

OLD MUTUAL

Bruised — but ignore the noise

The insurer has a long way to go to catch up with its rivals, and may even miss its operating earnings target

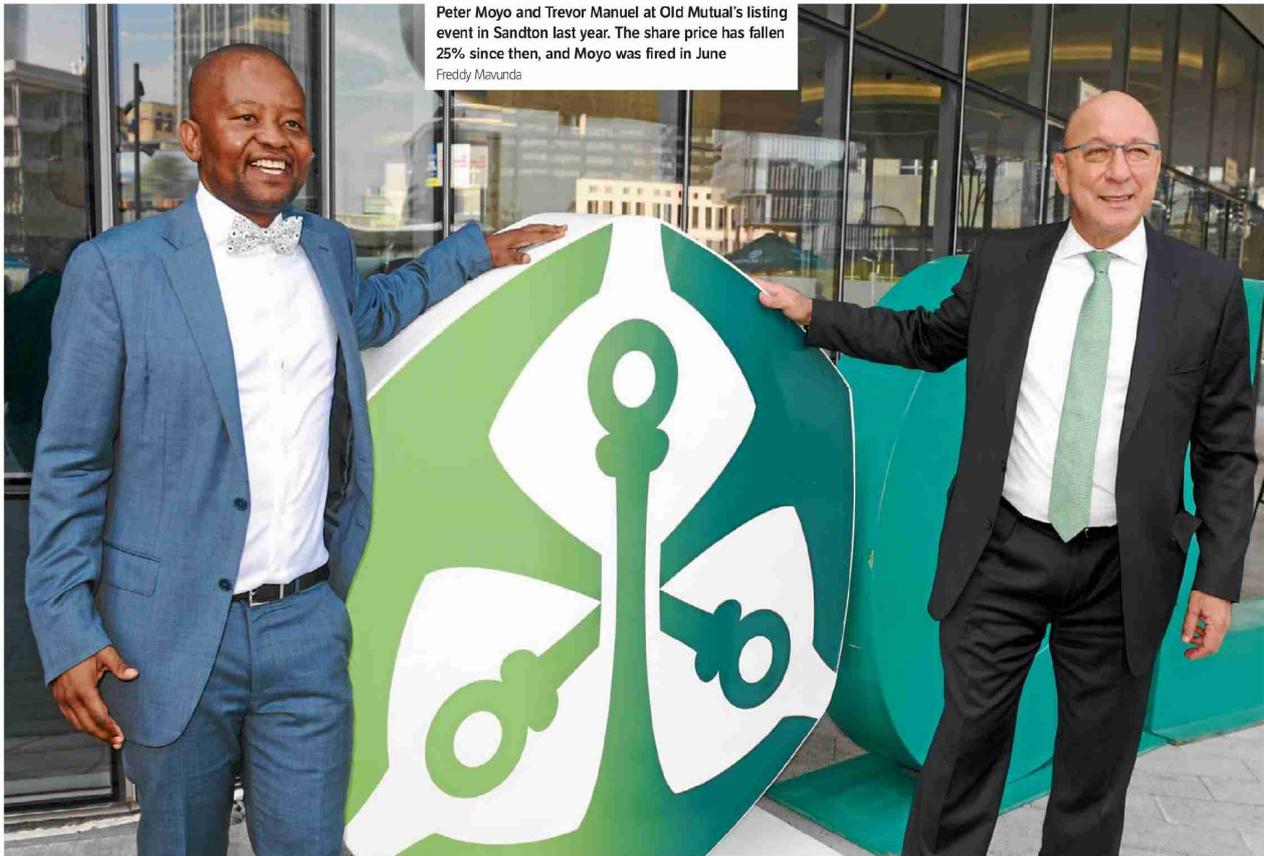
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● It was supposed to be a carefully choreographed return to SA. When Old Mutual relisted on the JSE last year, the “new” vehicle was what shareholders and analysts had been looking for. It was a business anchored in Africa, and one that had put a line under its disastrous

investments in the UK and US.

Yet its share price since relisting has fallen 25% to R21.20.

Even before the current punch-up between former CEO Peter Moyo and chair Trevor Manuel, Old Mutual was showing no sign of



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catching up in market cap terms with archrival Sanlam. Including its remaining 20% holding in Nedbank, Old Mutual's market value of R102bn is still just over half of Sanlam's R181bn.

Gavin Wood, CIO of Kagiso Asset Management, believes Moyo was a strange choice for CEO as he had rarely got his hands dirty by running a business – with the exception of a brief stint in charge of the Old Mutual employee benefits unit. He has spent most of his career in lofty management positions or on boards.

"And I would have been a lot more comfortable if Old Mutual had appointed a chair with solid business experience, [rather than] a retired politician."

The uncertainty about the identity and arrival time of Old Mutual's next CEO is bound to put a ceiling on the share price.

But at least the company can rely on a united board, which voted unanimously against Moyo, apparently including even his former colleagues in the Mutual C-suite, Peter de Beyer and Marshall Rapiya.

This doesn't mean, says Tabby Tsengwiwe, Old Mutual's chief communications officer, that the directors are under the sway of the chair.

But it's not surprising that investors are wary about Old Mutual for the moment.

Warwick Bam, head of research at Avior Capital, argues that investors are usually reluctant to provide new management teams with credit for their strategic ambitions before there

is evidence of value creation.

"The recently appointed management team at Old Mutual has yet to inspire a 'leadership premium' in Old Mutual's valuation."

In terms of total shareholder return, Old Mutual underperformed its competitor Sanlam by 7.4% in the second quarter of 2019, which implies that the governance concerns have had a material effect on Old Mutual's valuation, Bam argues.

Acting CEO Iain Williamson is competent to run the company in the short term and all the business unit heads have proved themselves, with the exception of the youthful head of wealth & investments Khaya Gobodo, and Old Mutual Insure's boss Garth Napier, who is a former retailer.

Karabo Morule, head of the personal finance middle-market unit, remains the bookies' favourite to be the next CEO.

Not everyone is happy with Moyo's contribution, but Stanlib's head of financials Louis Chetty says he was taking out costs. He had a goal of reducing annual costs by R1bn, and he had taken out R750m by the end of 2018. He also restored Old Mutual Insure (the former Mutual & Federal) to a more respectable position in the industry. Its underwriting ratio of 5.3% is within the company's target range, after years when the firm was barely able to eke out a 1% surplus. Operating profit in 2018 was up 28% to R670m.

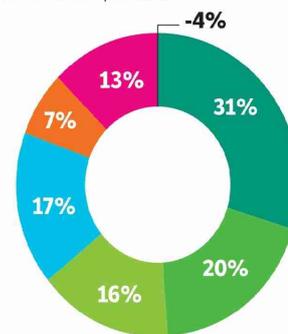
But Old Mutual still has a long way to catch up with rival Santam, particularly in specialist and corporate lines.

For years, even from before Bruce Hemphill began the managed separation from Nedbank in 2015, Old Mutual has been shrinking, selling businesses in Sweden, the US, Germany and Australia. Most recently it sold its Latin American business for R4.4bn. Its African operations are supposed to be the platform for growth, but Chetty says they have nowhere near the potential of Sanlam, which has a pan-African presence after its purchase of Casablanca-based Saham Finances. Old Mutual's African portfolio is dominated by its Zimbabwe operation, in a country where the stock market lost 17% of its value in the first quarter and inflation rose to 67%. Because of the US dollar shortage in the country, and the company's inability to take out dividends, the firm had to impair its declared earnings in Zimbabwe by 42% to R2.2bn.

The most recent trading update shows that the Old Mutual group is unlikely to meet its operating earnings target of GDP growth

THE BREAKDOWN

Segment contribution to results from operations



Source: Old Mutual reviewed preliminary annual results

plus 2% over three years, as operating earnings growth was negative in 2018, being down 4% to R9.9bn.

Wood says he has a negative view of businesses which have as much dependence on SA as Old Mutual does.

"It has a strong brand and distribution so I think its business units will at least go sideways even if conditions get tougher. It has some very strong businesses, notably the mass & foundation cluster, which has high market share and margins." That division now accounts for 31% of group operating profit. But Wood says this is under threat from the high growth of Capitec Bank's funeral and life products as well as from Sanlam Sky, the former African Life. In fact, the division had a mediocre 2018, with profit up just 3% to R3.1bn.

Neville Chester, a senior portfolio manager at Coronation, says umbrella funds should be an important growth area for Old Mutual, as it already runs the market leader. Increasingly, small pension funds are happy to merge with umbrellas to avoid the growing governance burden. Old Mutual has a much larger employee benefits unit than even Sanlam and grew operating profit by 8% to R1.6bn last year.

Investors should cut through the noise, as the Old Mutual brand alone should justify its current p/e ratio of less than seven and its 5.5% dividend yield.

But it's worth waiting to see what dirty linen is uncovered when Moyo challenges his dismissal in court. The case starts on July 16. **x**



Iain Williamson:
Competent to run the
company in the short term
Hetty Zantman