

30 August 2011

Trustco Group Holdings Limited reported annual results which showed an 8% increase in revenue for FY2011. Profit after tax is up by 38% to N\$190m boosted by a N\$90.9m contribution from the property division. HEPS grew to N\$132m, registering a 55% growth from FY2010. Trustco is again locked in litigation, this time around with Econet Zimbabwe, which follows on the heels of the litigation with SABC, Atlanta Cinema, and DEX Group. EPS has increased by 38% to 28.02cps, HEPS by 55% to 19.48cps, while DPS expanded to 3.50cps from 2.00cps. Owing to its conglomerate nature, our preferred valuation methodology is the Sum-of-the-Parts (SoTP).

| | |
|---------------------------|-------------|
| Company: | Trustco Ltd |
| NSX Ticker: | TUC |
| Sector: | Finance |
| Current Price: | 70cps |
| 12-m Target Price: | 87cps |
| Exp. Total Gain: | 29.0% |
| Recommendation | HOLD |

GROUP OVERVIEW AND FY11 RESULTS

• Our Views

Trustco is a Namibian conglomerate with a footprint in Namibia, South Africa and Zimbabwe. The group's growth strategy is to expand operations into other African countries by leveraging the life-insurance cover which is attached to Trustco Mobile.

• Litigations

Trustco tends to be involved in litigation and this has become an issue of concern. While the litigation against SABC was ongoing, Trustco got involved in litigation against the Namibian Law Society on the fees lawyers charged Trustco's clients, followed by litigation against Atlanta Cinema CC for a loan which the latter apparently failed to repay. Litigation has also been instituted against the DEX Group for an overdraft facility of N\$19.449m, which the DEX Group is said to have failed to repay. There are new litigations against Econet and a certain party who purchased the Trustco restaurant business. The sources of the litigation, which are a N\$17m underwriting fee paid to a third party insurance firm in Zimbabwe during the sortie to Zimbabwe via Trustco Mobile, and a N\$14.0m loan advanced to the party that bought the restaurant business, are said to have caused an increase of 10.0% in the administration expenses during FY2011.

Table 1: Financial Summary

| N\$'000 | FY09 | FY10 | %Change | FY11 |
|---------------|---------|---------|---------|---------|
| Total Revenue | 484,514 | 550,448 | 6.6 | 587,018 |
| Gross Profit | 227,342 | 271,361 | 18.6 | 321,874 |
| Other Income | 33,521 | 23,754 | 174.2 | 65,144 |
| Operating Exp | 223,960 | 229,761 | 11.4 | 255,884 |
| PBT | 66,526 | 161,498 | 38.7 | 223,954 |
| PAT | 93,378 | 137,544 | 38.0 | 189,771 |
| # Shares | 660,197 | 677,240 | | 682,029 |
| EPS (cents) | 14.00 | 20.31 | 38.0 | 28.02 |
| HEPS (cents) | 10.81 | 12.60 | 54.6 | 19.48 |
| DPS (cents) | 1.0 | 2.0 | 75.0 | 3.5 |

Source: TUC, NEB

Table 2: Key Ratios & Variables

| | |
|---------------------------|----------------|
| Free-float factor | 30.0% |
| FF Mkt Cap. (N\$m) | 142.220 |
| P/E (x) | 2.5 |
| HEPS(cps) | 19.5 |
| DY (%) | 5.0 |

Source: TUC, NEB

Micro-Insurance and Technology Division

The Micro-Insurance and Technology division was only able to increase revenue by 5.0% to N\$419.960m, while profit after tax grew by 39% to N\$89.956m, thanks to cost control measures. The puny revenue growth of only 5.0% can partly be attributed to the company's decision to keep premiums unchanged as a gesture of goodwill on the occasion of Trustco's 10th Anniversary.

The Micro-Insurance and Technology Division has operations in Namibia, South Africa and Zimbabwe. The Namibian operations accounted for 27% of revenue and 55% of profit after tax, while the corresponding contributions by the South African operation were 63% and 18%.

The South African operation, which is popularly known as **Trustco Financial Services, TFS**, has been the dominant contributor to the group revenue. Although it kept its dominant role, it has met its Waterloo because of what management describes as a “challenging period for the South African insurance industry”. The trading environment has caused revenue to retreat from N\$291.699m by 9.8% to N\$263.123m, and profit to decline by 18.32% to N\$16.284m. Notwithstanding the revenue contraction, TFS accounted for 44.8% of group revenue.

Inasmuch as the Zimbabwean operation contributed a handsome N\$45.317m to the group revenue and N\$23.910m to profit after tax, it ended up being nothing but a sortie. We are not privy to the reasons why the expansion ended up being short-lived and all we know is that the daggers are out and litigation has commenced.

Table 3: Contributions of the Constituents to Revenue and Profit

| Division | 2010 | 2011 | % of |
|---------------------------------------|----------------|----------------|--------------------|
| Micro-Insurance and Technology | 400,064 | 419,960 | Revenue |
| Namibia | 108,365 | 111,520 | 26.55 |
| South Africa | 291,699 | 263,123 | 62.65 |
| Zimbabwe | - | 45,317 | 10.79 |
| Micro-Insurance and Technology | 64,922 | 89,956 | % of Profit |
| Namibia | 44,985 | 49,762 | 55.32 |
| South Africa | 19,937 | 16,284 | 18.10 |
| Zimbabwe | - | 23,910 | 26.58 |

Source: TUC,NEB

Micro-Finance and Education Division

Divisional revenue contracted by 12.7% from N\$104.542m in FY10 to N\$91.293m in FY11, while profit after tax shrank by 13.1% to N\$34.2m. Management attributes revenue contraction to stricter credit requirements and the severe flooding in the northern regions. Owing to the higher population density in the northern regions of Namibia, the bulk of Trustco’s students are invariably residents of those regions. Notwithstanding the adverse impact of natural calamities, gross Educational loans are said to have increased from N\$193.0m in FY2010 to N\$226.0m in FY2011. This division is only operational in Namibia.

Table 4: Contributions of the Constituents to Revenue and Profit

| Division | 2010 | 2011 | % of |
|------------------------------------|----------------|---------------|--------------------|
| Micro-Finance and Education | 104,542 | 91,293 | Revenue |
| Namibia | 104,542 | 91,293 | 100.00 |
| Micro-Finance and Education | 39,342 | 34,203 | % of Profit |
| Namibia | 39,342 | 34,203 | 100.00 |

Source: TUC,NEB

Private Equity Division

The division also has multi-jurisdiction presence and operates in Namibia and South Africa. In 2011, the division recorded the highest revenue growth of 107.0% to N\$60.123m. Thanks to proceeds of N\$68.0m from the sale of 54,000m² of its 1.8m square metre plot in the Lafrenz Industrial Area, net profit soared by 32% to N\$92.0m. The local operation is the dominant contributor to both revenue and net profit and accounted for 99.7% of divisional revenue and 98.9% of divisional net profit in 2011. Thus, despite its multi-jurisdiction presence, in revenue terms this is very much a Namibian operation.

Table 5: Contributions of the Constituents to Revenue and Profit

| Division | 2010 | 2011 | % of |
|-----------------------|---------------|---------------|--------------------|
| Private Equity | 29,107 | 60,123 | Revenue |
| Namibia | 28,875 | 59,949 | 99.71 |
| South Africa | 232 | 174 | 0.29 |
| Private Equity | 69,565 | 91,889 | % of Profit |
| Namibia | 69,814 | 90,904 | 98.93 |
| South Africa | -249 | 985 | 1.07 |

Source: TUC,NEB

DIVISIONAL CONTRIBUTIONS TO GROUP REVENUE AND NET PROFIT

Table 6: Divisional Contributions to Revenue

| Division | 2010 | 2011 | % of Segment | % of Total |
|---|----------------|----------------|--------------|--------------|
| Micro-Insurance and Technology | 400,064 | 419,960 | | 71.5 |
| Namibia | 108,365 | 111,520 | 26.55 | 19.00 |
| South Africa | 291,699 | 263,123 | 62.65 | 44.82 |
| Zimbabwe | - | 45,317 | 10.79 | 7.72 |
| Micro-Finance and Education | 104,542 | 91,293 | | 15.55 |
| Namibia | 104,542 | 91,293 | 100.00 | 15.55 |
| Private Equity | 29,107 | 60,123 | | 10.24 |
| Namibia | 28,875 | 59,949 | 99.71 | 10.21 |
| South Africa | 232 | 174 | 0.29 | 0.03 |
| Head Office & Strategic Business | 16,735 | 15,642 | | 2.66 |
| Namibia | 16,735 | 15,642 | 100.00 | 2.66 |
| Group | 550,448 | 587,018 | | |

Source: TUC, NEB

Table 7: Divisional Contributions to Net Profit

| Division | 2010 | 2011 | % of Segment | % of Total |
|---------------------------------------|----------------|----------------|--------------|-------------|
| Micro-Insurance and Technology | 64,922 | 89,956 | | 41.6 |
| Namibia | 44,985 | 49,762 | 55.32 | 23.03 |
| South Africa | 19,937 | 16,284 | 18.10 | 7.54 |
| Zimbabwe | 0 | 23,910 | 26.58 | 11.07 |
| Micro-Finance and Education | 39,342 | 34,203 | | 15.8 |
| Namibia | 39,342 | 34,203 | 100.00 | 15.83 |
| Private Equity | 69,565 | 91,889 | | 42.5 |
| Namibia | 69,814 | 90,904 | 98.93 | 42.08 |
| South Africa | -249 | 985 | 1.07 | 0.46 |
| Group | 173,829 | 216,048 | | |

Source: TUC, NEB

GROUP INCOME STATEMENT AND BALANCE SHEET

Table 8: Income Statement

| Income Statement | 2009 | 2010 | 2011 |
|---|----------------|----------------|----------------|
| Total Revenue | 484,514 | 550,448 | 587,018 |
| Insurance Premium Revenue | 93,847 | 108,365 | 111,520 |
| Revenue | 390,667 | 442,083 | 475,498 |
| COGS | 257,172 | 279,087 | 265,144 |
| Gross Profit | 227,342 | 271,361 | 321,874 |
| Investment Income | 4,500 | 7,883 | 29,306 |
| Fair Value gains and losses on investment property | 2,730 | 88,261 | 63,514 |
| Other Income | 33,521 | 23,754 | 65,144 |
| Operating Expenses | 201,567 | 229,761 | 255,884 |
| Insurance benefits and claims | 21,760 | 16,922 | 21,405 |
| Transfer to policyholders' liabilities | 471 | 2,427 | 3,408 |
| Change in unearned premium provision | 165 | 367 | 629 |
| Administration expenses | 153,796 | 189,556 | 208,303 |
| Finance cost | 25,375 | 20,489 | 22,139 |
| Profit Before Taxation | 66,526 | 161,498 | 223,954 |
| Taxation | 26,852 | -23,954 | -34,183 |
| Profit for the year | 93,378 | 137,544 | 189,771 |
| Other comprehensive income, net of tax | 4234 | -753 | -684 |
| Revaluation of property, plant etc, net of deferred tax | 4234 | -753 | -684 |
| Total comprehensive income for the period | 97,612 | 136,791 | 189,087 |

Source: Company publication & NEB Forecasts

Table 9: Balance Sheet

| Assets | 2009 | 2010 | 2011 |
|--|----------------|----------------|------------------|
| Total Non-Current Assets | 524,519 | 673,047 | 810,431 |
| Property ,plant and equipment | 154,210 | 139,366 | 129,697 |
| Investment property | 33,753 | 143,233 | 232,829 |
| Intangible assets | 186,942 | 194,718 | 240,922 |
| Investment in subsidiaries | - | - | - |
| Deferred income tax assets | 45,147 | 50,855 | 62,096 |
| Educational loans advanced | 79,003 | 106,840 | 120,266 |
| Other loans advanced | 24,188 | 37,163 | 24,164 |
| Finance lease receivable | 1,276 | 872 | 457 |
| Amounts due by related parties | - | - | - |
| Total Current Assets | 237,805 | 248,057 | 411,916 |
| Available for sale financial assets | 10,035 | - | - |
| Assets fair value through profit and loss | - | 18,274 | 25,699 |
| Short-term portion of educational loans | 54,024 | 71,463 | 87,473 |
| Short-term portion of other loans | 386 | 908 | 833 |
| Short-term portion of finance lease receivable | 337 | 387 | 419 |
| Amounts due by related parties | 3,002 | - | - |
| Inventories | 30,244 | 18,677 | 16,541 |
| Trade and other receivables | 31,018 | 46,549 | 197,500 |
| Current income tax assets | 263 | 752 | 766 |
| Cash and cash equivalents | 108,496 | 91,047 | 82,685 |
| Total Capital and Reserves | 370,477 | 478,645 | 672,540 |
| Share capital | 162,645 | 162,645 | 162,645 |
| Deemed treasury shares | -19,137 | -18,731 | -18,731 |
| Vendor shares | 14,976 | - | 14,976 |
| Contingency reserves | 726 | 1,902 | 2,361 |
| Revaluation reserves | 16,851 | 16,098 | 15,414 |
| Distribution reserves | 194,416 | 316,731 | 495,875 |
| Total Non-current liabilities | 164,742 | 197,055 | 247,909 |
| Long-term liabilities | 117,832 | 111,090 | 151,435 |
| Other liabilities | 1,590 | 3,150 | 334 |
| Deferred income tax liabilities | 27,062 | 57,082 | 87,833 |
| Policyholders' liability under insurance contracts | 2,472 | 4,899 | 8,307 |
| Amounts due to related parties | 15,786 | 20,834 | - |
| Total Current liabilities | 227,105 | 245,404 | 301,898 |
| Current portion of long term liabilities | 15,700 | 15,367 | 55,288 |
| Current portion of other liabilities | 1,128 | 1,645 | 3,127 |
| Amounts due to related parties | - | - | 8,826 |
| Trade and other payables | 179,368 | 187,572 | 167,262 |
| Technical provisions | 15,834 | 17,189 | 18,428 |
| Current income tax liabilities | 128 | 2,005 | 7,778 |
| Bank overdraft | 14,947 | 21,626 | 41,189 |
| Total Equity and Liabilities | 762,324 | 921,104 | 1,222,347 |

Source: Company publication & NEB Forecasts

CONCLUSIONS

We have changed our valuation methodology for Trustco to the SoTP methodology and have not only unpacked the group's value to divisional value but also drilled deeper into the divisions' constituents. The motive for changing the methodology is to determine the contribution of each subsidiary to the group's value and attached value to the various operations on a stand-alone basis. It is our belief that through such an approach a better understanding is gained as to where the bulk of the group's value comes from and which subsidiaries have higher profit margins.

As can be seen from *Table 6*, the Micro-Insurance and Technology Division is the dominant contributor to the group's revenue; however, the Private Equity Division makes a higher percentage of the group's profit. We are not sure whether the profit contribution split has not been slightly distorted by the proceeds from the sale plots in the Lafrenz Industrial Area, the tapping into the "land bank", i.e. the Lafrenz Industrial Area.

The Micro-Insurance and Technology Division comes in second in terms of contribution to the group's profit with a percentage contribution of 41.6%. Given that the latter division also accounts for 71.5% of the group's revenue, we conclude that Trustco is predominantly an insurance company. On a constituent basis, most of the revenue, 62.7%, comes from Trustco Financial

Services, TFS, while the Namibian component is the highest contributor to the division's profit, making up 55.3% of profit.

Knowing where the bulk of revenue and profit come from, as well as where potential for future growth lies, is invaluable information in the investment decision-making process.

VALUATION & RECOMMENDATION

Owing to the diverse nature of Trustco's business operations, our preferred valuation methodology is the Sum-of-the-Parts (SoTP) methodology. Through this methodology we arrive at a fair price of 86.8cps, which we round off to 87cps. Trustco is currently trading at 70cps which implies a potential share price appreciation of 24% and an expected total upside potential of 29%.

Under normal conditions, our call on such a share would have been a BUY; however, given our concerns about the endless rounds of litigation we have highlighted above, we believe that the best call is a HOLD.

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