

Sanlam: perception vs. reality

For some time now we have been investing in the second largest life insurance company in South Africa, Sanlam, on behalf of our clients.

Life insurance companies are at present not popular with the general public. And there is good reason for that: past practices have not resulted in good deals for policyholders. The discontent with the sector culminated during 2005 with the Pension Fund Adjudicator rulings against the practices of life insurers.

The general perception of life insurance as a sector is that it is a 'dying breed'. Increased consumerism and competition will result in a decline of existing business and profitability. Why then would one want to invest in a company that falls into this sector? The answer can be found in the gap between perception and reality. After all, the best opportunities can arise from such discrepancies.

What is Sanlam?

This seems like an obvious question but it's often the obvious questions that are seldom asked. A general answer would be a life insurance company. Management however like to refer to Sanlam as an integrated financial services company. Our approach is even more pragmatic. We ask what it is that we are buying when we invest in Sanlam and what it is worth.

Life insurance: It comprises risk protection (life insurance policies) and savings (endowments, retirement annuities etc.). We value life businesses on the earnings they can produce and the quality of those earnings. Sanlam's earnings are of a good quality, cash earnings have grown at a compound rate of 10% since 2001. This growth in earnings is attributable to entry into new markets (entry level markets of Africa and India) and new initiatives (home and personal loans).

Sanlam Investment Management (SIM): SIM is the second largest fund manager in South Africa. Funds under management at the end of December 2006 stood at more than R 405 billion and the business earned over R700 million after tax with net client inflows (excluding PIC withdrawals in 2005 and 2006). SIM is a highly cash generative business with the added advantage of captive funds from the life insurance company, which comprise approximately half of the funds under management.

Santam: Sanlam has a controlling interest in South Africa's largest short-term insurer, Santam. Short-term insurers are excellent businesses in which to invest. Over the long-term total return from investment in Santam comfortably outperformed the market and ranked among the best performers.

Shareholders' funds: Life insurance companies are required by law to hold statutory capital to serve as security for policyholders. The capital is invested in a balanced portfolio of equities and fixed income securities. Sanlam shareholders' funds are in excess of its requirements and management therefore is in the process of optimising capital structure by investing in value enhancing activities and/or returning the excess capital to shareholders.

Conclusion

Sanlam is changing with the times under the stewardship of CEO Johan van Zyl. The focus is on creating shareholder value by optimizing the use of capital whilst simultaneously growing earnings. A good example of the innovation at Sanlam is the recently introduced transaction account linked to the money market. Sanlam clients will have the convenience of a debit card whilst earning a high return on their deposits. It is not the old life insurance company that it used to be!

We believe that Sanlam is still attractively priced and continue to hold the share in our portfolios.

Commentary by Michal Nosek, Analyst, Allan Gray Limited