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Remgro and Richemont restructuring unlocks value for shareholders

Allan Gray's portfolios have benefited from the market's favourable reaction to the restructuring of Remgro and Richemont. These two shares constituted 10% and 9% of the Allan Gray Equity Fund respectively just prior to the transaction. The shares have relatively outperformed the FTSE/JSE All Share Index over the past quarter, partly due to the market's positive reception to the transaction.

Background

In October 2008, Remgro and Richemont were restructured to separate the companies' tobacco interests from their other interests. The catalyst for this restructuring was an impending change in the Luxembourg tax regime that would have prejudiced shareholders. This transaction grants shareholders added flexibility by providing direct access to the tobacco investments. It has unlocked value by eliminating some of the conglomerate discount inherent in the previous structures in a tax-efficient manner.

How does the restructuring affect your portfolios and what are the investment merits of these shares?

We have four separate shares in our portfolios as a result of the restructuring.

British American Tobacco (BAT) currently makes up 10.1% of the Allan Gray Equity Fund

Since BAT made up over half of Remgro and Richemont's intrinsic values, it has become one of the Equity Fund's top three shares now that our investors are able to own it directly. In GrayIssue no.72, published in October 2007, we elaborated on our investment case for BAT. Our arguments still hold true today. We remain confident in BAT's ability to sustain profits amidst challenging global conditions, given the constancy of demand for tobacco products over many decades. BAT is on a 4.7% dividend yield and will be returning £750m per year – almost all of its earnings – to shareholders by means of share buybacks. BAT's economics should enable the company still to grow its earnings in real terms despite paying out almost all of its earnings.

Compagnie Financiere Richemont (CFR) currently constitutes 5.1% of the Allan Gray Equity Fund

CFR is a luxury goods company, producing high-end jewellery, timepieces, writing instruments and accessories under a number of century-old brands. *Vacheron Constantin* is the world's oldest watchmaker, having produced timepieces for over 250 years. *Cartier* is a 160 year old prestigious and aspirational jeweller. Other CFR brands include *Montblanc*, *Dunhill* and *Van Cleef & Arpels*. The business is globally diversified, with Western Europe, the US, Japan and China/Hong Kong each accounting for about 20% of sales. Thirteen percent of the current valuation of the business consists of net cash. CFR's primary listing is on the Swiss stock exchange. It is currently trading at a PE multiple of 10x on what we would admit are high earnings. In our opinion, this is low enough to be attractive for a very high quality business with significant barriers to entry.

Remgro currently makes up 3.8% of the Allan Gray Equity Fund

Without British American Tobacco, Remgro now comprises of a broad portfolio of high quality, South African financial, industrial and resources companies. Approximately 60% of Remgro's portfolio consists of JSE-listed companies, with 30% held in unlisted investments and the balance in foreign-denominated net cash. Half of Remgro's listed investments consist of financial services through FirstRand and RMB Holdings. Other assets include Medi-Clinic, Distell and Implats. Major unlisted investments are Unilever SA, Total SA and TSB Sugar. Remgro is currently trading at a 28% discount to its net asset value and we find it attractive.

Reinet currently constitutes 0.8% of the Allan Gray Equity Fund

Reinet is a closed-end international investment holding company with a primary listing in Luxembourg. Its portfolio is ungeared, initially consisting mainly of BAT shares and euro-based cash. Management intends to diversify its portfolio with an objective of generating long-term capital growth. The current discount to net asset value more than compensates investors for the inherent fee structure.

Commentary by Simon Raubenheimer, Portfolio Manager, Allan Gray Limited