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EQUITY RESEARCH 14 July 2021

VUN – Vunani Limited FY21 Results Equity Update

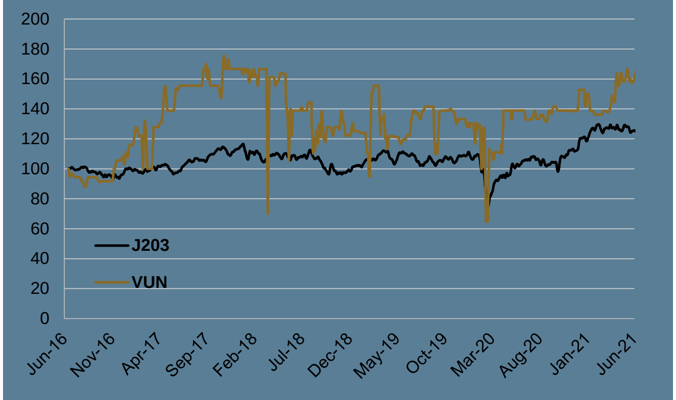
Valuation: Undervalued

VUN released full year results on 7 June 2021 for the period ended 28 February 2021

Price (R)			**2.75**
PE Fair Value (R)			**3.74**
DCF Value (R)			**4.09**
Upside(Downside) to DCF (%)			48.8%
DY %			4.5%
Price Performance			**Relative**
		Absolute	**to JALSH**
1 month		-5.9%	4.5%
3 month		12.9%	-5.9%
YTD		12.9%	-4.1%
12 month		**High**	**Low**
(SA Rands)		3.00	2.01

No. of shares (m)	161	Price (R)	2.75
NAV per share	1.74	Mkt cap (Rm)	453
EV (Rm)	737	Price/Book (x)	1.58

Financial Year	**2020**	**2021**	**2022F**	**2023F**
Turnover (Rm)	345	559	642	702
EBITDA	97	37	118	139
EBIT	73	10	87	103
PAT	39	0	74	82
HEPS (cents)	0.6	7.2	41.6	46.1
P/E ratio	432.4	38.0	6.6	6.0
EV/EBITDA	2.7	9.0	2.7	1.8
EBITDA margin (%)	28%	7%	18%	20%
ROCE (%)	10%	1%	10%	11%
ROE (%)	7%	5%	19%	19%



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RESULTS COMMENTARY

Vunani's latest results saw a significant decrease in performance from the Insurance segment and the loss from discontinued operations counteract strong performance from the Fund Management, Investment Banking and Asset Administration segments, despite tough trading conditions.

- Group revenue from continuing operations increased 62.1% to R558.7m with revenue from the Fund Management, Investment Banking and Asset Administration segments increasing by 40.8%, 24.1% and 3.8%, respectively.

- Despite the Fund Management, Investment Banking and Asset Administration segments reporting significant net profit increases, the Group's net profit after tax from continuing operations decreased by 65.9% to R20.1m, largely owed to losses in the Insurance segment caused by significant negative fair value adjustments to its insurance liabilities of R67.9m as well as impairments of intangible assets of R41.1m.

- Discontinued operations, consisting of the Private Equity segment as well as Fund Management operations in Malawi and Zimbabwe, recorded a loss of R20.2m, attributable to negative fair value adjustments to the private equity assets. As a result, the Group generated a total loss for the year of R159k.

- Vunani unbundled its Private Equity segment, held by Vunani Capital Partners, in February 2021 into a separate vehicle that was listed on the Equities Express Securities Exchange (EESE) on the 15th of June 2021.

- HEPS increased to 7.2 cents from 0.6 cents in FY20. A final ordinary dividend of 7.5cps has been declared.

OUTLOOK FOR NEXT REPORTING PERIOD

Vunani had a strong start to the FY21 year, on track to deliver an impressive set of results. However, while its other segments managed to escape the devastating impact of Covid-19 in H2 relatively unscathed, its Insurance and Private Equity segments faced major obstacles to profitability. Strong performance from the Group's Fund Management, Investment Banking and Asset Administration segments was offset by losses in its Insurance and Private Equity segments, which put the Group in a loss-making position.

During the period, Vunani unbundled the Private Equity portfolio held by Vunani Capital Partners (VCP). The volatility of the coal and commodity trading has significantly distorted results from year to year and consequently causes a value trap, as evident in FY21's results. The separate listing of VCP on the EESE will allow shareholders to realise the underlying value of the remaining financial services businesses. The share price has already responded positively to the unbundling, having reached R3.00, its highest price within the past three years.

The shares of VCP were unbundled to the shareholders of Vunani Limited on a one for one basis. Prior to its listing on the EESE, VCP executed a private placement by way of an offer to subscribe for between 15.2m and 37.9m shares at an issue price of 132cps. The private placement aimed to raise approximately R20m to R50m capital before expenses to fund the expansion of the company's investment portfolio, via acquisitive opportunities, and provides a solid foundation upon which greater value can be extracted from existing assets.

Overall, revenue is expected to increase by 15.0% to R642.2m in FY22 and a further 9.2% to R701.6m in FY23. The unbundling of VCP is expected to propel the Group out of its loss-making position as strong performance from the remaining financial services business will no longer be distorted by losses from the Private Equity portfolio. Net profit of R73.9m is expected in FY22, boosted by improved performance from the Insurance segment. Further net profit growth of 11.3% to R82.2m is expected in FY23.

HEPS is forecast at 41.6 cents in FY22 and 46.1 cents in FY23. Post-unbundling, the Group is on track to achieve its target of becoming a sustained dividend payer in the market.

SEGMENTAL PERFORMANCE

Following the unbundling of the Private Equity segment, the Group has four main segments: Fund Management, Asset Administration, Investment Banking and Insurance.

Revenue from the **Fund Management** segment grew by 40.8% to R133.6m while net profit climbed by 68.8% to R18.0m. Following the unbundling of the investment in Purpose Vunani Asset Management (PVAM), the segment now consists of Vunani Fund Managers (VFM) in South Africa and Vunani Fund Managers Botswana (VFMB).

VFM's performance improved during FY21, due to 29.8% growth in assets under management (AUM) to R51.5bn. VFM recorded revenue growth of 18.0% to R106.4m, which marginally outperformed management's expectations by 250bps, but is nevertheless still impressive given the trading environment, which was not very conducive to client engagement and business development.

The VFM brand is fairly well recognised in the market as evident by the push in AUM in recent years. Management believes that there is still a significant scope for growth in this business.

VFMB made a small profit of R600k in its first full year as part of the Group, despite recording a 22.0% decline in AUM to R4.6bn due to the withdrawal of funds by investors to deal with the impact of Covid-19. Pressures on performance were further compounded by VFMB's transition into a standalone fund management business, from being a member of the Stanlib Group, which it had a tough time bedding down.

VFMB is however showing great promise, having been shortlisted and recently selected by the Botswana Public Officers Pension Fund (BPOPF), the largest retirement fund in Botswana, as the preferred service provider for a R3bn fund. Management has advised that the deal, which is still subject to further due diligence by the BPOPF, could see AUM grow by as much as 75%.

VFM's recent strong AUM growth as well VFMB's BPOPF mandate provide the basis for our forecasted total AUM growth of 19.9% in FY22 and 13.8% in FY23. Management expects the benefit of the BPOPF deal to potentially start pushing through in H2FY22, depending on how quickly it can bed down the mandating process. As such, segmental revenue is forecast to increase by 37.5% to R183.7m in FY22 and a further 12.4% to R206.5m in FY23. On a net profit yield of 0.03%, we expect net profit to increase by 12.2% to R20.2m in FY22 and a further 13.8% to R23.0m in FY23.

The **Asset Administration** segment, which includes the Groups investment in Fairheads Benefit Services, recorded marginal revenue growth of 3.8% to R144.6m. Fairhead's assets under administration (AUA) grew by 9.0% to R7.3bn. The segment grew net profit by 18.3% to R19.6m, with the NPAT margin increasing to 13.6% from 11.9%.

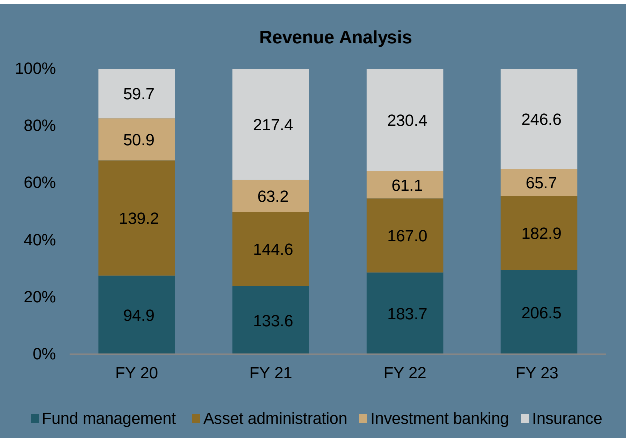
Fairheads Benefit Services, which is held through Mandlalux Limited, is an administrator in the retirement fund and fiduciary industries, with beneficiary funds, umbrella trusts and pension-backed home loans. During the year, the business continued with the onboarding of a R1.5bn book which should drive an increase in both revenue and earnings in H2FY22.

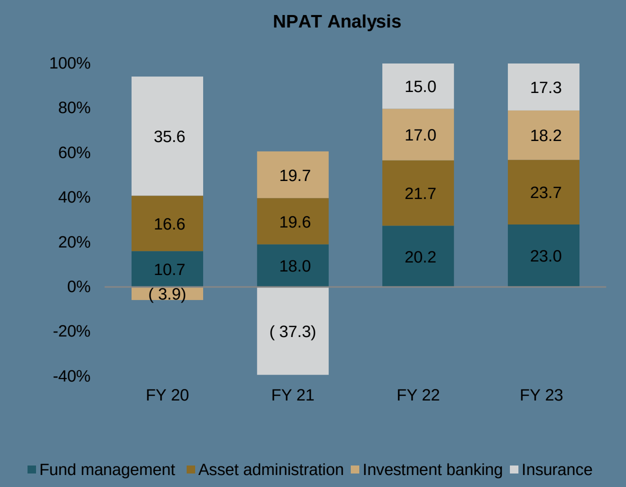
The Fairheads Financial Services business, which focuses on the tracing of dependents on behalf of unclaimed funds, turned its first profit in FY21 following an initial loss in its inception year.

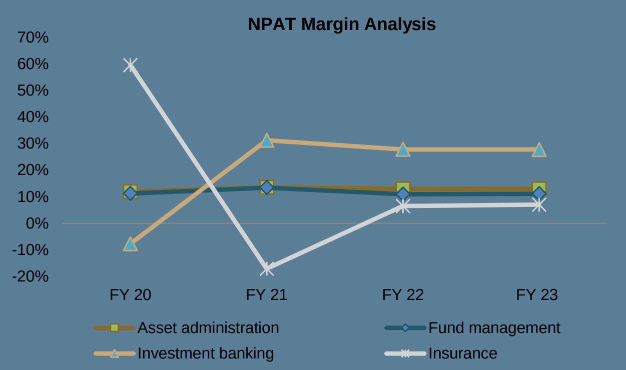
The onboarding of the R1.5bn book is expected to drive AUA growth of 10.0% to R8.0bn in FY22 and a further 9.5% to R8.8bn in FY23. Revenue and net profit are forecast to increase by 15.5% and 10.6% in FY22 to R167.0m and R21.7m, respectively. In FY23, revenue and net profit growth levels are both forecast at 9.5%, thereby increasing to R182.9m and R23.7m, respectively.

Revenue from the **Investment Banking** segment increased by 24.1% to R63.2m owing to strong performance from the businesses that comprise it, namely Advisory Services and Institutional Securities Broking. Impressively, the segment turned a profit of R19.7m, having made losses for the past two years.

Vunani Corporate Finance (Advisory Services) demonstrated improved performance in a tough environment, where lead times to finalise mandates were often longer. Revenue increased by 20.7% to R16.9m, Moreover, the business reversed its loss-making position and turned a net profit of R5.6m.







Similarly, the Institutional Securities Broking segment made a pleasing recovery during the period, increasing revenue by 25.2% to R46.2m and contributing R14.2m to net profit (FY20: R3.7m loss). Vunani Securities had an exceptional year, managing to reverse two years of losses and deliver a profit. This comes after the business's new venture into transition management, a type of broking targeted at corporates and retirement funds, in which it leveraged the Group's network to secure corporate clients. Similarly, Vunani Capital Markets had an exceptional year, performing well above targets and boosting the segment's revenue.

Despite performing exceptionally well in FY21, management has advised that maintaining the performance of the Institutional Securities Broking segment in FY22 will be tough as the trading environment remains tight, with margin squeeze becoming increasingly apparent. Trading costs imposed by regulators are unavoidable and continue to heighten as more customers require interfacing trading software.

We expect revenue to decrease by 3.3% to R61.1m in FY22 before increasing by 7.5% to R65.7m. A 13.8% decline in net profit to R17.0 is expected in FY22, pulled down by an expected ~23% net profit decline in the stock broking business as margin squeeze becomes increasingly more apparent. Thereafter, in FY23, net profit is expected to increase by 7.2% to R18.2m.

The **Insurance** segment, which includes the Group's 52% interest in Oracle Insurance, and Oracle Life, was severely impacted by the second wave of Covid-19. The segment recorded revenue of R217.4m and a loss of R37.3m.

Oracle Life incurred significantly higher death claims during H2, driven by the surge in Covid-19 cases in Eswatini. As a result, it recorded negative fair value adjustments of R39.6m, necessitated by actuarial adjustments based on the claims experienced during the year. Fair value adjustments had a major impact on the profitability of the segment and the Group as a whole. Despite losses, the business still has adequate capital cover, however, it may require a capital injection should another heightened claims experience take place. Oracle Insurance performed reasonably well during its first full year as part of the Group, turning a profit of R1.5m. Despite being an emerging business in the Oracle Group, the business is well known in the Eswatini market.

Revenue is forecast to increase by 6.0% to R230.4m in FY22 and a further 7.0% to R246.6m in FY23. The third wave of Covid-19 infections in H1FY22 is expected to impact the claims experienced, but the extent is difficult to predict, owing to Eswatini's small size. Net profit of R15.0m is expected in FY22, followed by R17.3m in FY23 as the mass vaccination of the population is expected to significantly reduce the number of claims.

VALUATION

The unbundling of VCP will allow the Group to unlock the true value of its well-diversified financial services portfolio, which has historically delivered strong performance. Good growth is expected to persist over the next few years as market sentiment improves and the South African economy begins to recover.

The Group's balance sheet remains robust with little interest-bearing debt. This solid base provides a degree of strategic flexibility which allows the Group to increase gearing where necessary to encourage organic growth and take advantage of possible acquisition opportunities.

Both our DCF valuation and our relative PE valuation indicate that the share is currently **Undervalued**.

With reference to the DCF table, we have considered a discounted cash flow analysis with cash flows forecast to FY24. Utilising a terminal growth rate of 6% and a discount rate of 22.9%[1] for the sensitivity table, a value of R4.09 is returned.

With reference to the relative PE table, we have compared Vunani to other financial services companies in the industry and applied a 10% discount to the peer average. The implied forward PE of 8.6x places the share at a valuation of R3.74.

Growth rate	DCF Discount rate 18.9%	20.9%	22.9%	24.9%	26.9%
0%	3.99	3.57	3.23	2.95	2.70
2%	4.36	3.87	3.46	3.13	2.86
4%	4.83	4.22	3.75	3.36	3.04
6%	5.45	4.68	**4.09**	3.63	3.26
8%	6.30	5.28	4.53	3.97	3.52
10%	7.52	6.09	5.11	4.39	3.85
12%	9.45	7.28	5.90	4.95	4.26

Financial Services	Price	Mkt cap (m)	1 year fwd PE
Sygnia*	18.19	2783	11.6
Alexander Forbes*	3.77	5402	9.0
Coronation Asset Management*	50.40	18024	11.5
Vunani Limited	2.75	453	6.4
Average			**9.6**
*consensus forecasts used			-34%
Vunani Limited	**2.75**	**453**	**6.35**
Premium (Discount) applied to average:			-10%
VUN : Implied current gain/(loss):	**3.74**	36%	**8.6**

[1] The discount rate is based on the average implied discount rate obtained from cash flow forecasts for companies with market capitalisations ranging from R301m to R10bn in our research universe

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