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Sasol share price sell-off

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INVESTMENT MANAGERS

By Simon Kendall, Portfolio Manager and Resources Analyst | **9 March 2020**

The share price of chemicals and petroleum producer Sasol has plunged in the past few days, falling by nearly 50% on Monday 9 March alone to its lowest level since October 2003.

The sell-off occurred on the back of both the broader bearish investor sentiment globally concerning the impact of the spreading coronavirus, and the 30% drop in the price of Brent crude oil to around US$33 per barrel on Monday. The latter was sparked by Saudi Arabia's decision to flood the oil market with extra supply in order to retaliate against Russia's rejection of OPEC's proposal to further curtail production.

Sasol's earnings are directly impacted by moves in the oil price. At its recent interim results presentation in February, Sasol indicated that if the oil price fell below US$45 per barrel and stayed there for six months, the company would likely face tighter borrowing requirements. At the time they did not expect to need to raise new equity, but they had nevertheless formulated a plan for this possibility. The company also has a programme to raise some US$2 billion from asset sales, of which they have so far delivered about US$400 million in cash.

With Saudi Arabia and Russia now effectively engaged in a price war, the oil price environment is fluid. If this environment persists for an extended period of time (which is uncertain), it is likely that Sasol will need to both raise new equity and accelerate its asset sales programme to repay debt.

Turning to the valuation metrics, Sasol's price/book ratio, our primary long-term valuation anchor for the stock, is now screening below 0.15X. The group reported six-month earnings (EBITDA) of R20 billion to 31 December 2019 – this is roughly 10% of its enterprise value of R203 billion and 40% of its market capitalisation of R19.5 billion (which is less than the last 6 months' profit). Based on these valuation metrics the investment attractive, even given the numerous challenges it faces.

It is true that the company faces a weak external environment, and that the time before it fully ramps up its cash flows has been prolonged due to the unexpected delays and cost overruns at its new Lake Charles ethane cracker plant. However, this capital spending is reportedly now 98% complete, and it is expected to make a positive contribution to earnings in the second half of the financial year.

We consider it imprudent to sell our position at the current share price and in the fluid and uncertain conditions in the oil market (and broader global equity markets). We acknowledge that the investment case for Sasol has become more risky after recent events and share and oil price movements and that the share price decline has been negative for our funds. However, our investment process incorporates a highly risk-conscious portfolio construction methodology which limits any single share and sector weight. Therefore our client portfolios would never be overly exposed to a single stock like Sasol. The below table shows our retail funds' exposures to Sasol prior to the market downturn and currently.

Prudential Unit Trusts	Sasol weighting As of 28 Feb 2020	Sasol weighting As of 10 March 2020
Equity Fund	3.0%	1.3%
Dividend Maximiser Fund	2.4%	1.0%
SA Equity Fund	3.7%	1.6%

Note that the weighting of Sasol in our diversified multi-asset funds is even smaller than the numbers quoted in the table above.

We are obviously concerned about the impacts of the recent broad global market downturn and the oil price war on our client portfolios and about their effect on our clients' returns. We are continually monitoring the markets to ensure we protect them as best as possible. We have been through similar market crashes in the past which we have navigated successfully thanks to our prudent, tried-and-tested investment process and the experience of our investment management team.

For more information on our broader market views, please see our communication "**Update: Coronavirus - Oil price market downturn**".