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JARRED HOUSTON: Like RMI, sleeping giant Old Mutual needs to unlock value

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The relative fall from grace of Old Mutual is well illustrated by comparing its present market cap with that of Rand Merchant Investment Holdings (RMI) over time.

The companies’ values have converged from opposite directions, Old Mutual moving south as value has been destroyed and RMI moving north as management’s value unlocking interventions were introduced.

What makes the convergence worse is that RMI has unbundled and distributed about R30bn worth of assets to shareholders and paid a special dividend over the recent period.

Equivalent value unlocking activity has been sadly absent at Old Mutual, whose share price has fallen more than 30% over the past 12 months and by about 45% over the past three years, according to Infront data. Reflecting these dismal returns is a valuation now at almost 50% discount to the group's equity value (GEV) which represents management's view of its value.

By contrast, RMI which was largely a holding company of insurance assets, has taken bold steps to unlock value, including the aforementioned unbundling as well as the well-timed sale of their interest in UK short-term insurer Hastings.

What remains is now almost exclusively the Outsurance group — a high return, fast growing and extremely cash generative business, the likes of which is in short supply on the JSE.

RMI CEO Herman Bosman must be applauded for the steps taken to unlock value at the group. This follows similar actions from the respective management of the PSG Group and Remgro, and has been a real source of value creation this year among tough market conditions.

In fairness there are differences in exposure to equity markets for long-term life insurers and short-term insurers as well as different risks covered. So, comparing Old Mutual and Outsurance is not exactly apples with apples. While the investment case for RMI is clear and has been well rewarded by the market, it is hard to understand the market caps of the two being equal given that the gross written premium of Old Mutual's Insure division, a mere 6% of its GEV, is R15.9bn while that of Outsurance is R23.5bn.

Old Mutual's primary operations remain its large life & savings business as well as businesses in asset management and banking & lending that span 14 countries and employ more than 30,000 people. It is fair to say Old Mutual is a sleeping giant in every sense of the word.

The company has a chequered past often characterised by poor and unfocused capital allocation. The managed separation which sought to focus the group on its African operations has seen no value unlock for shareholders four years on.

The 2017 move to an impressive shiny new head office in the middle of Sandton only serves to add to this questionable track record with what we have seen play out in the office sector. The business has a proud history of social impact and development in SA as well as nurturing some of the industry's best talent but unfortunately that is fast becoming a relic of the past.

While it is easy to criticise the group for past actions, what is clear is the underlying potential given the long history, strong brand and enormous footprint should it start to take action to more decisively turn around underperforming businesses and take a more proactive approach to capital allocation.

A well-known investment quote says “show me the incentive and I’ll show you the outcome” and it is little wonder to see the stark difference in executive shareholding and incentives at the successful value unlock stories referenced above as compared to Old Mutual, where the executive team does not even hold the minimum shareholding requirement as stated in their remuneration policy.

It is therefore encouraging to see recent share purchases in the open market by many of the executives as well as the recently announced Bula Tsela BEE scheme which, along with being extremely well structured and broad based, places a portion of the offering in the hands of employees.

We would urge the board to take more decisive action to unlock value. A fortress-like balance sheet is commendable in what have been turbulent times due to claims associated with Covid-19, the July 2021 unrest and the KwaZulu-Natal floods. However, it also provides opportunity when there is “blood on the streets” from the market sell-off for decisive action. The group needs to capture the opportunity that the market is presenting to it and go a long way to restoring the faith of the investment community in its ability to deliver returns for shareholders.

It is our job as investors to look beyond some of the obvious problems and recognise potential value unlock opportunities that can occur. But this requires a motivated, decisive and energised management and board response.

Two years ago RMI was trading at 30% discount to its net asset value but had several obvious opportunities to unlock value. Investor fatigue had set in around capital allocation and their primary asset Outsurance was not fully appreciated or properly valued. RMI management recognised the problems and took the opportunity to unlock value to the benefit of its shareholders.

The market has a tendency to extrapolate recent events well into the future. Old Mutual is being heavily discounted for underwhelming action in the most recent past and little value is being placed on what could potentially be unlocked in the future. Investors do not need a management team to tell them how difficult macro conditions are at present. We are only too cognisant of the issues both globally and locally.

What is attractive, however, is a programme of action to add value irrespective of market circumstances. We believe Old Mutual could be a great opportunity. But this would require more inventive and decisive action from management and more accountability for shareholder valuation creation from its board.

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