Date 11 November 2022

VUN – Vunani Limited Interim Results Equity Update

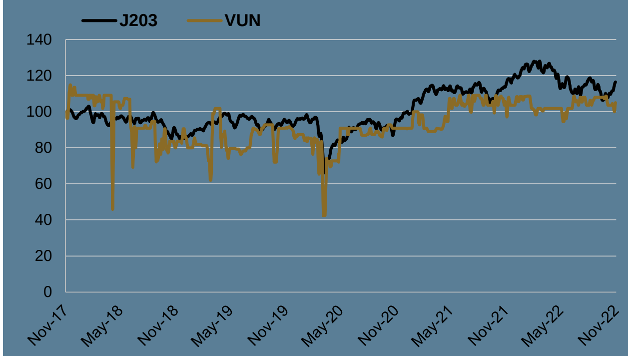
Valuation: Undervalued

VUN released interim results on 6 October 2022 for the period ended 31 August 2022

Price (R)			**2.98**
PE Fair Value (R)			**2.75**
DCF Value (R)			**3.48**
Upside (Downside) to DCF (%)			16.7%
DY %			5.5%
Price Performance			**Relative**
		Absolute	**to JALSH**
1 month		3.1%	-6.1%
3 month		7.8%	8.6%
YTD		8.2%	5.9%
12 month		**High**	**Low**
(SA Rands)		3.00	2.26

No. of shares (m)	161	Price (R)	2.98
NAV per share	2.04	Mkt cap (Rm)	480
EV (Rm)	410	Price/Book (x)	1.46

Financial Year	2021	2022	2023F	2024F
Turnover (Rm)	559	687	738	800
EBITDA	37	134	119	128
EBIT	10	107	98	108
PAT	0	72	73	81
HEPS (cents)	7.2	34.7	42.0	50.5
P/E ratio	34.7	8.6	7.1	5.9
EV/EBITDA	7.4	2.3	2.7	2.3
EBITDA margin (%)	6.7%	19.5%	16.1%	16.0%
ROCE (%)	0.9%	11.1%	9.9%	10.6%
ROE (%)	4.6%	17.0%	16.8%	18.5%



RESULTS COMMENTARY

Business post the domestic National State of Disaster continues to drive a new normal, but with new global and local challenges, Vunani juggles through a post Covid-19 recovery together with servicing current global economic uncertainties and threats to the local economy.

- Revenue and gross premiums increased by 17.2% to R376.8m in H1FY23, compared to R321.5m in the previous comparative period, with all segments realising expansion bar the securities broking segment on the back of turbulent markets.
- Net profit after tax saw a moderate 3.2% decline to R39.4m from R40.7m achieved in H1FY22.
- Negative fair value adjustments tripled to R46.9m during the period, having detrimental effects on Group profits.
- HEPS shrunk by 1.4 cents to 20.3cps when compared to 21.7cps in the previous comparative period, representing a 6.5% decline.
- An interim dividend of 9cps was declared by management, an increase of 38.5% from the 6.5cps declared at 31 August 2021.

OUTLOOK FOR NEXT REPORTING PERIOD

As the Covid-19 pandemic and its restrictive lockdowns dissipated, VUN found itself confronted by new challenges in the first six months of the year. Russia's invasion of Ukraine, rising energy and fuel costs, fierce monetary policy and Eskom's rolling blackouts added further pressure to a business base focussed on recovering well post the economic slump created by the pandemic. Although being moderately protected from the typical impacts of Covid-19, being a financial services business whose operations continued "from home" with little disruption, Vunani was stretched during the reporting period but managed to effectively navigate itself through the challenges mentioned above.

Negative fair value adjustments of R46.9m (H1FY22: R15.6m) have negatively affected the groups profitability with most of the adjustments attributable to the Insurance segment, slightly impacting their growth trajectory since inception.

Operating expenses have seen a 15% increase from R189.3m to R218.2m largely due to increases in staff costs as well as a 30% increase in reinsurance premiums from R27.4m to R35.6m following increases in premium incomes as well as the impact of inflation on other operating costs. Other incomes, which include once-off incomes, sundry income and director's fees have seen a combined 18.3% decrease from R8.2m to R6.7m.

As per the Groups strategy to grow their insurance segment within Eswatini, through their Oracle Insurance business, the period saw an 8.7% increase in insurance-related investments from R453.4m in February 2022 to R492.8m. Investment contracts and third-party liabilities were fair valued at the end of the reporting period at R529.1m, resulting in an increase of 4.6% from R505.9m reported in the comparable period.

Investment revenue which is received in the form of dividends increased by 100% to R5.4m from R2.7m reported in August 2021. This is due to increases in dividends from insurance-related investments driven by the performance of the underlying assets.

The Group has realised an increase in finance income as a result of an increase in returns from its cash investment positions and increases in interest rates, subsequently H1FY23 saw a finance income amount of R3.6m from R3.1m reported in H1FY22. Interest from investments also saw an uptake of 14.3% from R10.5m to R12m largely due to returns on the insurance segment's insurance-related investments which continue to deliver satisfactory returns.

As a result of a decrease in the Group's external financial liabilities, finance costs have also decreased from R3.2m in the comparable period to R2.9m, protecting the Group from increased finance costs associated with a rising interest rate environment.

We expect revenue to increase by 7.4% in FY23 to R737.8m and in FY24 to grow by 8.4% to R800m as recent monetary policy decisions start to ease inflation. NPAT is expected to rise by 10.8% to R79.4m followed by a 11.1% increase to R88.3m in FY24. Effective management of fair value adjustments is crucially important in retaining tangible profitability within the Group.

SEGMENTAL PERFORMANCE

The Group has five main divisions: **Fund Management, Asset Administration, Investment Banking**, which consist of the **Advisory services segment** and the **Institutional securities broking segment**, and the **Insurance division**.

The **Fund Management** division is made up of Vunani Fund Managers Proprietary Limited (VFM) in South Africa and Vunani Fund Managers Botswana Proprietary Limited (VFMB) in Botswana. Revenue for the period grew by 17.7% to R95.2m, (H1FY22: R80.9m) while NPAT saw a 13.9% decline to R18.3m compared to R21.2m reported in H1FY22.

The VFM business experienced a decrease in profitability and revenue as they saw their total assets under management (AUM) decrease by 13% to R53.9bn from R61.9bn AUM at 28 February 2022 as investors asses their risk aversion amidst rocky equity markets.

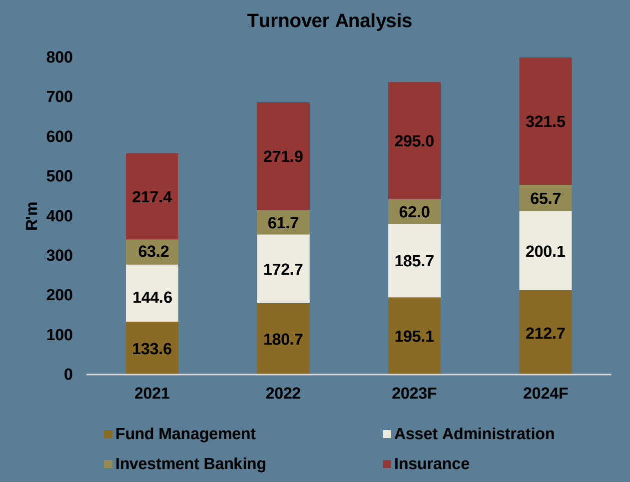
The effects of continued interest rate hikes by the SARB in response to rising inflation has also had an adverse effect on consumer confidence in the equity markets. As interest rates increase, investors opt for cash and safe-haven assets whose risk-reward ratios become more attractive than those of equities due to increased rates. However, with many major markets said to be experiencing the peak of inflation, the conservative efforts of monetary policy makers should tame inflation and deter further volatility in the equity markets to which VUN can redeem good returns in the future.

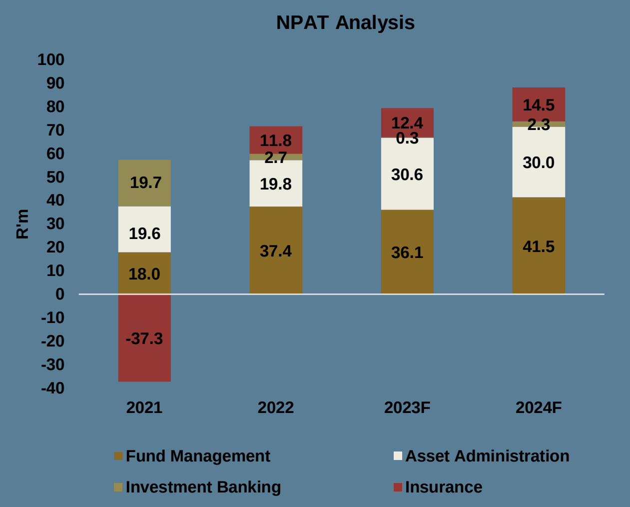
In addition, the conflict in Ukraine continues to drive global economic uncertainties which play a major role in further disrupting equity markets. Albeit South Africa partially shielded from extreme volatility by their exposure to natural resources which saw an uptake in price during the reporting period due to energy shortages on the back of Russia's invasion of Ukraine. The first six months of the year saw unusual volatility in the global equity markets following a bull market that lasted north of ten-years. As the war in Ukraine rages on, with no end in sight, this will continue to create instability within global equity markets resulting in lowered returns.

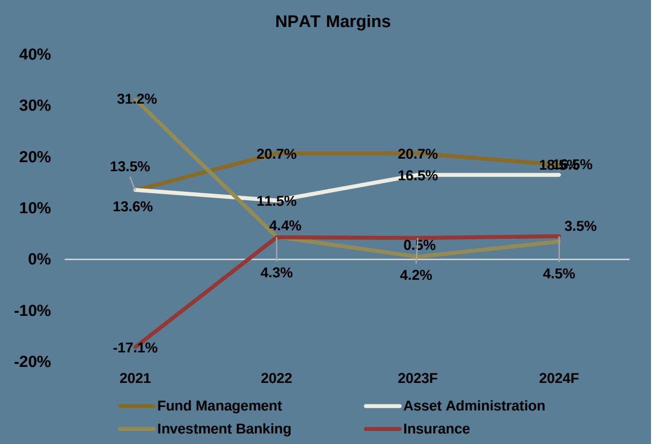
VFMB's AUM, however, saw an 18.5% uptake to R10.9bn from R9.2bn in February 2022, which management looks to contribute to the segment's future profitability, offsetting the decline experienced in the VFM business. AUM increases, together with any economic upturn will contribute meaningfully towards the segments profitability and revenue going forward.

Overall, we expect revenue to grow at a slower pace, however, still record high-single-digit growth of 8% to R195m in FY23 as equity markets seek stability amid high inflation, increased interest rates and global political uncertainty. NPAT is forecast to decrease slightly by 3.5% after which it is expected to realise a 14.9% increase in FY23 and FY24, taking the amounts to R36.1m and R41.5m, respectively.

The **Asset Administration** segment consists of investments in Fairheads Beneficiary Services Proprietary Limited (Fairheads) and Fairheads Financial Services Proprietary Limited (FFS). Fairheads AUM saw a slight 3.3% increase to R9.5bn from R9.2bn in February 2022. The segment saw double digit increases in both revenue and NPAT which led to the segment being the second greatest contributor to Group revenue and the largest contributor to overall NPAT. Revenue increased by 19.1% to R95.4m (H1FY22: R80.1m), while NPAT expanded significantly to R19m from R11.3m in the prior period, representing a mammoth 67.1% rise and overtaking the Fund management segment for top spot.







Vunani's recent acquisition of a 50% interest in Verso Group (Pty) LTD (Verso), through VUN's wholly owned subsidiary, Vunani Capital (Pty) Ltd (Vunani Capital), which came into effect on 1 October 2022, will help deliver improved revenue and profitability for the Group. Verso is a financial services group of companies specialising in providing comprehensive wealth management and Section 13B retirement fund administration services. Its businesses complement Vunani's operations and is well positioned to exploit the synergies and exemplary reputation provided by the agreement.

We forecast revenue growth of 7.5% to R185.7m in FY23 followed by a further 7.8% uptake to R200.1m in FY24. NPAT is expected to increase by 54.4% and then decrease by 2% in FY23 and FY24, taking the amounts to R30.6m and R30m, respectively.

The **Investment Banking** division consists of the **Advisory Services** segment and the **Institutional Securities Broking** segment.

Revenue from the **Investment Banking** division contracted slightly by 0.7% to R33.5m compared to R33.8m in the previous comparative period. NPAT for the segment saw a colossal 556% decline to a R4.3m loss from a profit amount of R0.9m printed in August 2021.

The Advisory Services segment includes Vunani Corporate Finance which offers a full range of advisory services and JSE, A2X sponsor services together with the Groups' management services to underlying subsidiaries and associates, including private equity company, Vunani Capital Partners. Revenue experienced a 32.2% increase from R14.9m to R19.7m while the segment saw a loss of R3.4m when compared to a profit of R0.5m in the previous period.

The Institutional Securities Broking segment includes equity, derivative and capital market trading services to institutional clients. On the back of volatile markets spurred by high inflation and global instability, the segment saw a decline in performance in the first six months of the year, returning a 27% decrease in revenue taking the amount to R13.8m from R18.9m while contributing a loss of R0.9m compared to a profit of R0.5m in H1FY22.

We expect revenue to increase by 0.5% in FY23 to R62m and a further 6% in FY24 to R65.7m. NPAT is expected to see a further 88.5% decrease from the previous year to R0.3m after which we expect an increase back to R2.3m from a low base as the markets stabilise following tamed inflation and in the hope of a more stable global political environment.

The **Insurance** division consists of the investment in Oracle Insurance and Oracle Life (Oracle) in Eswatini. Fairly new, the division has successfully reported impressive results since its inception. Currently it contributes the most towards Group revenue, achieving R152.7m in H1FY23 from R126.8m in H1FY22, representing a 20.5% increase. NPAT came in at R6.4m from R7.1m in the previous period, a 10.1% decline.

The division realised adverse effects by negative fair value adjustments to its insurance assets and liabilities amounting to R45.8m (H1FY22: R12.1m) and materially effecting the segments' profitability. Of this, R23.3m (H1FY22: R31.4m) can be attributed to insurance investment contract liabilities while R22.5m (H1FY22: R19.3m positive fair value adjustment) is due to the Group's insurance-related investments.

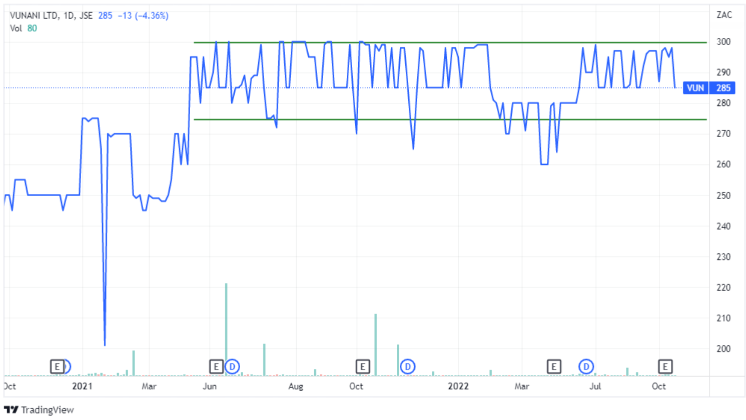
As the pandemic came to its tail-end, less claims came about when compared to those during the pandemic years, relieving pressure on the insurance businesses which saw extreme uptakes in claims as a result of high infection and death rates. The segment saw a 12.7% decline in insurance benefits and claims from R64.5m to R56.3m as the impact of Covid-19 reduces in Eswatini.

The need for insurance cover was highlighted during this period as more people started to understand the benefits of having short term, medical, business and life cover; hence the impressive growth seen within the segment in a short period of time. The pandemic's effect on mortality rates remains a major topic within the industry, as rates increased during the pandemic (Eswatini currently has a Covid-19 mortality rate of 1.9% as per the John Hopkins University) and many insurers were forced to reassess their product offerings, provisions, reserves and premium pricings to better suit their clients while emphasising revenue growth in a post-pandemic world. The Group stands to gain from these developments within the sector.

We forecast revenue for this segment to grow at a steadier pace of 8.5% to R295m in FY23 and a further 9% to R321.5m in FY24. NPAT is expected to grow by 5.4% to R12.4m and a further 16.8% to R14.5m in FY24.

TECHNICAL ANALYSIS

Looking at Vunani on a technical analysis basis, the share price has been in a tight band since May 2021. We have increased the lookback period to 2 years to have an improved view of the share price movement. The upper resistance levels are currently at R3 per share, while support is between R2.85 – R2.75 per share. A break lower, through support can see the share price reach R2.60 – R2.50 per share.



VALUATION

Despite a cumbersome six months, the Group realised improvements in their operational performances and is continually improving synergies of its operating businesses as a key growth strategy wherein it is constantly assessing acquisitions that will enhance their financial services business.

Our DCF valuation indicates that the share is currently **Undervalued**, while our P/E valuation indicates that the share is **Fairly Valued.**

With reference to the DCF table, we have considered a discounted cash flow analysis with cash flows forecast to FY25. Utilising a terminal growth rate of 4.5% and a discount rate of 21.0%[1] for the sensitivity table, a value of **R3.48** is returned.

With reference to the relative PE table, we have average. The implied forward PE of 8.25x places the share at a valuation of **R2.75**.

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DCF Sensitivity Analysis					
	Discount rate				
Growth rate	**20.0%**	**20.5%**	**21.0%**	**21.5%**	**22.0%**
0.0%	2.99	2.90	2.82	2.74	2.66
2.5%	3.36	3.25	3.14	3.05	2.95
3.5%	3.54	3.42	3.30	3.19	3.09
4.5%	3.74	3.60	**3.48**	3.36	3.25
5.5%	3.97	3.82	3.68	3.55	3.42
6.5%	4.23	4.06	3.90	3.76	3.62
7.5%	4.54	4.35	4.16	4.00	3.84

P/E Calculation			
PEERS	**Price**	**Market Cap (R'm)**	**P/E ratios**
Alexander Forbes Group Holdings Limited	4.66	5599	13.59
Coronation Fund Managers Limited	34.97	12232	8.11
Sygnia Limited	16.90	2542	9.23
Average			**10.31**
			-21%
Vunani Limited	2.98	480	8.16
Discounts			
Company specific discount			5.0%
Size discount			15.0%
Discount applied to weighted P/E			**20.0%**
Adjusted P/E			**8.25**
Total Valuation for Vunani Limited			
Adjusted P/E multiple			8.25
Sustainable earnings per share			0.33
P/E Value per share			**2.75**
Implied current gain/(loss)			**-7.85%**

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[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 R700m in our research universe