Date: 19 March 2020

*** Covid-19 has triggered a major downturn in global markets and shock impacts will still need to be assessed within the near future. It is too early to accurately forecast the full negative impact and all market participants are advised to exercise extreme caution.**

AVV – Alviva Holdings Limited FY21 Interim Results Equity Update

Valuation: Undervalued

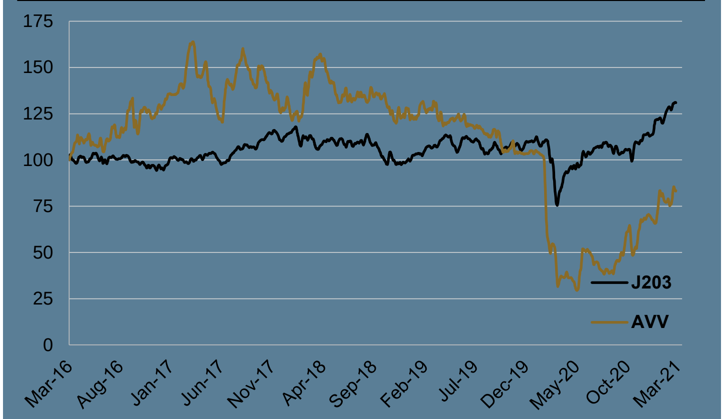
Alviva released Interim results on 1 March 2021 for the period ended 31 December 2020

Price (R)	**11.72**
PE Fair Value (R)	**16.24**
DCF Value (R)	**17.50**
Upside(Downside) to DCF (%)	49.3%
DY %	1.3%

Price Performance	Absolute	Relative to JALSH
1 month	6.8%	5.6%
3 month	20.8%	6.0%
YTD	26.7%	12.9%
12 month	**High**	**Low**
(SA Rands)	12.50	3.34

No. of shares (m)	118	Price (R)	11.72
NAV per share	19.44	Mkt cap (Rm)	1466
EV (Rm)	2068	Price/Book (x)	0.60

Financial Year	2019	2020	2021F	2022F
Turnover (Rm)	15923	14804	15736	16600
EBITDA	860	708	846	931
EBIT	670	389	526	658
PAT	391	137	269	367
HEPS (cents)	297	149	214	317
Dividend (cents)	30	15	21	32
P/E ratio	5.0	4.5	3.1	2.1
EV/EBITDA	3.6	1.5	1.7	1.4
EBITDA margin (%)	5.4%	4.8%	5.4%	5.6%
EBIT margin (%)	4.2%	2.6%	3.3%	4.0%
Net debt/equity	0.39	0.08	0.21	0.17
ROCE (%)	21.4%	12.0%	12.0%	15.6%
ROE (%)	17.3%	6.3%	11.3%	14.0%



RESULTS COMMENTARY

AVV delivered a pleasing set of results, with all operating divisions contributing positively, despite uncertain trading conditions.

- Revenue increased slightly by 2.1% to R7.5bn from R7.4bn.
- EBIT decreased by 7.3% to R254m from R274m. Profitability was negatively impacted by once-off costs and market forces.
- The Group acquired an additional 7.4% of Sintrex for R11m, increasing their total holding to 83%.
- HEPS increased by 16.8% to 110cps from 94.0cps aided by the share repurchase programme and solid operational performances in all divisions.

OUTLOOK FOR NEXT REPORTING PERIOD

Covid-19 has heavily impacted the South African economy, seeing GDP decline by ~7% in 2020. The ICT industry, however, has fared far better as it is ideally positioned to capitalise on the acceleration of digitisation around the world as countries adapt to the “new normal”. This trend will initiate a new phase of development in the digital economy. According to Huawei and Oxford Economics, the digital economy currently accounts for ~15% of the global GDP and is estimated to grow to ~25% by 2025.

AVV benefitted from the trend of increased demand for work-from-home products, bolstering their ICT Distribution segment. After the necessary implementation of a new ERP system which enables the provision of more advanced cloud offerings, the segment is in a stronger position for further growth. The diversification in the Services and Solutions segment proved successful as some businesses suffered from reduced customer infrastructure spend and unrenewed contracts while others took advantage of the increased demand for cloud computing, IT security and other applications that enable virtualisation. The Financial Services segment has recovered from the national lockdown in April and increased its book by ~R40m during the period and maintained estimated credit losses at acceptable levels.

A world-wide shortage of processors and components brought on by Covid-19-induced logistical issues resulted in the Group being unable to meet the local demand and seemingly losing market share or many orders have either been cancelled or delayed into 2021. The reduced inventory levels have improved working capital significantly, however the situation is expected to be resolved in H2FY21 as inventory levels normalise.

The majority of AVV’s inventory is imported, with purchases predominantly in US Dollar and selling prices linked to the ZAR/USD exchange rate. A stronger ZAR/USD exchange rate leads to downward pressure on selling prices and overall margins. The Group aims to manage foreign currency exposure with foreign exchange contracts (FEC) and minimise foreign exchange gains or losses coming through the income statement. Exchange rate volatility impacts mainly the ICT Distribution segment as services and solutions are largely virtual and denominated in ZAR. We have therefore used a twelve-month trailing exchange rate to forecast ICT Distribution’s organic and overall growth.

AVV is in the process of acquiring Tarsus Technology Group (Tarsus) for a total consideration of R185m which will further strengthen their distribution capabilities. The deal is still subject to the approval of the Competition Commission and has been excluded from our valuation until confirmation is received. The deal will be completed on a PE of ~5.3x indicating it to be earnings neutral, however, it should be accretive on a cash basis assuming finance costs are lower than the expected yield of ~19%.

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The Group redeemed R100m of its preference shares to Absa in August 2020, as was previously announced, reducing the total amount of preference share funding to R300m. In addition, the share repurchase programme's suspension was lifted during the reporting period and 11,4m shares were repurchased at a total cost of R87m.

Overall, we forecast revenue to increase by 6.3% to R15.7bn in FY21 before increasing by 5.5% to R16.6bn in FY22. The EBITDA margin is expected to recover to FY19 levels at 5.4% in FY21, increasing slightly to 5.6% in FY22. HEPS is expected to rebound off a relatively low base to ~80% of FY19 levels, increasing by 43.1% in FY21 to 214cps. The recovery is expected to continue in FY22, aided by the share buyback programme, seeing HEPS increase by 48.2% to 317cps.

SEGMENTAL PERFORMANCES

AVV consists of three main segments, namely: ICT Distribution, Services and Solutions and Financial Services.

The ICT Distribution segment is made up of Axiz, Axiz Services, Obscure, Pinnacle and VH Fibre. The Services and Solutions segment is made up of Solutions and Integrators, Renewable Energy and Applications and IP. Finally, the Financial Services segment is made up of only Centrafin.

	2020	Growth	2021F	Growth	2022F	
Revenue (Rm)						
ICT Distribution	9867.8	7.5%	10603.5	5.1%	11148.5	Revenue increased by 4.7% despite operating in a difficult trading environment. There was strong demand for work-from-home products and remote access services during Q1FY21, thereafter, exacerbated by product shortages, activity declined. According to Reuters, we expect the average ZAR/USD to appreciate by 0.5% in FY21 before strengthening a further 7.4% in FY22 off a relatively low base. We forecast organic revenue growth of 8.0% in FY21 and 12.5% in FY22. We expect overall revenue to increase by 7.5% to R10.6bn in FY21 and 5.1% to R11.1bn in FY22 as stock levels normalise. Revenue from IT products is also expected to be boosted by the acquisition of Tarsus Technology by R670m, should the Competition Commission approve the deal.
Services and Solutions	4738.9	4.1%	4932.6	6.3%	5244.6	Services and Solutions saw revenue decrease by 5.5% as customers dramatically reduced infrastructure spend, investing instead in work-from-home products. Tender activity, however, remains high which could realise sizable future returns. Revenue is forecasted to increase by 4.1% to R4.9bn in FY21 due to sustained demand before increasing further by 6.3% to R5.2bn in FY22 as the economy recovers and infrastructure spend recommences.
Financial Services	197.5	1.5%	200.5	3.0%	206.4	Revenue decreased by 3.9% as the division continues to recover after being heavily impacted by the national lockdown. The segment, however, managed to increase their book by R40m and estimated credit losses have been maintained at acceptable levels. We forecast a gradual improvement into the medium-term as the economy remedies and customer credit risk decreases.
Total	**14804**	6.3%	**15736**	5.5%	**16600**	
EBITDA Margin						
ICT Distribution	3.6%		4.0%		4.3%	EBITDA increased by 12.4% to R217m from R193m aided by the increase in revenue and the EBITDA margin increased to 3.9% from 3.7%. The Group's scale allows it to order in bulk and benefit from significant logistic synergies which improved margins as volumes increased in Q1FY21. Volumes have since shrunk as global stock shortages continue. We expect volumes to increase into the medium-term as stock levels and business activity normalises. We have taken a cautious view on margins and expect margins to revert to historic levels over the short- to medium-term.
Services and Solutions	5.0%		5.5%		5.5%	EBITDA decreased by 10.8% to R140m from R157m due to the change in product mix and the non-renewal of government contracts coming to an end. The EBITDA margin declined to 6.1% from 6.5%. The pipeline for the division remains strong and we expect government contracts to return once conditions normalise. We forecast margins to increase slightly to historic levels.
Financial Services	66.8%		60.0%		63.0%	EBITDA decreased by 17.6% to R60.9m from R74.1m as the Group attempted to stabilise operations after Covid-19's impact on the business. The EBITDA margin decreased to 62.4% from 74.5%. The business, however, remains well controlled and provides the Group with consistent earnings. We expect margins to fall further as the segment historically preforms stronger in the first half of the year, before recovering into the medium-term, given current market conditions and increased default risk.
Total	**4.8%**		**5.4%**		**5.6%**	

VALUATION

Management continues to grapple with a difficult economic backdrop defined by weak growth and low investment. The Group's operations and liquidity levels, however, remain solid. Revenue growth potential remains robust and new acquisitions offer exciting prospects despite the uncertain short-term outlook.

As general economic policy and conditions stabilise, we may see a material rerating in the share price which could see AVV trade closer to their NAV and TNAV per share of R19.44 and R12.59, respectively.

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

With reference to the DCF table on the right, we have considered a discounted cash flow analysis with cash flows forecast to FY23, utilising a terminal growth rate of 6% to yield our sensitivity table, for which we used a discount rate of 19.1%[1], yielding a value of R17.50.

With reference to the relative P/E table on the right, we believe it is appropriate to compare AVV to other ICT businesses and have applied a 10% discount to the peer group PE owing to the uncertain economic conditions and recent global stock shortages impacting the Group. The implied forward P/E valuation of 5.6x places AVV at a price of R16.24.

	DCF Discount rate				
Growth rate	**15.1%**	**17.1%**	**19.1%**	**21.1%**	**23.1%**
0%	16.24	13.79	11.88	10.34	9.09
2%	18.78	15.67	13.31	11.47	9.99
4%	22.24	18.13	15.13	12.86	11.08
6%	27.22	21.47	**17.50**	14.62	12.42
8%	34.99	26.27	20.73	16.91	14.13
10%	48.87	33.79	25.38	20.03	16.35
12%	80.66	47.20	32.64	24.53	19.37

Merchantec ICT	**Price**	**Mkt cap (m)**	**1 year fwd PE**
Adapt IT Holdings Ltd	4.39	641	4.7
Datatec**	29.20	5931	12.2
Eoh Holdings Ltd	8.38	1492	7.1
Mustek Ltd	9.70	685	4.5
Alviva Holdings Ltd	11.72	1466	4.1
Cognition Holdings Ltd	0.64	148	5.0
Average			**6.3**
*consensus forecasts used			-35%
Alviva Holdings Ltd	**11.72**	**1466**	**4.1**
Premium (Discount) applied to average:			-10%
Alviva Holdings Ltd: Implied current gain/(loss):	16.24	39%	**5.6**

[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