A winding road

I hitched a ride with a vending machine repair man
He said he's been down this road more than twice
He was high on intellectualism
I've never been there, but the brochure looks nice

Everyday Is A Winding Road
Sheryl Crow

Like many of my colleagues, I didn't follow a traditional linear route to end up in investments. My career thus far has mostly involved taking the opportunities that have come along to learn and grow. Sometimes this has meant taking risks, all of which led me to **Granate, an incredible home.**

by Catherine Blersch

After a year of 'finding myself' as an exchange student in Belgium (i.e. learning to drink beer and eating lots of waffles and fries) I began a degree in civil engineering. It was 2006, which happens to be the same year that Afrimat was listed on the JSE, a time when both of us were optimistic about the construction sector in South Africa. Like my own life, the Afrimat of today looks very different to how it did back then, thanks to a road paved with interesting new opportunities.

Afrimat was initially a construction materials business, that primarily owned and operated quarries (where rock is mined, crushed and sorted for use in roads building and concrete) and produced concrete products. Dipping their toes into acquisitive waters, their quarry operations were beefed up in 2007 by the additions of Malans Group and Denver Quarries. These were exciting times in construction in South Africa, and I too remember that the prospects for a budding civil engineer seemed bright. Comments from Afrimat's February 2008 results attest to this; *"Government's and private sector's commitment to infrastructure investment continues to drive significant industry growth, stimulating ongoing strong demand"*. Soccer stadiums and the Gautrain were being built in preparation for the 2010 FIFA World Cup, the Gauteng highways were being upgraded, and Transnet and Eskom were investing in their infrastructure.

However, when I started my first job as a consulting engineer in 2010, the boom was starting to wane and private sector spending had been impacted by the global financial crisis, both putting pressure on Afrimat's business. Afrimat's management team realized that being a one trick pony made them vulnerable to the construction cycle, so they started to look for opportunities to leverage their core skills (i.e. open cast mining) in more diverse end markets.

Being brave when others are fearful

As an engineer, I experienced the gradual slowdown in the construction industry and challenges in infrastructure service delivery firsthand. I worked in wastewater treatment, mostly on municipal projects spread across the country. Every project I worked on involved overloaded infrastructure in a dilapidated state, in need of critical upgrades. Despite this, projects struggled to get off the ground due to a lack of municipal funds and capacity available for capital projects and lengthy delays in permitting (water use licenses, environmental approvals etc.).

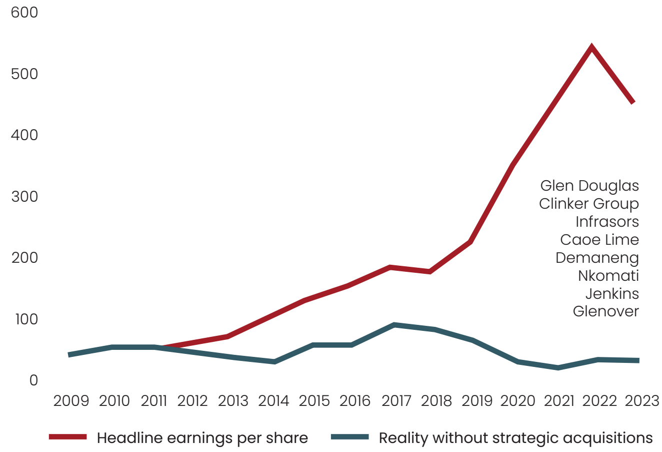
It was very demoralizing to rarely see projects come to fruition, so I made the risky move in 2018 to venture out on my own – wanting to figure out a solution to the municipal infrastructure funding challenges I had witnessed. This was the peak of the Zuma-years pessimism in South Africa and it was becoming increasingly challenging to do business in this sector. Government infrastructure spending had dried up – the roads builder Raubex, for example, saw their SANRAL (South African National Roads Agency) order book drop from R2.2 billion in 2013 to zero by 2019. When the macro backdrop is this bad, what can a management team do?

Diversify. Unfortunately, many companies do this very badly, making unsuccessful forays into lines of business they don't have the skills for or into countries they don't understand. **Afrimat is one of the few that got it right**.

They made their first big move in 2011, buying the Glen Douglas mine from Exxaro, an open pit dolomite mine supplying metallurgical dolomite to the steel industry, aggregates for construction, and agricultural lime products. Similar industrial mineral businesses were added over the next two years. These investments enabled earnings growth of 12% p.a. to 2017, while their legacy quarry businesses were basically flat.

In 2017, they branched out further and bought the Demaneng mine in the Northern Cape which produces high quality iron ore for export. This was complemented in 2020 with the Coza acquisition, adding the Jenkins mine for domestic iron ore supply. Helped by the post-Covid commodity boom, the performance here has been stellar. They invested a total of R680 million at Demaneng (including the acquisition cost and capital expenditure) and have delivered R1.6 billion in net profit to date – a 2.4x return. At Jenkins, their R425 million investment has delivered R448 million in net profit in just a year and a half of operation. Why do opportunities like this exist and how does Afrimat get it right?

Figure 1: Profit history with and without acquisitions



Source: Afrimat

The hardest thing about mining isn't mining

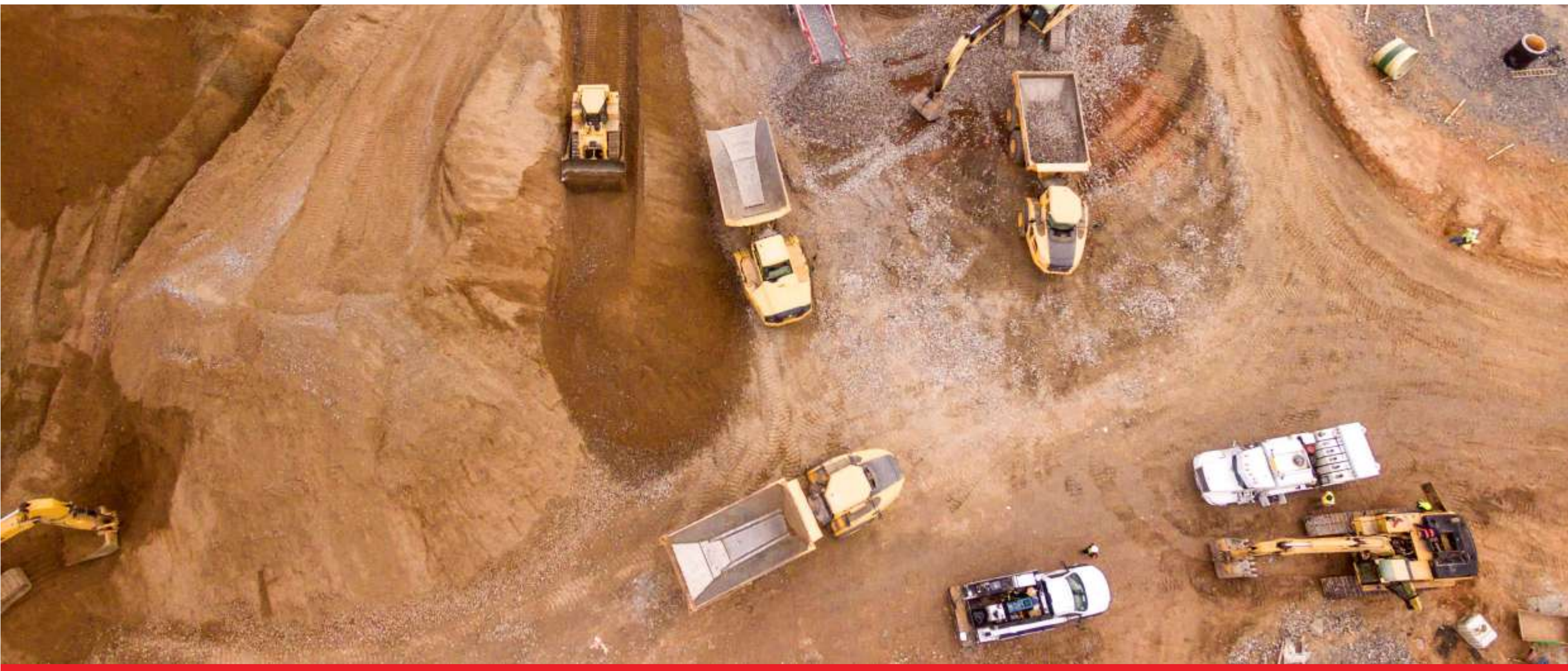
South Africa is a hard place to do business, and an even harder place to mine. This means there are asset owners looking to jump ship, giving rise to many opportunities coming across Afrimat's path. Their framework is to look for quality mineral assets with unique metallurgy, within their circle of competence, that have been poorly managed and are operationally or financially challenged. Inherent challenges mean they can usually pick up these assets at bargain prices without having to make overly optimistic assumptions about commodity prices to make the sums work. Often after a business rescue or similar workout, they can then bring in the Afrimat magic.

Their culture, the "Afrimat Way", is based on nine foundational principles: fostering a caring environment, being results driven but avoiding bureaucracy, growing talent and fostering ownership, an entrepreneurial spirit, humility, relationships and teamwork, empowerment and a winning attitude.

We see evidence of this in everything, from their positive relationships with government stakeholders, openness with shareholders, investments in training and development and proactive labour relations to their community investment. It is clear that the "Afrimat Way" is as important to their business as our values are to us at Granate. When asked about their source of competitive advantage, their culture always comes up as a key component.

This culture enables many positive features in the business. Firstly, they are always on the lookout for new opportunities. These can come in the form of new products – such as growing hemp as a construction material and developing a new lime paint in the industrial minerals business - or acquisitions of new mineral assets. Adding Jenkins to Demaneng was a great idea as it balanced the export business linked to spot iron ore prices, with a stable fixed-price local supply agreement to a domestic customer. They have also added anthracite (high quality coal used in the making of steel) with their Nkomati project and the Glenover project will add super phosphates, which are used as fertilizer, vermiculite used in fire protection and insulation, and rare earths which have battery and technological applications.

Secondly, they understand all the permitting and licensing requirements inside out and, by having people on the ground, they can get over all the hurdles with ease. For example, they announced the Coza acquisitions (including Jenkins) in late 2020 and were able to secure all mining and water use licenses by August 2021, getting the mine up, running and profitable in record time. Thirdly, they have good relationships with their local communities and workforce, even in very challenging areas. At the Nkomati mine in Mpumalanga, for example, they have three separate communities bordering the project site and have successfully agreed local employment arrangements, housing resettlements and community upliftment investments. Employees, community members and shareholders all share in these benefits.



Making your own luck

Great opportunities often come along when you least expect them. Whilst working for myself, I met a couple of my future Granate colleagues through a shared interest in infrastructure investment. They saw an opportunity for me to reconfigure from engineer into an equity analyst and asked me to give it a try in late 2019. I took a risk and was immediately hooked, loving the work of an analyst, as well as the caring people, supportive culture and startup spirit that has been the heartbeat of Granate. I have never looked back. Whilst there was a huge amount of luck involved in being in the right place at the right time, I also think it helped that I was open to opportunities, even when people thought I was a bit crazy.

Afrimat was thought of as a quarry business. People were skeptical when they ventured into industrial minerals but over their first 10 years after listing they delivered an impressive average annual return of 16% (on a total return basis). When they announced the Demaneng acquisition, people thought they were mad, but they have delivered another 16% a year since then. We don't think of Afrimat as a mining business. Instead, we see them as an investment business: a team of very smart capital allocators who have configured their business in a way that enables them to find amazing opportunities to buy quality assets at reasonable prices and get the most out of them. They have also had their share of luck (e.g. favourable commodity prices) but we think the odds of getting lucky are much better in a business that combines an entrepreneurial culture with investment discipline.

With SANRAL starting to invest in road infrastructure, there are signs of life in construction materials again. Afrimat is adding to this segment, recently announcing the acquisition of Lafarge South Africa. Cement is a tough industry, and people are again skeptical, but at the bargain price they are paying they are, in their words, *"buying a good aggregates business and getting a free option on cement"*. Nkomati is ramping up and the first phases of Glenover are starting, creating excitement across all areas of the business about the possibilities ahead. We have held Afrimat in the Granate BCI Flexible Fund and the Granate BCI Balanced Fund from the day we launched them. To date this has been a good outcome for our clients. We think this is a business that has the potential to keep compounding for a long time, but we constantly monitor progress and regularly revisit the investment thesis to ensure that remains intact. This helps guard us from falling into the trap of owning too much of Afrimat, or perhaps even too little.

Granate is a people business.

We are committed to creating a rich and rewarding culture through our shared values. Granate is configured thoughtfully and intentionally so that our team can thrive for the benefit of our clients. We care about the same things you do and are *relentlessly* **committed to protect and grow your savings**.