

## Is the Old Mutual Bula Tsela deal worth considering?

### A look at the public offer, which sees the insurance giant offering 1.3% of the company to qualifying black South Africans

There is a lot of excitement in the market around the latest public broad-based black economic empowerment (B-BBEE) share offer, the Bula Tsela (BT) scheme from Old Mutual (OM). This offer is the first after the 2019 Barloworld Khula Sizwe offer and the 2021 listing of AB InBev Zenzele Kabili, which both proved to be popular with investors.

The BT offer adds financial services exposure to the public B-BBEE share landscape which has been dominated by telecommunications (Vodacom's Yebo Yethu and MTN Zakhele Futhi), media (MultiChoice Phuthuma Nathi and Media24's Welkom Yizani), chemicals and oil (Sasol Khanyisa, Sasol SOLBE1), and specialty retail (Motus's Ukhamba 2 scheme).

The last financial services B-BBEE share offers Eyomhlaba and Hlumisa, both from African Bank ended in tears as shareholders lost their entire investment when the bank collapsed in 2014. However, the two before that from Nedbank (Eyethu) and the JSE Ltd were successful.

The Bula Tsela deal comprises a staff, community trust and public component which are structured differently to each other.

The deal is part of Old Mutual's commitment post its massive restructure in 2018 which saw it spin off international businesses and a large portion of its Nedbank shares. The deal will see OM's black shareholding increase to 30%. This analysis focuses on the public offer, which sees OM offering 1.3% of the company to qualifying black South Africans.

### Deal structure

Qualifying investors are invited to apply for a minimum of 200 Bula Tsela shares at a cost of R10 a share. This equity contribution from investors comprises 15% of the total funding required to buy the 1.3% stake in OM.

Old Mutual is offering assistance to investors in the form of a contribution of 15% of the deal, and the balance of 70% is funded with debt.

There is an initial five-year lock up period in which BT shareholders will not be able to trade their shares. This is normal. There is a 10-year funding period which is the period that the scheme has to settle the debt. This too is normal.

What is unusual is that the empowerment period is not stated upfront. Earlier deals such as Inzalo (Sasol), Zakhele (MTN) and others all stated the empowerment period upfront. The empowerment period refers to the duration of the deal and often aligns to the funding period. At the end of the empowerment period is usually a liquidity event where shareholders get the underlying shares, or where the shares are no longer beset with debt. Having no set empowerment period is clever as it gives the board room to adjust to prevailing conditions in 10 years' time. Sasol and MTN would have appreciated this wiggle room at the end of their respective deals.

### Dividends and debt

Investors can expect a 15% trickle dividend (after the payment of taxes and operational expenses) from BT, which is good. This means that 85% of the net dividend income received by BT from the OM shares it owns will be directed towards servicing the debt. Unlike with MTN Zakhele Futhi, shareholders will get some dividend income.

There is always the risk that OM does not pay a dividend, as was the case with MTN and more recently with Discovery. OM did not pay an interim dividend in 2020 although it managed to pay a final dividend. It also suspended dividends during the global financial crisis.

The question that naturally arises when one considers the possibility that the underlying company may not pay a dividend, is what about the debt that needs to be serviced by expected dividends?

The preference share (debt) funding is provided by Old Mutual at a cost of 85% of prime. This is relatively cheap funding, although in line with many other public deals. Having a 'friendly' debt funder makes it easier for BT to navigate tough times compared to having a traditional debt funder.

### A unique feature of this scheme

A unique feature of the BT scheme is that we do not know upfront how many BT shares will be issued. This is due to the fact that the cost of the 63.6 million OM shares to be bought by BT is not known upfront. The reason for this is to avoid a situation experienced by MTN Zakhele Futhi and SAB Zenzele Kabili shareholders where the subsequent share price movement in the underlying companies wiped out the discount, and potential investors would have been better off investing in the underlying than via the B-BBEE share.

What this means is that if the OM share price falls and the deal is done at a lower price than prevailing, there will be fewer BT shares available to the public. While this seems to miss the broad-based aspect of a public deal, it will ensure that those who are allocated shares will be getting a good deal.

Fewer BT shares in issue will mean that there will be more OM shares per BT share in issue. When one takes into account that the shares will be allocated to those who apply for the minimum first, it implies that smaller investors (by amount) will be allocated shares. This is more in the spirit of B-BBEE ownership objectives.

### Should you invest in Bula Tsela?

The late American economist Benjamin Graham said that you do not have to know a man's exact weight to know that he is fat. The same principle applies to BT given the number of BT shares to be issued is not known. The deal is well structured and offers a lot of value to potential investors. However, as we saw with African Bank and Media24 before, it is important to have a view on the underlying company. Fortunately OM does not need to shoot the proverbial lights out in the coming 10 years for investors to make a good return.

The deal structure bakes in a sufficient margin of safety for investors. MTN's Zakhele was able to deliver market-beating returns despite the MTN share not performing over the empowerment period. Old Mutual, like other South African insurers, has been through a torrid time in the past three years with Covid. The current market volatility and weak economic environment have also contributed to the share price trading well below pre-Covid prices. Historically the best time to buy into a company is after it has been through a tough period. That may not be in the next year or so for OM, but the current market and economic crisis will end and confidence will return to the market. OM will benefit from that. It currently trades at a large discount to group equity value so there is an additional margin of safety.

I suspect that the deal will be oversubscribed and many will get a refund, but if it is skewed towards the smaller investor, it will be a big win.

This article was originally published on [moneyweb.co.za](http://moneyweb.co.za) on 13 September 2022.



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