

A short research note on  
**EOH Holdings Ltd. (JSE Listed)**

**A real world IT business**

**Prepared by Körner Perspective (Pty) Ltd**

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# Introduction to EOH Holdings

- Essentially a technology company
- Well diversified business model, across services, outsourcing, infrastructure, data
- Not really a proprietary IT company (e.g. IBM, Microsoft) but more a services company
- Essence is to help clients use technology to service customers and clients better
- Historically very acquisitive, but now more focussed on organic growth
- The prominent IT company in SA



# A few key statistics on EOH

- 12 500 staff
- 5 000 customers
- Low reliance on government/ parastatals
- 15 year average growth rates:
  - Revenue 44%
  - Net income 41%
  - Normalised EPS 40%
- The biggest division is IT services, which generates 35% of earnings

# Investment hypothesis – EOH

- A real business that happens to be in tech
- A well diversified business model
- Technology is becoming fully ingrained into business, for example:
  - IT systems are now mission critical to most businesses
  - Technology is interconnected (e.g. networks, phones, data)
  - Technology has become a critical part of offering (e.g. loyalty cards)
  - Data has become critical
- A big player that can do most things for clients
- Highly rated (by clients and partners)
- Real annuity earnings much greater than the weighted average contract
- Proven to be resilient in tough economic environment
- Current valuations put EOH on a PEG of less than 1



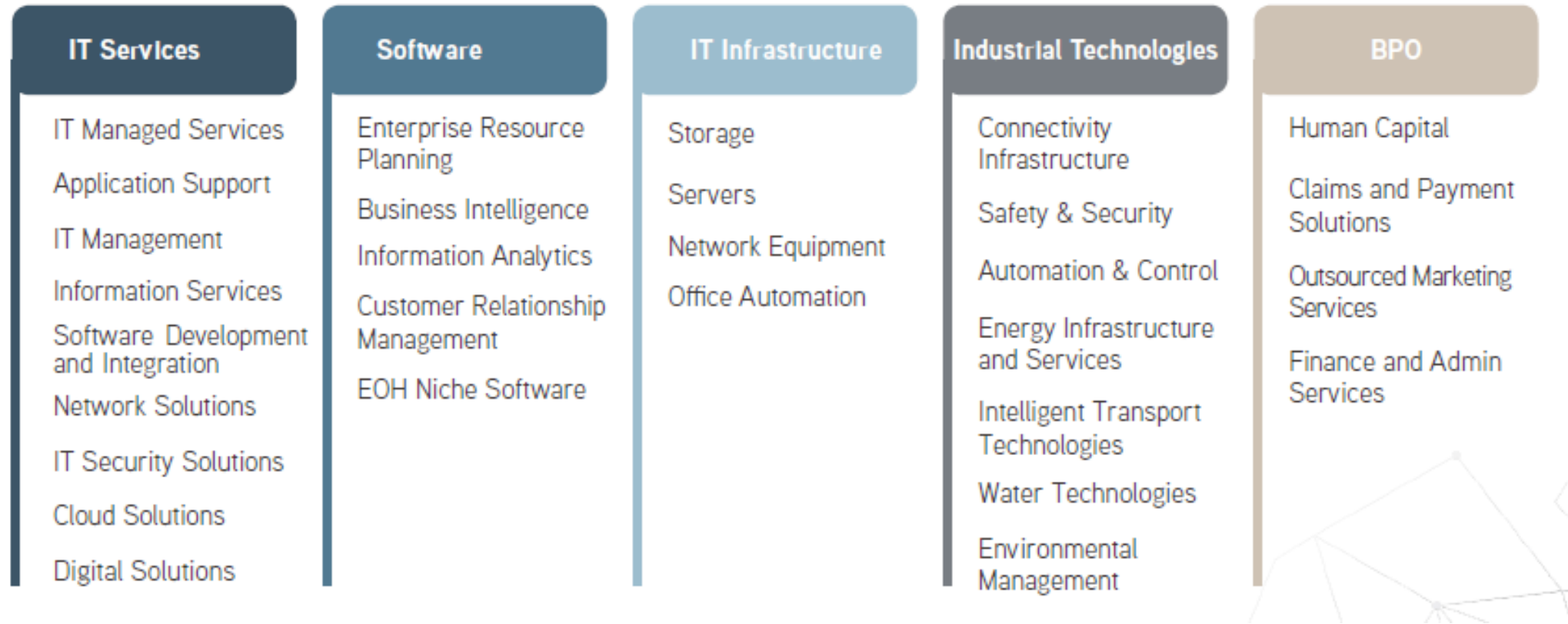
# Divisional breakdown



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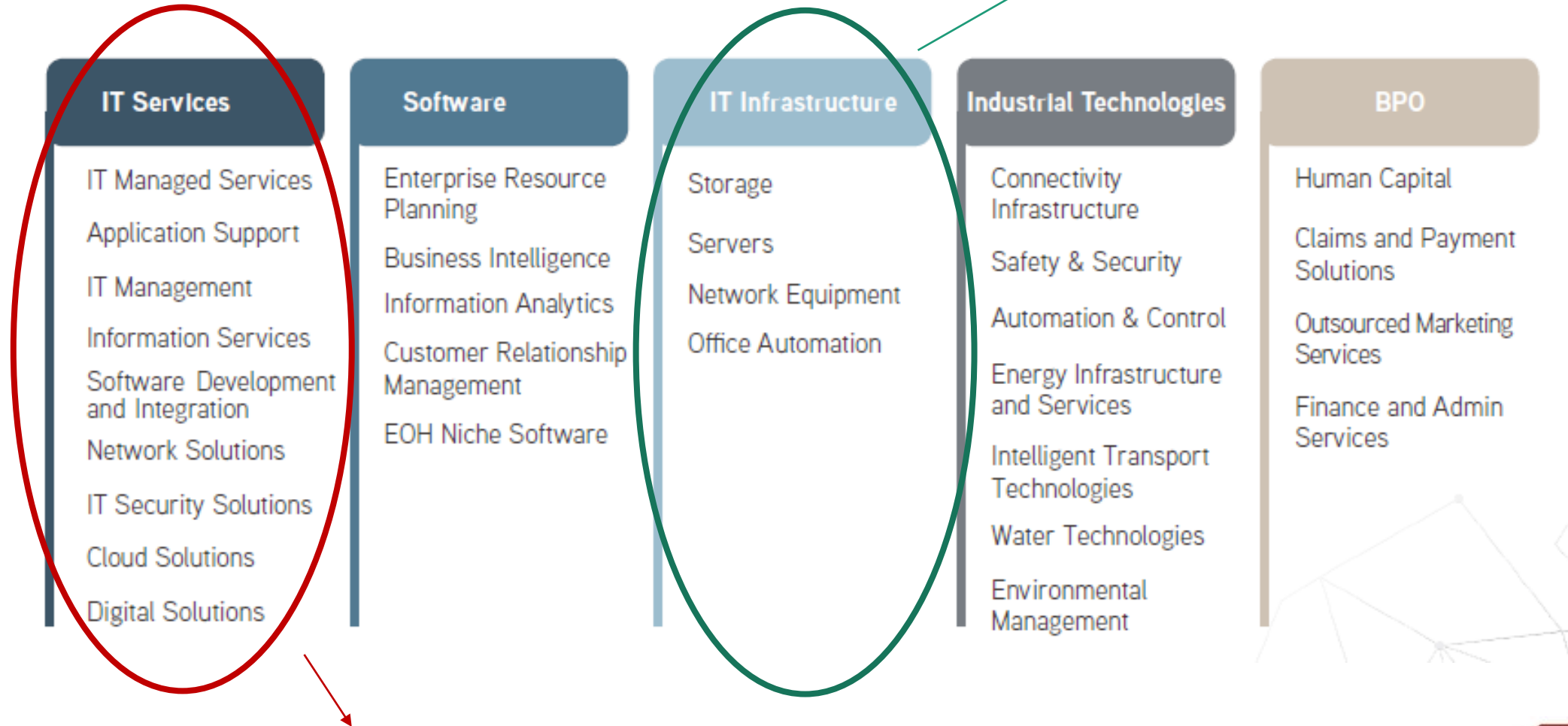


# EOH Divisions/ segments



# EOH Divisions/ segments

Infrastructure is the smallest segment (+- 3%)



IT Services is the biggest segment (+- 35%)

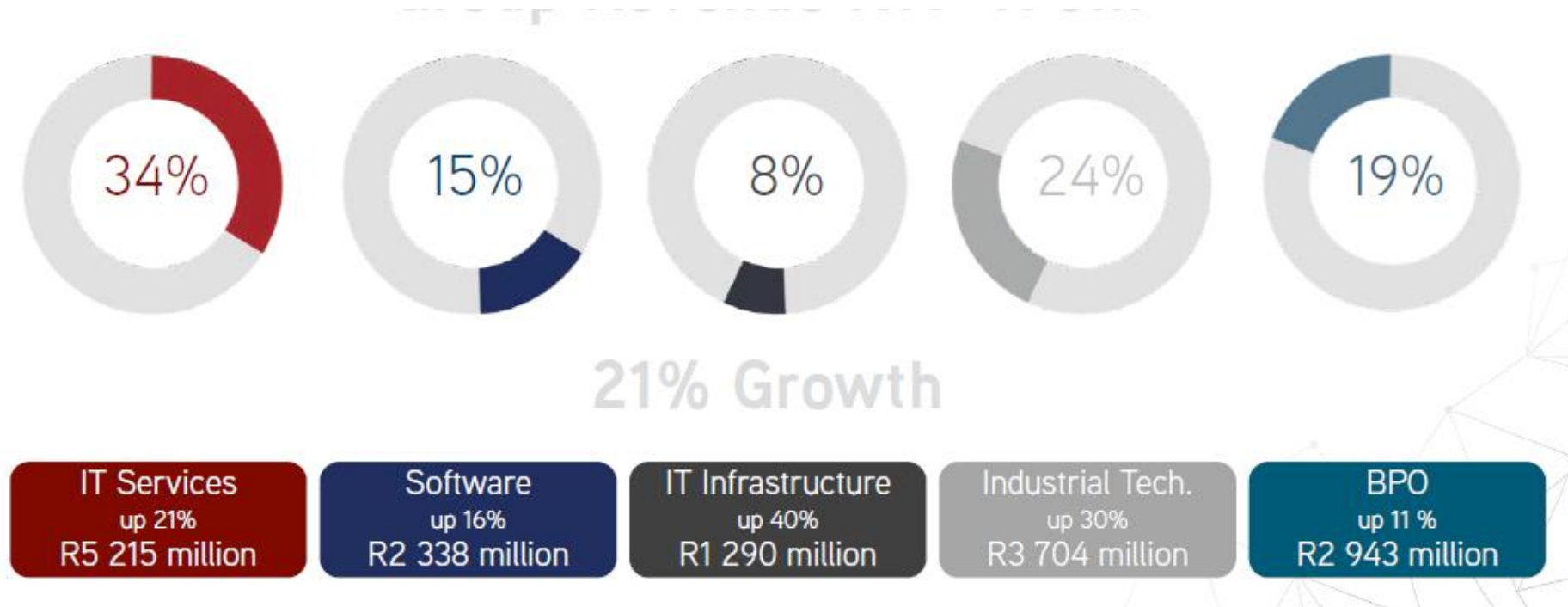


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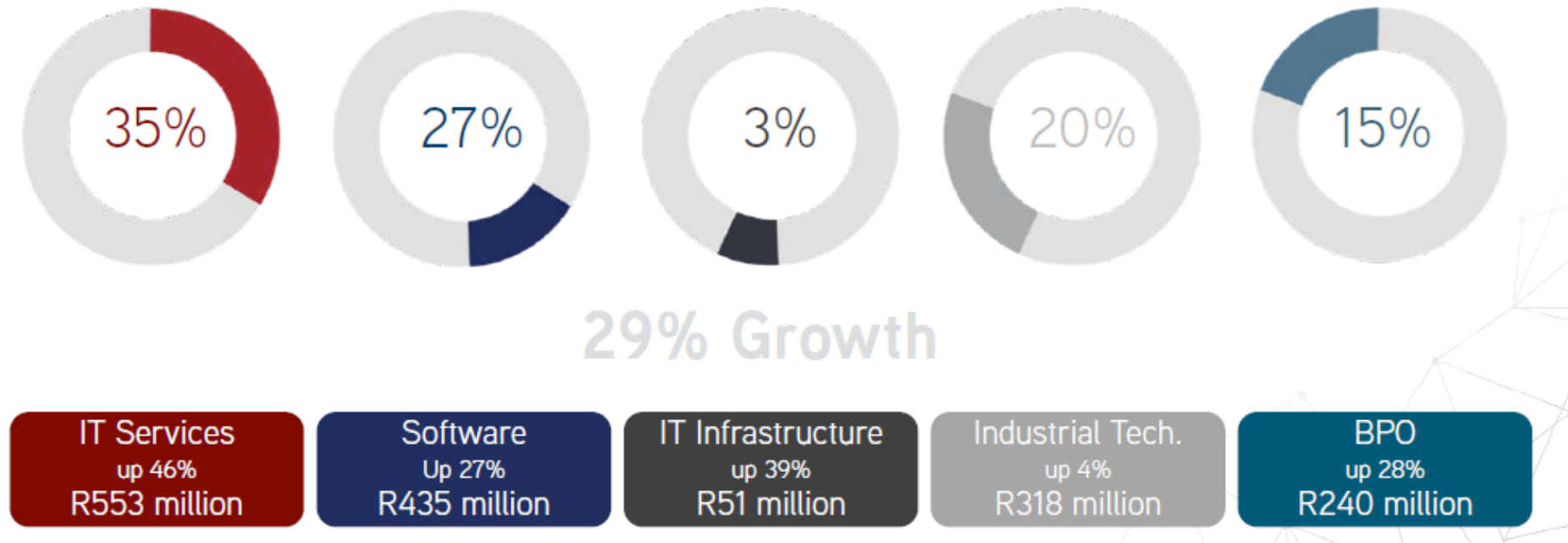
# EOH Revenue per segment (Rev. R 15.5 bn.)



Source : EOH



# EOH Earnings per segment



Source : EOH

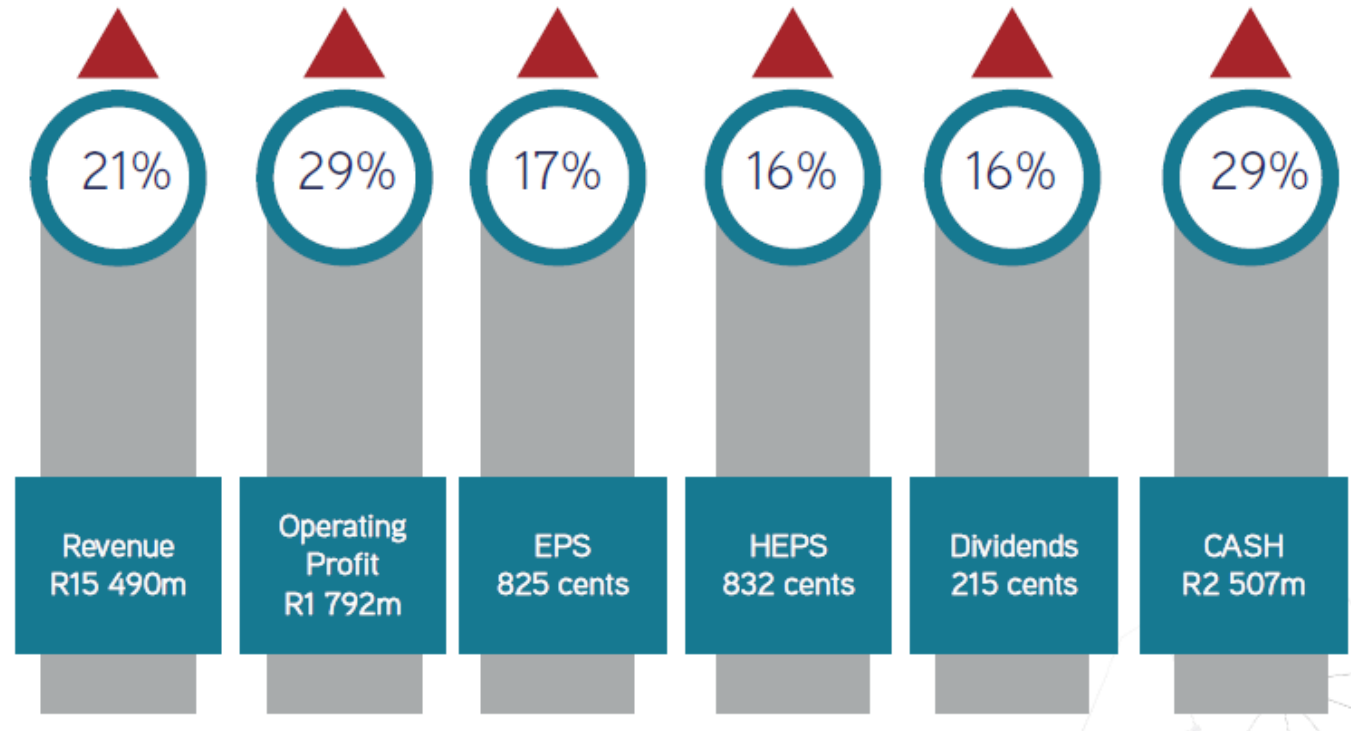
# A quick review of 31 July 2017 financial results (not an easy year)



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# Key metrics from 31 July 2017 results



# Comments on key metrics of 2017 FY

- Good operating leverage (rev up 21%, operating income up 29%)
- EPS lagging operating profit (17% vs. 29%) due to:
  - Higher finance costs (R 258 mil. vs. R 170 mil.), on 25% increase in borrowings
  - Lower share of profit on equity accounted (R 39 mil vs. R 72 mil)
  - Dilution of Shares in issue (150 mil shares in issue versus 141 last year)
- Dividends per share tracked HEPS growth exactly (+16%)
- Cash generated was weighed on by increase in working capital

# EOH's longer term performance



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# Recent results reflect the history (last few years)

- The last FY is an accurate reflection of the EOH history, where:
  - Revenue growth is boosted by acquisitions
  - Operating profit growth exceeds revenue growth (operating leverage was generally good over last 5 to 6 years)
  - EPS growth lagged (slightly) profit growth on dilution effect



# EOH Operating leverage



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# EOH's future will be slightly different to the past

- More mature business
- Less acquisitive growth...more organic growth...means:
  - Lower revenue growth than historic (e.g. 15% vs 40%)
  - Better overhead utilisation should see bigger improvement in operating leverage
  - EPS growth will be less diluted by new share issues
  - Dividend growth will track
- Lower revenue and earnings growth than in the past, but still very good in real terms



EOH has been performing for  
almost 20 years...  
it is no flash in the pan!



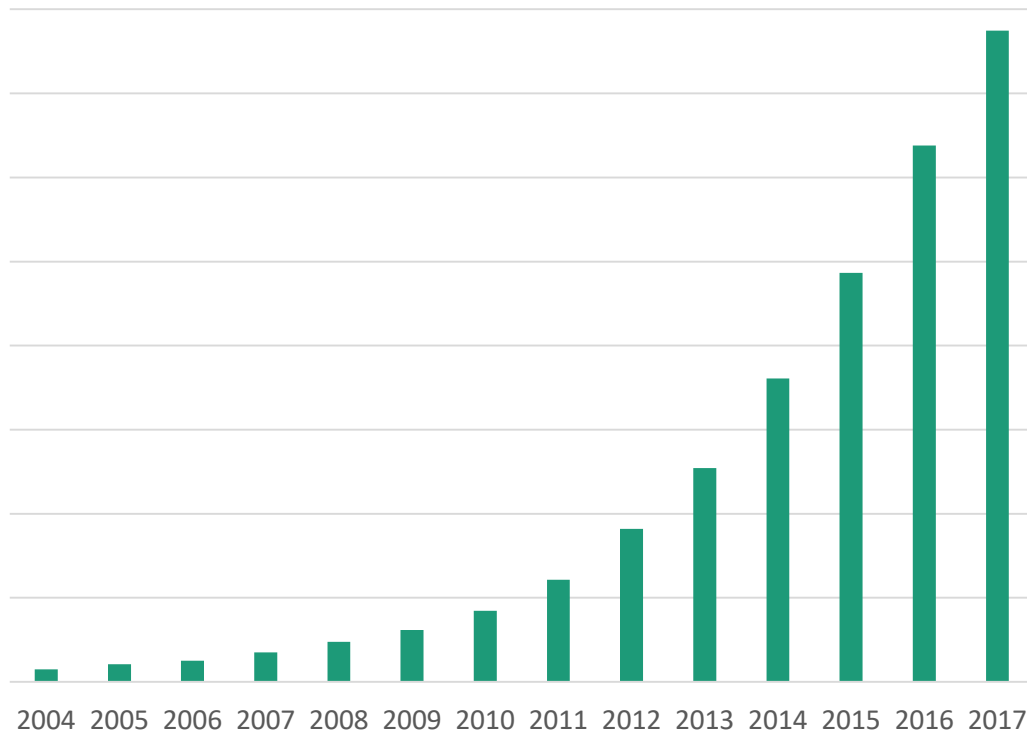
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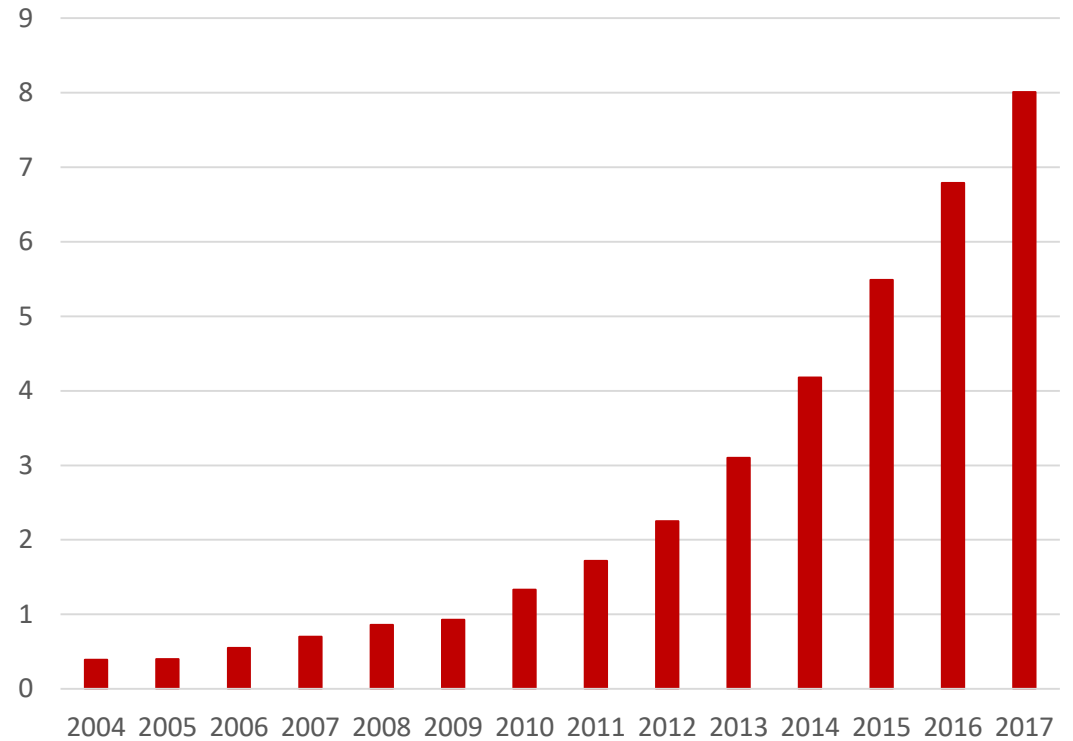
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# EOH – average growth rates are incredible

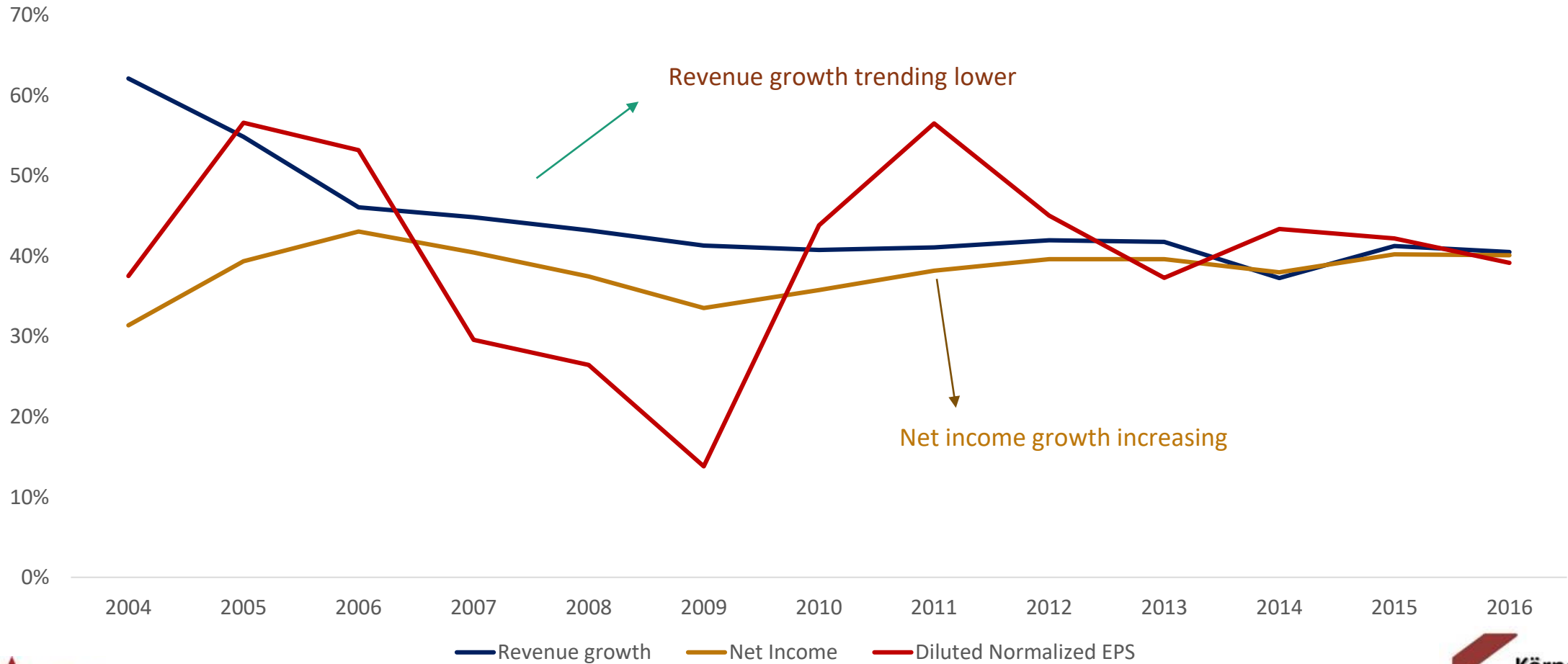
## Revenue Growth (CGAR 35%)



## Normalised Diluted EPS (CAGR 26%)



# EOH Rolling average growth rates all trending to 40%



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# Concerns around EOH largely addressed

## Concern

Growth has been only through acquisition

CEO departure a big blow

Growth rates are falling

IT companies are risky

Governance issues

Too much goodwill on the balance sheet

## Addressed by

Acquisitions are less of a driver than in the past. Organic growth is now almost 70%

While Asher Bohbot departure a loss, good & experienced team drives the business

While growth is slowing, it is still expected to be attractive (e.g. EPS growth of 12%)

EOH happens to be in technology but is a real business with modest valuation

EOH cleared of possible wrongdoing

The goodwill acquired continues to generate results. Not an NAV play



# Our best guesses for the next 2 Financial years

We assume modest (early teen) Revenue growth – 14%

We assume improving operating leverage – around 1.3 x to 1.4 x

We assume less dilution impact (due to base effect and less acquisitions)

We assume improved dividend pay-out ratio (to 30% and more)



# Our estimates (that we believe are conservative)

	2017	2018 (F)	2019 (F)
Revenue	15 490	17 659	20 131
Operating profit	1 792	2 143	2 548
Net income	1 173	1 377	1 607
Diluted HEPS	8.08	9.03	10.05
Dividend per share	2.15	2.71	3.27

	2017	2018 (F)	2019 (F)
Revenue growth	21%	14%	14%
Operating profit growth	29%	20%	19%
Net income growth	26%	17%	17%
Diluted HEPS growth	16%	12%	11%
Dividend per share growth	16%	26%	21%

# Compelling valuations (based on share price of R 104 p.s.)

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	2017	2018 (F)	2019 (F)
PE	12.9	11.5	10.3
Dividend yield	2.1%	2.6%	3.1%
PEG Ratio	0.76	0.98	0.89

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# We see recent weakness as an opportunity



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# Links

- Additional reading
- [Click here to access the EOH Annual report for 2016](#)
- [Click here to view the EOH 31 July 2017 results booklet](#)
- [Click here to view the EOH 31 July 2017 results presentation](#)



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