

FLASH NOTE: CHOPPIES SHARES RESUMES TRADING 12 August 2020

Introduction

Choppies' 20 month trading suspension was lifted by the Botswana Stock Exchange (BSE) with effect from the 27th of July 2020. This is after the retail giant finally released its long awaited audited financial results on the 24th July 2020. Choppies was suspended from trading on the BSE where it has a primary listing, and on the JSE where it maintains a secondary listing on October 2018 for failing to produce its audited financial results for the financial year ended 30 June 2018. Then followed a number of events including the brief suspension of the Chief Executive Office by the old Board, legal and forensic investigations, and the much anticipated Extraordinary General Meeting where the CEO was reinstated. This last act triggered the resignations of some board members from the Board. A new Board was immediately appointed to replace the old one. On the day the trading suspension was lifted on 27 July 2020, Choppies opened unchanged at P0.69 (69t) per share, which was the last traded price at suspension. As at 07 August, 2020 Choppies remained suspended on the JSE as the Exchange followed its own procedures required for lifting the trading suspension in that market.

Choppies suspension lifted effective 27 July 2020

Choppies traded laterally on first day, P0.69/share

Where does the trolley path lead for Choppies?

Choppies changed its auditors after PricewaterhouseCoopers (PwC) resigned in September 2019 and was replaced by Mazars in February 2020. Since the suspension in October 2018 a number of key developments have taken place such as exiting markets including South Africa, Kenya, Tanzania, and Mozambique. This therefore means Choppies now has a presence only in Botswana, Zimbabwe, Zambia and Namibia. The consolidation is an important step and will allow the business to focus more on profitable operations, and those that present the company with viable prospects for growth. This is expected to assist in increasing shareholder value in the long term. A point that needs to be clarified is the general miscommunication that Choppies shares were delisted from the BSE during the period of suspension. This is not the case as the shares were simply suspended from trading due to non-compliance with the continuing obligations of the Listing Requirements of the BSE.

Group divesting from a number of markets of operation

How did we get here...?

The company's 2018 year-end financial results were delayed by the then newly appointed auditors PwC, who had concerns around the accounting practices used in the Group's financial statements. The BSEL's Listing Requirements require listed companies to publish their financial results within a space of three months after their financial year ends. Failure to do that attracts a penalty, which sanction, the BSEL has imposed on other companies for similar transgressions before.

Suspension was triggered by the delaying of the publication of the AFS for Y/E 2018



A birds eye view on the financial results

The latest available full year financials results are for the year ended June 2019 and show that Choppies had an annual turnover of P9.62bn, v/s P10.79bn in the prior year. In the aftermath of a series of poor financial performance spanning a number of years, the Group revisited its strategy to improving profitability by among other things, closing a number of loss-making regional operations and exiting those markets. Together, these discontinued operations collectively accounted for 44% of the Group’s total turnover in 2019, but significantly, also contributed to most of the Group’s losses as well. Some had even never registered a profit since becoming part of the Group.

Discontinued operations accounted for 44% of Group’s total revenue for the financial year 2019

On the other hand, operations that the Group will be concentrating on include Botswana, which in 2019 was the biggest contributor to the continuing operations revenue – as has been the case since the Group listed in 2012 – contributing 77.4%, followed by Zambia at 10.9%, Zimbabwe at 9.5% and Namibia at 2.2%. GP margins were flat at 19.7% while EBITDA fell considerably by 142.1%. Headline EPS stood at -25.87t for the same period under review.

GP margin for continuing operations flat

One of the key fundamental drivers attributable to the company’s success has been its footprint in Botswana — which diligently contributed the highest revenue for the Group’s operations since it listed. The Group added 3 more stores to its Botswana portfolio, bringing to a total of 91 of stores in the country for the period ended 30 June 2019. The revenue in this region increased 1% to P4.15bn, with the corresponding GP margin increased to 24.1%. EBITDA was up to P1258.3mn, as a direct result of impairment losses dropping P115mn.

Three more stores added to Botswana portfolio

In the same period, Zimbabwe was the only other region to produce profits for the period, albeit a marginal one at P2.04mn. This was a show of resilience in the region as the Company opened an additional two new stores, however, four stores unfortunately closed in this period. Currency translations also weighed in on the overall contribution of the region, due to the volatility of the local currency, weakening against the Pula.

Zimbabwe and Botswana the only two regions to produce profits for the period

In Zambia, turnover increased for the period, following the opening of three additional stores. EBITDA remained in the negative however, increasing to a P38.0mn loss, which subsequently led to an increased loss before tax of P50.97mn from the lesser loss of P31.35mn reported in the prior year. The decline was attributable to the weakened Kwacha relative to the Pula, while some of the overhead costs in that region, e.g. rent, remained fixed and chargeable in US Dollar terms.

Trading revenue improved to P119.7mn in Namibia for the 2019 year end, (v/s P45.2mn in 2018), while maintaining an unchanged store count, which bodes well for future prospects in this region. GP margins improved to 16.6% from 11.7%, while EBITDA losses increased to P9.2 million (2018: loss P7.6 million).

Trading prospects looking positive in Namibia



Of the operations being discontinued by the Company, South Africa was the second largest contributor to overall trading revenue at P3.74bn in 2019, down from P4.04bn in 2018. EBITDA losses in this region significantly jumped to P196.6mn from P18.4mn as a direct result of depressed trading conditions in the North West province of the region. Loss before tax for the period stood at P306.6mn (2018: loss before tax of P273.8mn) The South African operations were eventually sold off during the year 2020.

Difficult market conditions in Kenya resulted in an operational loss of P58.2mn in the period ended 30 June 2020, compared to a lower operational loss of P27.8mn in the prior period. As expected, the loss before tax increased to P95.3mn from the prior period's P70.4mn.

Trading losses were also registered in Tanzania and Mozambique, to the tune of P18.2mn (2018: loss of P5.9mn) and P15.5mn (2018: loss of P11.7mn). The Tanzania operations are in the process of being sold as the Company exits the region. Meanwhile, the Company shut down the Mozambique operations and has since exited the region. The moveable assets of the Mozambique operations have been transferred to the Zambia operations while the non-movable assets, i.e. the buildings, are to be disposed for an amount of US\$1mn, the proceeds to which will be used to settle outstanding loan balances.

Opinion on Fraud Allegations

Accompanying the financial results published on the 24th July, was an update on the fraud allegations in relation to the stock held by Choppies subsidiaries, and the bulk sales of the aforementioned stock. At the recommendation of the forensic investigation report published in December 2019, a "Focused Investigation" was launched by the Board of Choppies to determine the validity of the allegations. The conclusion, as provided by Advocate Meyerowitz (the Company's Board appointed independent Counsel to carry out the Focused Investigation), was that the allegations of fraud in respect of stock in both South Africa and Zimbabwe would in all likelihood not succeed in a court of law, nor in any formal quasi-judicial setting such as a disciplinary hearing. On this basis, Choppies then proceeded to submit all outstanding financial information covering four outstanding reporting periods to the BSE, which resulted in the lifting of the trading suspension by the Exchange.

Fraud allegations are likely not to succeed in a court of law

What does the lifting of suspension mean on the share price and liquidity?

With the suspension lifted on the trading of Choppies' shares, the Group's shares can now be freely traded once more on the BSE. This will allow shareholders who have been unable to take any positions in the last 20 months whilst the stock was suspended to once again start trading, and not to be locked in or out of transacting in the stock. Being one of the most liquid stocks on the BSE this will over time, in turn aid price discovery and possible realisation of value, whilst also boosting market turnover. This is a welcome development for the BSE equity market where turnover has been subdued for most parts.

Choppies' return expected to add to overall market liquidity

As expected, significant trading in the stock was observed in the first 10 days of trading (after the suspension was lifted) where cumulatively, 10.62mn shares changed hands at prices ranging from 69 thebe to 66 thebe. Almost all of this trading was accounted for by retail clients as institutional investors take time to digest the fair amount of financial results covering four reporting periods, namely the year-end to 30 June 2018, interims to 31 December 2018, year-end to 30 June 2019, and interims to December 2019, and which were all presented at once. So far, the demand has been able to absorb the supply, but the position might well change once (institutional) investors have finished the process of analysing all this financial information on the company that they are currently assessing. The company is currently in a closed period, with the results for the year ended 30 June, 2020 expected to be released by end of September, 2020. It will be after these particular set of results are released that the market might get some direction as to where the stock is headed.

Motswedi Securities will produce a more detailed analysts report on the company at that stage.

In the meantime, we might see some further weakening of the share price in the short and possibly medium term, whilst we also expect some stability in the price in the longer term as the company refocuses, and consolidates its positions in those markets that have been identified as key for the improved performance and profitability of the company, going forward.

The positives...

Consolidation. The closure of loss making operations in South Africa, Kenya and Tanzania was long overdue. The consolidation process now allows the business to be much leaner, with focus on more profitable operations which should grow shareholder value going forward. The company will still concentrate on growing and retaining market share where it operates, with Choppies still commanding a market leading 34% market share in Botswana for example, according to Management.

Consolidation process likely to grow ultimate shareholder value

The **recapitalisation** of the business by P150mn comprising of a loan of P100 million from founding shareholders and P50m from trading operations should send a positive signal and help stabilise the Group's financial position, overall.

Recapitalisation efforts should help stabilise the Group

Improved corporate governance. Another positive is that of developments around improved corporate governance issues as shown by tighter governance structures, a clear succession plan and a new Board that is expected to exercise its fiduciary oversight functions in a more robust manner. The appointment of a Deputy CEO for the first time in the history of the company, and one boasting a wealth of experience in the industry, bodes well for a clear success plan, and is a welcome development.

Tighter corporate governance introduced

The downside...

Going Concern. This appears to be the elephant in the room for the Group after recording a negative equity of some P80.15mn as at the end of the financial year end to 30 June 2019. This was reported as being a result of a decline in the foreign currency translation reserves as well as trading losses from those regions that the Group has since exited. The company's Board have given the assurance that the going concern status at the level of each jurisdiction will continue to be monitored closely on a continuous basis, and corrective and decisive action taken timeously, when required. The Directors' statement accompanying the financial results for the year ended 30 June 2019, state that they have no reason to doubt the company's ability to operate as a going concern in the near future. More direction on the going concern status will be provided by the company with the interim results to 31 December, 2020.

Group records negative equity for the first time in its history

Conclusion

The release of the long outstanding financial information from the company, as well as the resultant lifting of the trading restrictions on the stock has been a welcome and positive development in the market. With the information now in investors hands, this allows them to be in a position now, to make informed investment decisions on what to do at the counter.

On the surface, interim results to 31 December for 2019 show revenue from continuing operations declining by 20% to P3.00bn (2018: P3.61bn). GP margins were flat at 22.9% (2018: 22.5%) while EBITDA margin stood at 5.8% (2018: 5.5%). Headline EPS stood at -9.29 thebe (a blended figure made up of 5.44 thebe from continuing operations and -14.73 thebe from discontinued operations). Management is of the belief, and is convinced that the fundamentals remain resilient and the company is well positioned to recoup its accumulated losses within a fairly short period of time. The market would surely welcome this, were it to materialise.

Clearly more thorough analysis of the financial information recently released, including that is soon to be released for the year end period to 30 June 2020, will have to be undertaken first to make any informed decisions as to what the long term prospects at the company are. Going forward, however, the company's ability to recover lost ground, and thereby give the market any semblance of confidence will depend on the ability of the company to formulate and execute a proper and clear strategy anchored on the following premise:

Group strategy remains resilient

- Drawing a line under all loss making and value destroying operations, and markets;
- Consolidating around businesses presenting the best potential for revenue growth and profitability;
- Adopting best practices in terms of strict adherence to good corporate governance practices at all times.



Recommendation

Until a more thorough analysis of all the long outstanding results has been done, including up to year ended 30 June, 2020 and more interaction with senior management has been carried out, we will advise extreme caution in trading in Choppies stock. However, and at current levels, opportunities might well present themselves to the patient, long term investor who might be able to pick up volume at low and attractive prices.

Investors should exercise extreme caution when trading Choppies shares

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