Brands - these counters have managed to grow earnings consistently ahead of nominal GDP, regardless of the economic cycle.



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We surveyed stock markets across 25 countries and our findings revealed that the most significant factor to impact on the growth in company earnings is GDP growth. This came as something of a surprise to us. More than any strategy adopted by businesses, including diversification or globalisation, beyond any industry variables or geography, our evidence shows that GDP growth has the greatest impact on company performance. (It should be noted that we looked at the economy relative to corporate profitability over time, not at stock market performance.)

For companies to perform well, then, it helps to have a supportive business environment in which to operate. However, this is not always the case and in South Africa it's no secret that the economy is growing at rates well below its potential. But bad times do not last forever and we can expect a recovery to come from several quarters.

## Global growth

Notwithstanding the current local malaise, South Africa's growth rate for the last 20 years has taken its lead from world economic growth. Global growth is the best indicator of what our structural growth rates are likely to be into the future. We believe that for the next ten years we will see an average annual global growth rate in the region of 3.5%, giving South Africa a baseline growth rate of 2.5%-3.0%.

There are two additional factors which could double this potential growth rate. First, a further 1.5% growth is possible if

South Africa boosts intra-regional trade and intra-regional flows of people, information and capital. This freer movement of factors would enable the country to tap into the outstanding growth rates of plus 6% being experienced in the rest of sub-Saharan Africa.

Second, if the R1 trillion infrastructure expenditure programme is undertaken in a meaningful way, another 1.5% could be added to South Africa's growth rate, to yield in the order of 6% annual economic growth. Infrastructure development has one of the greatest multiplier effects in terms of job creation, especially with regard to the promotion of low-skilled jobs.

Significantly, both of these kickers are structural in nature: they would result in a permanent lift in the country's output potential. But, while waiting for the environment to recover, what can companies do?

## Striking evidence

Harvard Business Review (2012) published a study by Rita McGrath of Columbia University which shows that of 4,793 companies, each with a market value in excess of \$1bn, only 8% were able to grow real earnings faster than world GDP without interruption between 2005 and 2009. Admittedly this was during a period of economic stress, but even between 2000 and 2005, when times were easier, that number is only 15%.

Considering the full ten year period 2000 to 2009, McGrath's evidence is even more striking: just ten firms in her five thousand firm sample achieved uninterrupted real earnings growth ahead of world GDP. Arguably, an even more intriguing result is the firms which make up this exclusive set of ten which includes search firm, Yahoo (Japan), Spanish construction operation, ACS, Chinese brewer Tsingtao and Atmos Energy, a US-based gas business.

We extended McGrath's research to include South Africa over seven ten-year periods to end 2013 to assess the application of her findings to our market. Notably, we too have a low success rate. Of the more than 1,000 firms we surveyed, just a handful generated real earnings growth that also is ahead of South Africa's GDP growth over this time. And our small set of thrivers is as eclectic as McGrath's, including Clientele Life, Truworths, Mr Price, WBHO, EOH and Famous Brands.

We sought to establish if there was a common element which the businesses that thrive displayed and others didn't and we found two key factors common to these stocks - agility and absorption:

1) Agility means their nimbleness with regard to operations, portfolios and strategy:

- Operational agility is the ability to take advantage of opportunities to improve operations.
- Portfolio agility is reflected in companies which are able to adapt their underlying holdings in line with a changing environment. Good local examples of this would be Imperial, Bidvest and Barloworld.
- Strategic agility occurs where leaders have vision and courage to follow new paths and where mistakes are corrected swiftly, before they become entrenched.

2) Absorption means that a company can withstand the vagaries of a challenging environment - that it has 'shock absorbers' in place to cushion it during turbulent or trying times. A sound balance sheet with modest debt levels, a diversified (and strong) cash flow and loyal customers are examples of traits which an absorptive company displays. Other examples would be constant innovation, taking many small bets and listening to what clients want.

## Two examples

Two companies which exemplify the need for these attributes are Kodak and Fujifilm. The former is a shell of its former self while the latter has grown inexorably. The trends are evident in the employee numbers: in 1995, Kodak employed some 150,000 staff but by 2014, that number had shrunk to 8,800; by contrast, Fujifilm has seen its employee numbers rise from 15,000 in 1990 to 50,000 today.

Recognising that the traditional photographic industry was in the death zone, Fujifilm used its agility to reinvent itself. Using its background in materials chemistry, imaging, optics and analysis, the group has developed a diverse range of products from digital X-rays to cosmetics. In recognition of its achievements as one of the world's most innovative companies, Fujifilm was named a Thomson Reuters 2014 Top 100 Global Innovator for the third year in a row. Kodak filed for bankruptcy in 2013 and is currently attempting a come-back.

Companies which are able to balance both the qualities of agility and absorption are able to command premium valuations and experience better profitability and return on equity. Those companies wishing to see off the challenges of a subdued business environment should look closely at these two factors - agility and absorption - and find ways to enhance both.

## ABOUT DR ADRIAN SAVILLE

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