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Capital Appreciation

ANCHOR STOCKBROKERS

Investing for future growth

- The extent of the investment in its Software operation combined with lower terminal sales revenue in the Payments business, resulted in FY23 results missing our estimates. Fundamentally we are not concerned about either of these events - Software continues to experience strong revenue growth (ahead of our estimates) and the terminal estate exceeds our expectations. The FY23 dividend represents a 58% payout ratio, and we see this rising to 70%
- Payments – a higher proportion of rental terminals, an ongoing shift to considerably cheaper Android devices and delayed sales, were the reasons for terminal sales revenue disappointing (-20% vs +9% estimate). Rentals and Android devices attract additional annuity payment revenue and as a consequence other payment revenue was broadly in line. A strong pipeline of sales exists for FY24E. The outlook remains optimistic as ageing terminals are replaced in favour of new technology, bank terminals are to be refreshed as 2G and 3G networks are retired, the ongoing shift to digital payments and terminal functionality is enhanced. We forecast revenue growth of 23% in FY24E.
- Software (47% of group revenue) - it is poised for strong revenue growth given the demand for its services (particularly in Cloud, Digital & Intelligent Data) and the expansion of its operations, domestically and internationally. It accounts for the bulk of the 97-group headcount increase to 524. This combined with a 484% increase in hardware and third-party license fees (at considerably lower margins), saw margins decline from 23.6% to 19.1%. Core activity margins remained stable. We anticipate ongoing spend in FY24E with some minor relief to margins. Halo Dot gained further contracts in SA and abroad - we still don't model for Halo Dot revenue in FY24E and remain optimistic on its offering which should see further traction once MPoC certification is obtained at calendar year end.
- Management continues to be opportunistic with acquisitions, acquiring Dariel on an adjusted 2.2x EV/EBITDA should profit warranties be achieved. Its Responsive acquisition has performed ahead of its 25-month earnings warranty targets. The company has cash resources of R495m from which to make additional acquisitions. Dariel should be effective from 1 July 2023 and should contribute circa R21m to EBITDA in FY24E with an additional 19m shares in issue.
- The GovChat provision of R70.8m against the loan provided to it was necessary given it was placed into business rescue. The platform and IP function well, however, there has been little progress in monetising the government contracts. CAPPREC owns the IP and could monetise it with other parties. Management remains optimistic about a recovery based on the merits of government's Meta claim that should finalise in FY24E.
- Given lower FY23 HEPS and ongoing investment spend, we adjust FY24E from 21.6c to 18.6c. However, our FY25E HEPS remains largely unchanged at 23.8c, reflecting confidence in our fundamental outlook. We continue to see CAPPREC as an attractive stock to benefit from the trends in digital spend, Cloud, Digital and Intelligent Data. CAPPREC is trading on a 10m forward EV/EBITDA of 4.6x and P/E of 8.1x. It yields an attractive forward dividend yield of 8.7%. In our DFCF valuation we calculate a fair value range of R2.45-2.74/share. Given the strong balance sheet, cash of R495m (circa 38c per share) , no debt and treasury shares valued at circa R75m, CAPPREC is in an enviable position in that it can continue to invest in high growth technologies, acquire businesses on favourable terms, buy back shares and continue to pay an attractive dividend.

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Price (2023/07/13):	R1.50
Market cap	R1965m
Shares in issue	1310mn

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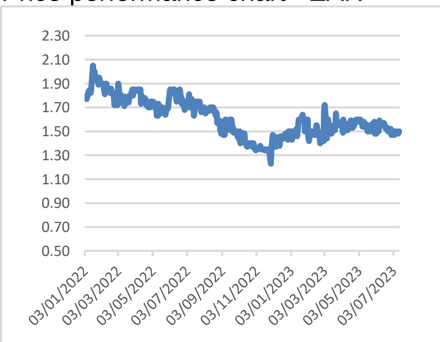
Price performance chart - ZAR



Source: FactSet

Figure 1 Financial summary

Year Ending	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023 A	FY2024 F	FY2025 F	FY2026 F
Income Statement								
Sales	608	701	620	831	996	1,355	1,582	1,837
Sales growth (%)	*19.6%*	*15.4%*	*-11.7%*	*34.2%*	*19.8%*	*36.0%*	*16.8%*	*16.2%*
EBITDA	161	197	173	252	236	328	425	526
EBITDA Margin (%)	*26.5%*	*28.0%*	*28.0%*	*30.3%*	*23.7%*	*24.2%*	*26.9%*	*28.6%*
EBIT	139	162	138	211	193	278	369	462
EBIT Margin (%)	*22.8%*	*23.1%*	*22.3%*	*25.3%*	*19.4%*	*20.5%*	*23.3%*	*25.2%*
Profit before tax	174	206	157	232	156	320	413	500
Net profit	125	150	126	162	91	233	301	364
Net profit post minorities	125	150	126	162	91	233	301	364
Headline earnings	125	143	127	163	162	233	301	364
% Change	*-13%*	*14%*	*-11%*	*28%*	*0%*	*44%*	*29%*	*21%*
Diluted EPS (ZAc)	8.17	11.0	10.2	12.6	6.9	17.1	21.7	26.2
Headline EPS (ZAc)	8.17	10.7	10.3	13.3	13.2	18.6	23.8	28.4
% Change	*-12%*	*31%*	*-3%*	*29%*	*-1%*	*41%*	*28%*	*19%*
DPS (ZAc)	4.3	5.0	5.5	7.5	7.7	13.0	16.7	19.9
Payout ratio (%)	*52%*	*47%*	*53%*	*56%*	*58%*	*70%*	*70%*	*70%*
Balance Sheet								
Cash and Cash equivalents	611	505	538	533	495	613	655	773
Current asset (ex – cash)	70	92	67	146	262	319	368	425
Net Fixed assets	22	29	26	24	43	55	69	87
Intangible assets	791	791	790	825	829	753	720	681
Investments	45	24	42	68	32	38	97	88
Other assets	5	7	19	4	4	6	8	10
Total assets	**1,545**	**1,448**	**1,481**	**1,600**	**1,664**	**1,784**	**1,917**	**2,064**
Debt	4	8	9	9	4	4	4	5
Current liabilities	59	90	71	86	136	142	154	176
Other liabilities	35	41	25	22	28	31	35	39
Total liabilities	**98**	**139**	**105**	**116**	**169**	**177**	**193**	**219**
Shareholders' equity	1,447	1,309	1,376	1,483	1,495	1,612	1,734	1,859
Minorities								
Total shareholders' equity	**1,447**	**1,309**	**1,376**	**1,483**	**1,495**	**1,612**	**1,734**	**1,859**
BVPS (ZAc)	*0.9*	*100*	*105*	*113*	*114*	*123*	*132*	*142*
ROE (%)	*8.9%*	*10.9%*	*9.4%*	*11.3%*	*6.1%*	*15.0%*	*18.0%*	*20.3%*

Year Ending	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023 F	FY2024 F	FY2025 F	FY2026 F
Cash Flow								
Reported net profit before tax & interest	**139**	**162**	**138**	**211**	**193**	**278**	**369**	**462**
Change in net working capital	52	24	19	-60	-66	-50	-34	-32
Interest (paid)/received	-27	-22	-45	-61	-66	-84	-148	-204
Tax paid	-62	-58	-53	-57	-67	-87	-112	-135
Depreciation	23	34	35	41	45	50	56	64
Other adjustments	0	-14	9	13	11	5	7	3
Cash flow from operations	**124**	**126**	**102**	**86**	**50**	**112**	**139**	**158**
Net Capex	-15	-17	-7	-17	-33	-27	-32	-37
Capex/sales (%)	*2.5%*	*2.5%*	*1.1%*	*2.0%*	*3.3%*	*2.0%*	*2.0%*	*2.0%*
Other investing cash flows	-5	22	-51	-51	-52	37	-61	7
Cash flow from investing	**-20**	**5**	**-58**	**-68**	**-86**	**10**	**-92**	**-29**
Equity raised/(bought back)	-7	-227	-1	-14	6	5	6	0
Net inc/(dec) in borrowings	-3	0	0	0	0	1	1	1
Other financing cash flows	0	-9	-8	-9	-10	-10	-11	-11
Cash flow from financing	**-10**	**-236**	**-9**	**-23**	**-4**	**-4**	**-4**	**-10**
Net cash flow	**94**	**-105**	**35**	**-5**	**-39**	**118**	**43**	**118**
Free cash flow	**109**	**147**	**154**	**106**	**72**	**164**	**248**	**322**
Repayment of lease liabilities	**0**	**-6**	**-8**	**-9**	**-10**	**-10**	**-11**	**-11**
Net Free cash flow	**109**	**141**	**147**	**97**	**62**	**154**	**237**	**311**
Valuation Summary								
Valuation Metrics								
Share Price (ZAc)	74	57	99	185	150	150	150	150
P/E (Underlying) (x)	0.1	5.3	9.6	13.9	11.4	8.1	6.3	5.3
P/BV (x)	0.8	0.6	0.9	1.6	1.3	1.2	1.1	1.1
EV/Sales (x)	2.5	2.1	2.4	1.8	1.5	1.1	0.9	0.8
EV/EBITDA (x)	9.3	7.6	8.6	5.9	6.3	4.6	3.5	2.8
EV/EBIT (x)	10.8	9.2	10.8	7.1	7.7	5.4	4.0	3.2
FCF Yield (%)	5.5%	7.2%	7.5%	4.9%	3.2%	7.8%	12.1%	15.8%
Dividend Yield (%)	5.7%	8.8%	5.6%	4.1%	5.1%	8.7%	11.1%	13.3%
Net debt	-569	-436	-502	-506	-457	-574	-615	-620
Net debt/Ebitda	-3.5	-2.2	-2.9	-2.0	-1.9	-1.7	-1.4	-1.2

Source: Company data, FactSet, ASB Research

Overview of FY23 results and outlook

Figure 2 Summarised segmental statement – R'm

	2022	2023	%	2024E	%	2025E	%
Revenue	831	996	20%	1,355	36%	1,582	17%
Payments	534	524	-2%	646	23%	739	14%
Sale of terminals	317	255	-20%	331	30%	372	12%
Maintenance & Support Services	149	177	19%	200	13%	222	11%
Terminal rental income	22	29	32%	45	57%	66	47%
Transaction related income/Other	46	63	35%	70	13%	78	11%
Software	297	472	59%	703	49%	833	18%
Services & consultancy fees	219	305	39%	534	75%	651	22%
License & subscription fees	60	63	4%	66	5%	72	10%
Hardware	18	104	484%	104	0%	109	5%
International	0	1		5	900%	10	100%
EBITDA	252	236	-6%	328	39%	425	30%
Payments	218	206	-5%	252	22%	296	17%
Software	70	90	28%	136	51%	191	41%
Corporate	(33)	(53)	60%	(60)	13%	(66)	10%
International	(4)	(7)	100%	0	-100%	4	
EBITDA Margins							
Payments	40.9%	39.4%		39.0%		40.0%	
Software	23.6%	19.0%		19.3%		23.0%	
International	0.0%	-1440.0%		0.0%		40.0%	

Source: ASB Research, company data

Payments

Revenue growth in FY23 was disappointing at -2%, although the base was very high – FY22 was up 35% after declining 22% in FY21. This was driven by sales of terminals revenue which is erratic by nature. Despite the terminal estate growing strongly by 18%, terminal sales revenue declined by 20%. This is attributable to the following:

- Base effect - FY22 saw the estate grow by 28% with sales up 51%.
- Simplistically, terminal sales is defined as the delta in the terminal estate. We have noted previously that this is distorted given rental units as well as the replacement of maturing devices. We assume there has been a reduction in the replacement of maturing devices due to the extension of maturities by certain retailers given the weaker operating environment. Load shedding would also have played a role given lower retail activity, particularly in smaller retailers. The terminal estate increased by 51 000 units to 328 000, 18% growth.

- There is a growing shift towards Android devices given their functionality and cost – they can be as much as 30% cheaper than a Linux based terminal. Certain banks are favouring a shift towards Android. Both Ingenico and Newland supply Android devices, the former a bit late to the market. As a consequence, the average sales price per unit declined from R5 288 to R5 002, down 5% (this is however an over simplistic calculation given other moving parts).
- Its undisclosed by number, however, growth in the terminal estate was also a result of increased rental units. We estimate rental units rose from 2 000 to 10 000. Therefore the 51 000 sales recorded in the year is overstated, equating to growth in sales of terminals of 15% instead of 18%. Rentals are generally for 3-years and attract annuity revenue. We estimate rentals are circa R300 p.m. which would suggest it's a more profitable alternative to sales.

The other annuity Payment revenue grew by 24%. Maintenance and support revenue was up 19%, in line with the terminal estate growth. Transaction related income was up 35%, benefitting from specialised payment offerings and software license fees that accompany Android devices.

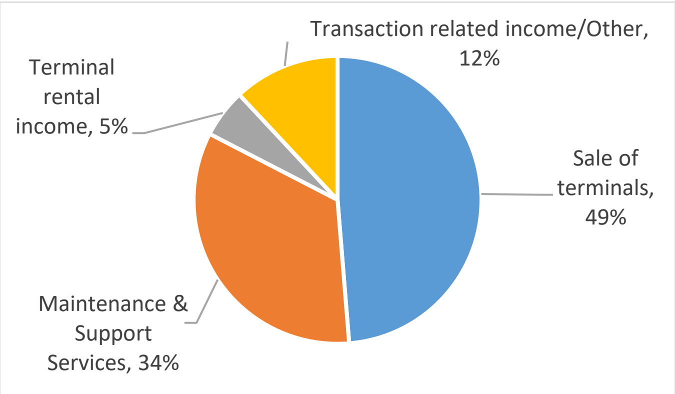
Outlook

We continue to see a move to digital payments and CAPPREC gaining further market share. Globally the industry continues to expand – growth in terminals shipped in 2021 was 35.7% in Middle East/Africa. The phase out of 2G and 3G networks will see early maturities of certain devices, further benefitting sales.

DashPay Glass, operating under pilot certification which limits the extent of the roll-out, is being marketed to retailers and we anticipate some traction in smaller to mid-size retailers.

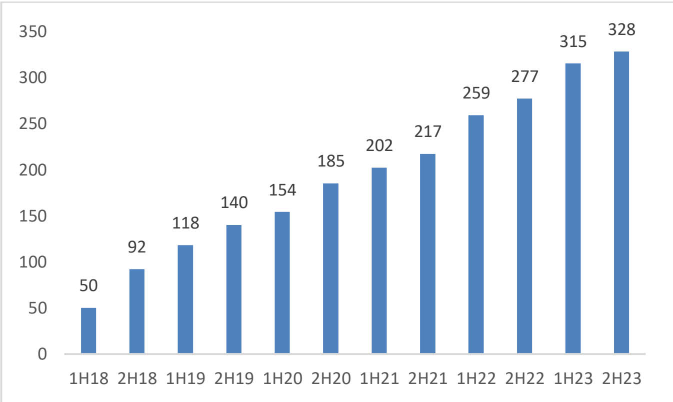
We forecast terminal sales revenue to grow by 30% given underlying growth in the industry as well as delayed orders being realised. Our forecasts allow for further declines in the average sales prices of units given the ongoing shift towards Android devices. We also factor in lower replacement of maturing devices. We have maintenance and transaction related revenue growing at 13% each, whilst rental income should rise strongly (+57%) off a low base as rentals are appealing to certain banks for certain of their retailers.

Figure 3 Payment revenue sources – FY23



Source: Company data, ASB Research

Figure 4 Terminal estate – '000



Source: Company data, ASB Research

Software

The Software business saw its revenue and EBITDA up 59% and 28% in FY23, in part supported by the Responsive acquisition which contributed R50.9m in revenue (R4.7m in FY22) and operating profit of R12.1m (FY22 R1.2m). Stripping Responsive out, growth was 44% and 13% respectively.

Services & consultancy fees were up 39%, the largest component of revenue at 65%. Growth in Cloud, Digital and Intelligent Data remains robust with domestic and global client wins in the year. The Cloud offering has been extended to Azure and Google Cloud, a positive trend for margins. Its logistics project in Singapore is also benefiting from the weaker Rand.

Growth in security hardware third-party licence revenue was an astounding 484%, in part due to increased Hardware Security Modules (HSM) sales to two major banks – these happen every 5-7 years and the replacement cycle continues into FY24E. Security is dynamic and essential therefore transaction flow is strong. Margins are, however, considerably lower than the rest of Synthesis – estimated at 10-11%.

EBITDA growth has been negatively impacted by considerable spend in headcount, platforms, the international office and marketing. This spend is required in order to capitalize on the strong growth trends seen in the underlying operations. It includes R15.9m (R4.9m in FY22) of spend on Halo Dot and DashPay Glass, R6.9m (R2.6m) on marketing and an increase in headcount of circa 97 (R35.5m). Importantly to note, that whilst margins declined from 23.6% to 19.1%, margins in the core product and service offerings remained stable.

Outlook

We forecast revenue growth of 49%, boosted by the inclusion of Dariel for 9 months (circa R107m). We include Dariel in services & consultancy fees, up 75% - excluding Dariel we target 40% growth given the strong demand in Digital, Cloud and Intelligent Data. Synthesis is very well poised to benefit from these trends given its expertise, customer base in financial services, its contract in Singapore and increased capacity due to investment in skills and platforms. We forecast for no growth in Hardware due to the high base.

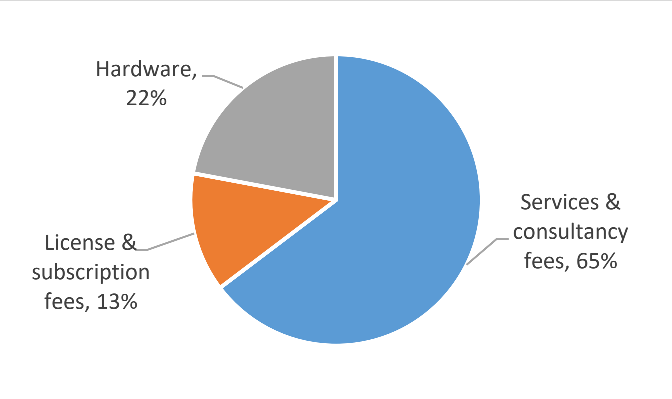
We forecast for small margin expansion, from 19% to 19.3%, impacted by another strong year from Hardware and the inclusion of Dariel which operates in lower margin services. Dariel is estimated to contribute R21m in FY24E. We anticipate a sharp rise in margin to 23% in FY25E as the benefits of the spend accrues, still below that of FY23.

The International operations are now disclosed separately, they made a R7m operating loss given the set-up costs. Visibility is poor on the outlook as contract wins can vary in size, they are hard currency based and can be material off the low base. We anticipate revenue to rise from R1m to R5m with break-even achieved in FY24E. We believe we are being conservative.

We make no revenue forecasts for Halo Dot in FY24E. It added further contracts, domestically and internationally and its clients now included local and foreign banks. It will commence with its MPoC certification (3–4-month process) in September 2023 with the hope of obtaining it before the end of the calendar year. Existing clients are operating under the pilot certification which limits the number of users to circa 10 000. Whilst this limitation is not that constraining it does prevent larger institutions from signing up until the limit has been lifted. We therefore anticipate an acceleration in the take up in 1Q24.

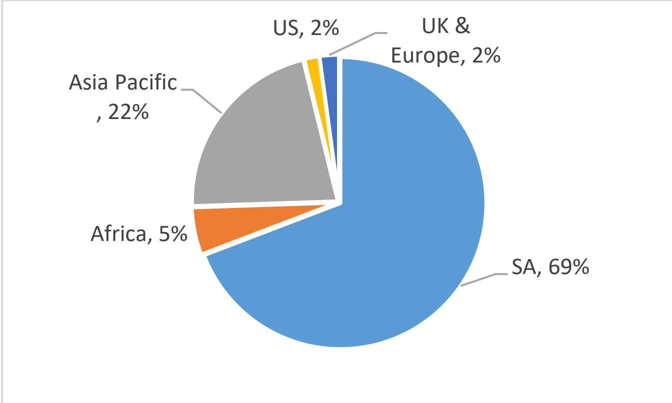
We remain positive on the role SoftPOS will play in the payment industry, particularly for small and mid-size retailers.

Figure 5 Software source of revenue – FY23



Source: Company data, ASB Research

Figure 6 Software geographic source of revenue



Source: Company data, ASB Research

Valuation

Figure 7 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	11.4%
Beta	0.8
Market risk premium	6.5%
Marginal tax rate	27.0%
Pre-tax cost of debt	9%
Cost of equity	16.6%
Target debt/value ratio	0.0%
Target equity/value ratio	100.0%
WACC	16.6%
Growth Rate assumption	
Sustainable long term growth rate	4.0%

Source: ASB Research estimates

Figure 8 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
Terminal Growth	3.0%	272	261	251	242	233
	3.5%	277	265	255	245	236
	4%	282	270	259	248	239
	4.5%	287	274	263	252	242
	5%	293	279	267	256	246

Source: ASB Research estimates

We value the group on a DFCF basis, applying a WACC of 16.6%, a risk premium of 6.5%, a beta of 0.8 and a sustainable long-term growth rate of 4%, as highlighted in the table above. The lack of gearing negatively impacts its WACC. Applying some sensitivities to WACC and terminal growth rates leads to a valuation range of R2.45-2.74/share. R0.38/share is in cash at 31 March 2023. Applying the midpoint of the valuation range (R2.60), values the stock on a 22-month forward P/E of 10.9x, a 6.9x EV/EBITDA.

Based on our HEPS forecasts, the stock trades on a 10M forward P/E of 8.1x, a 4.6x EV/EBITDA. Given this is a business operating in fast growing segments like Cloud, Digital, Intelligent Data and digital payments, as reflected by our 29% HEPS growth p.a over the next three years, the valuation is attractive. In addition, we forecast a progressive dividend payout ratio, delivering an attractive 8.7% forward dividend yield.

With the R495m of cash on hand and additional treasury stock, earnings enhancing acquisitions will continue and opportunistic share buy backs on any share price weakness. FY23 saw 200 000 shares bought back at an average price of 147c, which would suggest at current levels management would be buying shares.

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