HCI's buyout offer to KWV investors inevitable

There was something inevitable about the mandatory buyout offer by empowerment giant Hosken Consolidated Investments (HCI) to minority shareholders of Paarl-based liquor group KWV Holdings.

Though the *Financial Mail* (FM) mentioned this possibility in October, HCI had quietly indicated in competition tribunal hearings in May last year that it intended adding to its 34.95% stake in KWV.

The tribunal documentation specifically states that HCI intended acquiring another 0.05% of KWV's issued share capital "as a further step in its goal of attaining sole control of KWV".

So in December HCI snatched the additional shares (638 to be exact) to trigger a mandatory offer, which has been pitched at R8.50/share.

Though the offer was not entirely unexpected, what would be surprising is if any significant number of KWV shareholders opted to accept the HCI offer. Those bailing out would be giving away a chunk of value.

KWV must still obtain a fair and reasonable pronouncement on the R8.50/share tag, but the latest company annual report shows an intrinsic net asset value (NAV) of more than R18/share.

The official NAV number itself is contentious because KWV accounts to a good number of so-called "heritage assets" (iconic Wineland properties and a stunning art collection) at historic cost. Some observers estimate a value of between R22/share and R26/share for KWV by estimating a market value for these heritage assets.

Albert Eksteen, KWV's legal & risk executive, says it would be premature to comment on the process of assessing the HCI offer, adding that the board's recommendation will be included in the circular to be posted to shareholders.

The FM suspects that after KWV's recent poor operational performance the fair and reasonable valuation may come in slightly lower than the R11.50/share to R14.40/share value placed by KPMG on KWV in early 2010, after a mandatory offer to minorities from former large shareholders Zeder and Rootstock (set at 960c/share).

If anything, the latest seemingly miserly offer reinforces a statement made at the AGM by Chris Logan of Opportune Investments about the folly of not valuing KWV's heritage assets accurately.

Logan noted: "Because you have grossly undervalued assets and because you are getting such a poor return on equity, your share price trades at a massive discount and every man and his dog constantly has a picture of taking the company over. It is a natural inducement."

HCI has, to its credit, been an opportunistic empowerment player and noone can begrudge any entity's efforts to snatch value on the cheap.

But what some shareholders might in hindsight find disconcerting is the reluctance of the KWV board - with significant HCI representation - to entertain a proposal at the last AGM to consider using part of its sizeable cash balance to buy back its own shares.

Buying back shares at less than half of the officially stated NAV has a prudent ring about it - doubly so when there have been no fewer than four (Zeder/Rootstock, Halewood, Pioneer Foods and HCI) attempts to buy out the company.

However, KWV has stressed the need to retain funds on the balance sheet to reinvigorate the tired liquor business.

At last year's AGM, HCI CEO Johnny Copelyn noted: "This is an old business. It is a deep business. It's got a long past and it should have a long future, but it cannot have a long future if it is going to take all the cash that it has got and worry about the shareholders' problems."

He argued that KWV was not a business that was focused on buying shares. "It is not a share-buying company. This is a wine and spirits business. It should focus all its efforts on wine and spirits."

Last year KWV spent R80m on marketing and promotion, and if it wants to develop into a global brands business, it will need to keep this spending intact or even increase it.

Eksteen says the board, with the company's interests in mind, has indicated that management's objective should be to grow KWV through market and product diversification.

"As such, the first call on cash is unlikely to be a share buyback programme, where the benefits would not accrue to the company."

He stresses the HCI offer is a regulatory requirement with the breach of the 35% threshold and should not influence the board's view on a share buyback programme.

The reluctance to embark on a share buyback programme should perhaps be viewed in conjunction with acting KWV CEO André van der Veen's AGM presentation, which reiterated that asset disposals and the release of NAV was not a priority for the company at the moment. "The message from the board and from the shareholders which we have canvassed is clear: focus on the operating capacity of the business. Focus on building a sustainable business and then we will deal with the balance sheet later."

The difficulty for shareholders, at this juncture, is determining how successful the new shareholders and management team will be at bolstering KWV's operating capacity.

Results for the half-year to end-December should be out by mid-March. In the interim, shareholders might be anxious to gauge the success of recently launched "wine fusion" ready-to-drink products Ciao and JimmiJagga, which are aimed at diversifying the traditional wine and brandy brand offering with higher-volume sales.

But Eksteen is reluctant to talk about early sales trends of the new brands, save to say that there are plans to further diversify the product range in 2012.

Though most observers believe KWV's interim numbers - which will include the cost of launching the new brands - probably won't be easy to swallow, it may still be the best option for shareholders not to give in to HCI's advances.

And shareholders should not discount the chances of HCI's advance bringing a rival bidder out of the woodwork.

Source: *Financial Mail*