INSIMBI

Metal firm shows polish

Gutsy performance and game-changing expansion even as commodity and industrial cycle is at a low point

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For a small-cap company with a market value of less than R500m, Insimbi is a fairly difficult investment proposition to assess. Certainly the company's business model is not something easily condensed into a short, sharp paragraph.

Essentially Insimbi revolves around metal – supplying alloys to the steel and stainless steel industry, foundry sand, ceramic ducting to ferrous and nonferrous foundries and automotive foundries as well as electroplating specialists, and specialised ceramic refractory linings to the cement, paper and pulp, steel and platinum industries.

With SA's commodity and industrial cycle at a stuttering low point, Insimbi is certainly not operating in conditions that fortify investor sentiment. Sadly, this has meant the market has overlooked some gutsy performances over the years.

But more problematic for Insimbi is the fact that the company has no real comparative counter on the JSE – save for a reference point with old metal trading and mining listing Metmar. Under the circumstances this is unavoidable – but also most unfortunate, considering Metmar's unrewarding tenure on the JSE up until its delisting in late 2015.

In truth, the longer-term performance of Insimbi, which listed in 2008, displays a remarkable operational consistency in sometimes difficult market conditions, rarely skipping a dividend. Sentiment, however, remained mostly brittle.

In 2015 Insimbi made an important move in diversifying operations by acquiring Polydrum, a blow-moulding business that manufactures plastic containers for the chemical, agricultural and food industries.

But the real game-changer came late last year when scrap-metal specialist Amalgamated Metals Recycling (AMR) was acquired by Insimbi in a R284m transaction.

Clearly this was a minnow-swallowing-the-whale transaction, and investors might well be wary that such ambitious corporate manoeuvres can introduce operational complications that often cause small companies to flounder.

There is some reassurance in the deal terms, though.

The deal effectively reverses AMR assets into Insimbi to craft a partial exit strategy for the founders as well as an opportunity to participate in further upside (and dividend flows) in the scrap-metal endeavours via a listed vehicle.

The AMR deal terms comprised a R200m cash payment to the vendors with R100m funded by senior debt and the balance of R100m funded by a placement of Insimbi shares. The vendors will also be issued 50m new Insimbi shares at 100c/share. Another R34m cash payment will be made for the associated AMR property.

On paper, it seems there can be little reason to fret about Insimbi overpaying for AMR. The deal was struck on a trailing earnings multiple of less than six times and earnings before interest and tax of only three and a half times. Even if net profit this year falls back to the R40m posted in the 2014 financial year, Insimbi would have acquired AMR – which has stretched its operating margins from 2.84% to almost 4.5% in the past three years – on a forward earnings multiple of seven times.

AMR trades in ferrous and nonferrous metals, collecting and sorting iron and steel as well as aluminium, copper, zinc, stainless steel, lead, nickel, brass, tin and bronze.

Exports account for more than 65% of the scrap-recovery revenue.

The AMR transaction did initially spark some market interest in Insimbi, but sentiment appears to have cooled. Insimbi's shares have climbed down from a December 2016 high of 134c to around 107c at the time of writing.

The AMR deal – which was included for only two months of the year to end-February – has perhaps not been fully appreciated by market watchers.

A recent investor presentation by Insimbi showed that AMR generated R1.94bn in the year to end-February 2016 with operating profits coming in at R85m on a margin of around 4.5%. Net profits for the period were R53.5m.

It would then be fair to say Insimbi has bought a high-volume/low-margin business. The net profit margin is 2.79%, lower than what has been achieved over the longer term by Insimbi's metals businesses.

Insimbi says there is operational leeway, with smelter capacity utilisation in the group set to be increased. An increase in exports could also help fatten margins with offshore sales attracting a 20% premium over local sales.

If AMR's year to end-February results are taken into account then Insimbi becomes a R3bn/year revenue business with an after-tax profit of R80m. In other words, new-look Insimbi should be capable of generating around 20c/share – perhaps 25c/share in a strong year – in the new financial year.

This puts the share on a modest earnings multiple of just over five times, which seems a flippant dismissal of the profit track record and executive management's prudent strategic efforts in bulking up Insimbi over the years. x

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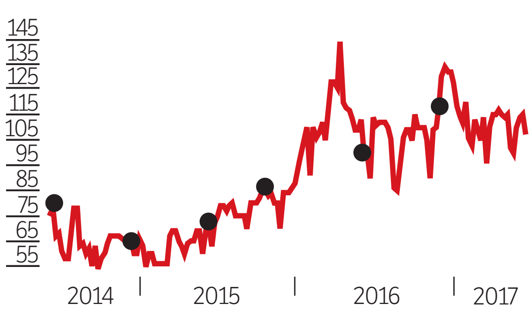
Insimbi Refactory & Alloy supplies share price (c) – weekly



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