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Date: 03 August 2021

EOH – Meeting with Management

We recently met with various executives at EOH to better understand and appreciate the changes to the business since last meeting the company in 2018, prior to the appointment of Stephen van Coller as CEO. In the past two years it is one of the most reported on SA companies by the media and the JSE - it has released 112 SENS announcements since 1 September 2018. In this note we take stock of where the company is on its transformation and what the growth strategy is going forward as normality approaches. Our note does not delve into earnings and valuation as a stable earnings platform is yet to be achieved given ongoing material disposals, write downs, restructuring costs etc. We anticipate FY21 to provide a realistic earnings base from which growth can be achieved, measured and forecast.

We do not want to delve too deeply into EOH's turnaround but focus more on its operations, its strategy, opportunities and risks. However, highlighting some of the events that have occurred sheds light on the magnitude and complexity of the problems that the new management team had to contend with. All the time being very transparent to stakeholders and ensuring customers and suppliers are kept satisfied and retained. The new management team believe strongly in EOH's future as they have given up senior positions at numerous blue-chip companies and exposed themselves to reputational and financial risk.

EOH was a sizeable IT solutions company, the biggest in SA before its turnaround. Its rate of acquisitive growth was astounding and not even its clients realised how broad the group's reach had grown. For this reason, its demise would have had systemic risk issues, particularly in the public sector where it was assisting large municipalities (City of JHB, Tshwane) and services (SASSA, Home Affairs). Its presence across SA banks and insurers was also significant, although this became more apparent as the turnaround was underway. Therefore, failure was not an option and assistance from the public sector, its large financial clients and its lenders was key.

Pending clarity on SITA's stance on public sector participation (management is confident a status quo will be maintained), we believe EOH news flow will turn positive as it demonstrates its returned path to financial growth with significantly better earnings visibility. With management more focused on the future of the business and reputation risk dissipating, we anticipate the business pipeline to grow and on more favourable contract terms. This combined with EOH's strong market presence, energised management team and world class service offering in a high growth sector, its likely to see investors once again being attracted to the company.

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Price (03/08/2021):	R6.50
Market cap	R1 100m
Shares in issue	168.76m

Entering of the new guard

The new management arrived at staggered times with the CEO joining on 1 September 2018. The extent of the problems would surpass all their expectations. Below we touch on some of the key challenges and action taken:

Vendor management – an acquisition spree hangover

EOH was comprised of 272 legal entities, many run by young entrepreneurs looking to achieve their earn outs. Buy-outs were traditionally done on a part stock part cash basis but there were also cases where 100% in stock was paid given the successful share price at the time. When the stock crashed vendors wanted answers from management. Lots of wealth had been destroyed and motivation faltered. The company had a R600m VFA (vendor finance agreement) provision set aside for earn out payments. Honouring these payments was, however, problematic given the capital constrained balance sheet. Management consulted with all the vendors and two options were proposed:

- The vendor could buy the back the business utilising some of the initial cash proceeds. In some instances, the VFA's to a single vendor was so large management literally gave the business back to preserve the cash – ongoing working relationships were maintained on an SLA basis.
- The vendor could earn back 50% of its lost share value over a period of three years if it met financial targets. This is a win-win solution as the vendor and EOH share the loss equally and EOH benefits from the vendors ongoing commitment to grow EOH's business.

Management has been able to reach agreement with all vendors.

Asset disposals - selling the crown jewels.

Not only did management inherit the much-publicised fraud and corruption, but the debt (R4bn) was also too significant for the company to survive. A process of asset disposals was necessary, in many cases some of the more viable and promising businesses needed to go as they could fetch the highest proceeds faster. At FY20 81 companies were sold that accounted for R1.4bn of revenue.

After a full review of all the businesses in the EOH stable, the new management team identified three categories of business that needed to be exited:

- Capital Intensive Companies
These were companies that focused on providing IT solutions to projects, such as rail, water etc. These contracts are capital intensive and given the capital constraints they needed to be exited. Most of these companies were in NEXTEC.
- Businesses that developed their own IP
There were seven of these businesses in 2018, with promising "homegrown IP" that was ready to scale. EOH would have liked to remain invested in these businesses given their strong growth outlooks. Unfortunately, capital was required to fund such growth. Two such examples include CCS (Construction Computer Software) and Sybrin. Clearly these are difficult decisions for management to take but unfortunately the balance sheet could not support their growth needs.
- General clean-up of the portfolio
Companies that have little synergies in the new structure or are high risk businesses.

Whilst this process is still ongoing the end is in sight and disposals should largely be dealt with in FY21.

Risk management – the total lack thereof

Fatima Newman was hired as the Chief Risk Officer (CRO) in April 2019. ENSafrica were appointed to conduct several investigations focused on the public sector contracts. PwC and the University of Stellenbosch Business School assisted in the implementation of various governance and compliance initiatives.

There was little to no risk management prior to the turnaround. No internal audit, a part-time company secretariat, a small legal department, a single person compliance team and no formal procurement policy and process. Somewhat concerning given 272 legal entities and 800 business units. Business heads were left to act alone; in essence achieve revenue targets at all costs. There was little to no interaction between these businesses, often competing with each other. Minimal was done around AML and corporate governance – what little was disclosed was often not what was implemented. Some examples:

- Enterprise development loans were given but never repaid. Many of these were made to BEE fronted businesses to ensure public sector tenders.
- Government officials were being paid directly to ensure deal flow. Payment was via holidays, cars, home improvements etc.
- Large political donations were being made to ensure government contracts. Disclosure was not even discreet and, in most cases, disguised.

While many of these contracts were loss making, unfortunately two government contracts required restitution via the Special Investigations Unit (SIU) over a 3-year period, namely:

- Overcharged the Dept of Defence for Microsoft licenses – agreement has been reached and is being settled.
- Overcharged the Dept of Water & Sanitation for SAP licensing – a settlement is currently being finalised.

There were 8 (referred to as the legacy contracts) of the 54 public sector contracts that had a significant negative impact on the financial results. Six of these contracts have been settled, one has been terminated and the remaining one has been ceded and the final arbitration process should be dealt with by the end of FY21. This has significantly reduced the risk the group is exposed to.

The government corruption cases resulted in the CEO having to testify at the Zondo commission dealing with State Capture. ENSafrica was also present to disclose its findings. This was a deliberate decision by the board to ensure there could be no questions around the independence of management with regards to the evidence. This came late in the turnaround process and opened some wounds, however, it has held EOH in high regard amongst its customers, suppliers and staff. It is anticipated that the NPA (National Prosecution Authority) will go after certain government officials implicated in the scandal. Prior to this testimony the Hawks and the Financial Intelligence Centre (FIC) had already been involved for two years.

The above gives a sense of the rot that needed to be dealt with by the new CRO. It has come at an extraordinary cost given the involvement of lawyers, advisors, fines and settlements. However, it was part of managements drive to be as transparent as possible with stakeholders and ultimately to build a civil claim against the perpetrators. The civil suit will mark the closing of its inherited legacy issues by holding to account those responsible for the governance failings that took place. The following action is being pursued:

- Suing the co-founder and former CEO Asher Bohbot for R1.7bn
- Suing the former CFO John King for R1.7bn
- Suing the former EOH Public sector business head Jehan Mackay for R1.5bn

- Suing the former EOH International head Ebrahim Laher for R1.6bn.

It is uncertain what will be recovered, and the process is likely to be lengthy. However, any compensation would be a victory.

The turnaround in numbers

- 272 legal entities in August 2018 - 185 entities at 31 January 2020 - 129 entities at 31 January 2021 - 34 targeted by January 2022.
- 11 423 employees in August 2018 – 8 408 in February 2020 – 7 333 in January 2021 – estimated to be closer to 6 000 by the end of 2021
- Reduction of 66 581 sqm of office space by 31 January 2021 – at the time a further 14 900 sqm being negotiated.
- More than 100 buildings exited resulting in over R100m of annual rental savings.
- Debt down from R4bn to an estimated R1.7bn post the proceeds from the Sybrin sale.
- To manage liquidity during Covid 19 in 2020, 2 788 employees took a 20% cut in salary for two months and 10% cut for a further month.
- Financial asset impairment losses in excess of R1bn on continued operations.
- R900m had been stolen from EOH through fraudulent invoicing prior to the transformation.
- 16 former EOH employees have been reported to law enforcement.
- 80 implicated Enterprise Development entities have been blacklisted and reported to the Authorities, including 18 directors of these companies.
- 46 names of implicated individuals have been reported to the Hawks, including 12 government employees.
- The Department of Home Affairs (DHA) contract was R410m, bid internally at the time at R200m below other competitors to ensure success. To date EOH has only received R282m in payment even though 51 of the 60 work orders had been completed and successfully signed off by the DHA. This contract has now been ceded to a sub-contractor following a year long process with the department of National Treasury. There is an arbitration process in place to settle the final amounts on this contract.
- Between July 2018 and December 2019, ENS conducted 559 bid reviews for EOH. These bid reviews included all public sector bids (local and international) and private sector bids (above R10 million – local and international) submitted by EOH. EOH has now built-up internal capacity and has an internal bid review process in place. Public sector contracts are now delivered from the various product centres of excellence to ensure the same quality of work regardless of whether its public or private sector contracts.
- GP margins have increased to 29% from 22%. This ensured the first operating profit in 1H21.
- PWC became new auditors in 2020 and delivered an unqualified audit opinion which underlines the monumental clean-up effort from management to get the financial accounts right. This follows balance sheet write offs due to incorrect capitalisation of costs, incorrect invoicing resulting in ballooning uncollectable debtors and overpayment for acquisitions that were also partly financed by debt. In many cases the acquisitions were not cash generative placing the company under a heavy liquidity squeeze.

Overview of the EOH operations

Prior to the turnaround the group lacked structure in that it was largely a portfolio of a significant number of IT related acquired companies. These companies all operated in isolation and as they had their own client bases, and the vendors were focused on their earn-outs instead of cross selling within the group. Essentially many of these EOH companies were competing for the same tenders without the group's knowledge. The group was so large and diverse that some of EOH's blue chip clients totally underestimated their exposure to the broader group.

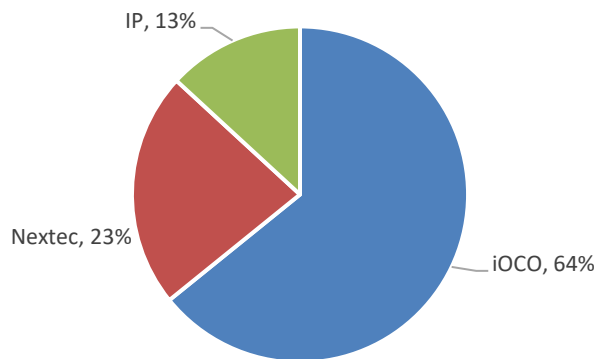
There are currently three divisions within EOH: namely iOCO, NEXTEC and IP. iOCO dominates from a revenue and EBITDA perspective. IP assets have been consistently reduced over time to create liquidity for the group to ease its debt burden (and allow them to be scaled). It is envisaged that all its assets will be exited in the short to medium term. We therefore don't focus on the IP division in this note.

Figure 1 EOH – Group structure

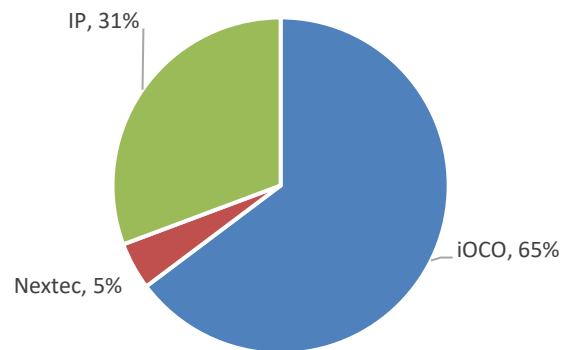


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Source: Company data

Figure 2 1H21 Gross revenue split

Source: Company data, Chronux Research estimates

Figure 3 1H21 EBITDA split

Source: Company data, Chronux Research estimates

iOCO

This is the core ICT (Information and Communications Technology) business which attracts the largest client base (circa 5 500 clients) within the group and the so-called core of EOH. It's structured around four pillars of activities – Advisory; Technology; Managed Services and Digitisation. Together they cover almost the entire ICT value chain and are therefore capable of providing a holistic client solution from a single organisation. To tailor these capabilities to match a client's needs, iOCO has created a distinct Go to Market (GTM) approach to understand the required business outcomes from a client's perspective and to ensure an end-to-end solution while co-ordinating the delivery of the offering.

Historically, EOH's ICT structure had a dedicated Public Sector vertical which is where many of the governance issues were detected. Public sector is now incorporated with the GTM and Sales teams, ensuring they are treated as any other corporate client, following the same process of onboarding. Until recently all public sector mandates were screened by ENSafrica.

Some of iOCO's partners include: AWS (Amazon Web Services), SAP, Q Link, Huawei, Infor, Google Cloud, Oracle, Broadcom, Cisco, Salesforce, Symantec, Dell and HP Inc.

Figure 4 iOCO Divisional Structure

iOCO

iOCO Advisory



Product Agnostic
Solutioning



2%
Total Revenue
contribution

iOCO Technology



Software reseller
Enterprise
Applications
Hardware Reseller



17%
Total Revenue
contribution

iOCO Digital



App Dev
Data Analysis
Cloud & Security
International
Automation



15%
Total Revenue
contribution

iOCO Services



Network Solutions
Manage & Operate
Digital Industries
Knowledge Process
Outsourcing



28%
Total Revenue
contribution

KEY TECH
PARTNERS



Source: Company data

The four pillars to the business:

- **Advisory** (2% of group revenue)

Advisory overlaps the three other pillars. Advisors are appointed by corporates to identify IT solutions for their business problems. A fee is agreed for the service and recommendations are provided. The client is not obliged to make use of EOH for the solution but in most cases it does. Advisory works closely with GTM and would normally follow them into the client.

- **iOCO Technology** (17% of group revenue)

One could consider this the “retail” arm of iOCO in that it is a reseller of hardware and software. It can be broken down into these operations:

- Software reseller

This is the franchise part of the business where iOCO represents its key OEM brands in its market.

It includes OEM software implementation and the sale of software licenses to customers as well as ensuring continuity of the product with maintenance renewals. Very little of the software is developed internally. Key OEMs include: CA; Microfocus; Qlik, etc. This accounts for the bulk of revenue in iOCO Technology. Clients would generally commit to a 3-year term as it requires upfront resources to implement. This is sticky business as most corporates cannot afford to unplug their mainframe software to seek an alternative as it has business continuity risks. There are two channels to market: namely direct sales and through 3rd party resellers.

- Hardware reseller

Traditional hardware sales such as desktops, laptops, printers, servers etc. OEM's include Dell, HP and Huawei. Contracts with OEM's are not exclusive. Hardware has a life span between 3-5 years, 5 years being more typical. During Covid 19 clients have pushed replacement further out

with revenue from Hardware declining in 1H21. A maintenance contract would accompany sales, offering an annuity revenue stream with inflation linked escalations.

- Enterprise Applications

This entails the sale and implementation of an appropriate Enterprise Resource Planning system to run all phases of a corporates operations. Integration across all business processes (e.g. sales, accounting, HR, inventory, manufacturing etc) needs to be ensured. Solutions include those provided by Oracle, Salesforce, OpenText etc. These agreements are not exclusive. Competitors would include DiData, Accenture and Deloitte.

It was widely publicised that Microsoft withdrew its EOH accreditation for its products in SA. The reputational damage has been more meaningful than the operational impact as iOCO remains a key user of Microsoft products and continues to bid on Microsoft contracts with accredited Microsoft dealers. No other OEM's have withdrawn accreditation, in fact more OEM's have been added over the past two years (Sales Force, IFS as examples).

iOCO Digital (15% of group revenue)

This incorporates the new age aspect of technology – digital transformation. This is a faster growing segment of iOCO as the world enters the fourth industrial revolution. There is vast opportunity in this space given most older companies have legacy systems which require a complete transformation to remain competitive. Covid 19 has exposed some of the shortcomings in many corporates and a desire to digitalise has been expedited.

Newer companies that are not burdened with legacy systems can interact more effectively with customers as product lines and systems are fully integrated. Those with legacy systems do not enjoy this benefit and require a journey to get there – this would be true for most banks and insurance companies where systems are very product focused requiring the customer to interface across different platforms.

The benefits of digital are lower hardware requirements and a pay for what you require and use in terms of software and Cloud. The products are solution based with no off the shelf options. It is comprised of the following divisions:

- App development

This encompasses the development of software applications as well as App's for client solutions. In a world where companies like Uber and Airbnb are considered software companies, this is an exciting space. One area of focus is on call centre technology where the group is active. The biggest challenge to this units' growth is skills availability in SA, a reason why the Egypt and UK offices have been retained. For example, there are proven, good skills in Egypt at a lower cost base than South Africa, which mitigates the lack of available skills in South Africa. The ability to leverage the global footprint of the group is thus a key competitive advantage in delivering software projects across the globe, at a competitive price.

- Data analysis

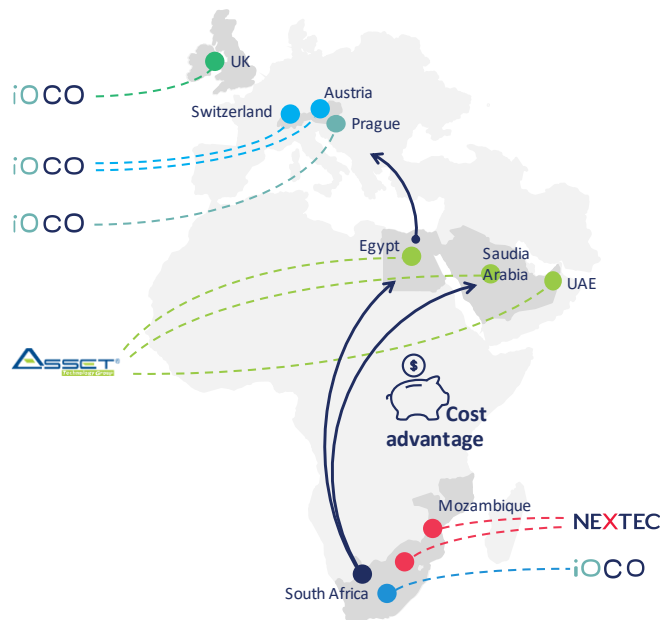
This is a niche offering for iOCO at present as the group has never made an acquisition in the space. It is, however, a significant growth area (especially for large customers looking to increase cross selling by utilising data insights within their organisations) and focus is being applied. iOCO assists companies in evaluating the potential of their data and ensuring their data is accurate, safe and relevant.

- Cloud & Security

Cloud forms the foundation for any digital strategy and a migration away from legacy and more costly systems. iOCO has a comprehensive offering in this space that includes a local hosted cloud option, right through to Hyperscale (public cloud) with significant global partnerships such as AWS. The offering is positioned as a "journey to the cloud partner", which includes advisory as well as providing a management layer and offering that enables ease of use, management and decision making.

- Automation
This is the automation of manual business processes as well as the use of robotics. Automation of call centres is a fast-growing trend with an increased use of Bots. iOCO will partner with software and product providers to deliver a solution to the client but is also capable of adding additional internally developed applications. This is an exciting space and strong growth is expected.
- Quality assurance and testing
This is a key offering for large scale, turn-key, complex programs, providing automated testing, as well as fully-fledged resource intensive testing services and management. This also compliments the other offerings and ensures the complete wrap of services so that clients can choose to receive a complete, fully-fledged, end-to-end delivery program. This is an area that many clients outsource, as they do not see it as being core or central to their operations.
- International

Figure 5 EOH's International presence



Source: Company data

The groups international operations sit within this division. Management has indicated its desire to significantly grow the contribution from its international operations from the current 13% of revenue. There were numerous international businesses that EOH acquired historically. Many of these businesses have been exited. Apart from opening the group to new markets and customers, they also provide new skills to the group and in the case of Egypt cheaper skills. In Egypt, the cost of an IT developer is half that of SA which is only 60% of that in Europe.

Given capital constraints, growth in the medium term will be organic and little capex is required. Its Africa strategy is largely driven by SA corporates looking for solutions in their Africa operations. On the continent management does not intend to open offices outside of SA and Egypt.

The international strategy revolves around leveraging off SA's differentiated offerings and gaining access to IT resources which are becoming scarce in SA. Focus is on mid-market corporates. The international offering will not be exclusive to Digital – other value-added services within the group will also be marketed where there is a value proposition. Development of the international operations has been slow during the turnaround phase, but the structure and strategy is now finalised and poised for growth. All operations are currently profitable.

Egypt

- This is the biggest revenue generator in the international portfolio. A business titled Asset is based in Cairo. It is essentially a mini iOCO with strong government and private sector contracts (circa 50 clients). App Development is a core focus for this business. The office is used as a steppingstone into the UAE and Saudi Arabia where a presence already exists.
- Management intends building a global delivery centre in Egypt that can deliver services to SA corporates given its broad and affordable skills base.

UK

- This is largely an App development and Cloud focussed business that will spearhead growth into Europe. 80-90% of its clients are UK based. There is a strong internal drive to grow this operation. This will include the strategy of growing the client base in the UK and Europe and where possible leverage off the cheaper SA and Egypt resource base. It will also provide the SA operations with skills and training.

Switzerland

- This business started because EOH had a customer in Switzerland. It is now an independent operation acting as a sales channel for SA business into Europe. It is a profitable business and going forward will be regarded as a branch of the UK operation.

Prague

- This is a business that has been around for many years and originated by following a SA based corporate. There is a development team in Prague. It is a small satellite office in Europe and its existence is to be re-evaluated in the short term – it's currently profitable.

iOCO Services – 28% of group revenue

This division facilitates communication across the client's IT platform (Wi-Fi, networking etc) and ensures the day to day managing of the system. There are four separate business units which are currently being consolidated together as the "Engine room" or "manage your IT infrastructure" offering. Knowledge Process Outsourcing will not be consolidated. The creation of a single support structure will remove significant duplication and create efficiencies. The most important feature is the vertical integration of the product offering from managed connectivity through to managed hardware and software, to managed cloud whether private, hybrid, public or hyperscaler.

■ Network solutions

Primary services include: MPLS (Multiprotocol Label Switching) moving to SD-WAN (Software Defined Wide Area Networks); Wi-Fi as a service; firewalls; perimeter security and voice mobility enablement in the enterprise space. This is mostly annuity-based revenue with 12-24-month contracts. iOCO competes with the likes of MTN and Vodacom and hence margins are tight. It engages with approximately 29 last mile service providers in SA.

■ Manage & Operate

Managing a client's end to end IT ecosystem, helping clients cut IT costs and migrating clients to the Cloud are examples of services offered in this division. It ensures the effective day to day running of a

client's IT system. It is the dominant component of iOCO Services suite and is a large player in service desk, modern workspace and managed print services. It offers hybrid cloud services and is hardware agnostic.

- Digital Industries

This is about iOCO being a successful Operational Technology (OT) supplier and service provider. OT is the use of hardware and software to monitor and control physical processes, devices and infrastructure. It assists clients with the digital transformation journey in critical OT environments. This could include the automation of an operational process, for example a factory line and enable the client remotely. Services are provided using global best in class software augmented by its own IP platforms. The group is highly active in the mining and industrial sectors. This cluster has seen significant growth recently.

- Knowledge Process Outsourcing

The diverse cluster offerings include forensic and legal services. There are a few new and exciting ventures in this division that could be rolled out globally and which is EOH IP. There is an electronic document signature business called **Impressions** which is housed in the client domain and operates as a consent engine. Nuvoteq owns the **Cerebro** platform that assists in clinical trials and has FDA approval. It is also being used as a learning platform and has many application possibilities in the compliance and regulatory environments. Xtnd is a forensic business that owns **Veritas**, a business that focuses primarily on the insurance sector and specialises in validating claims. Xtnd also deploys Layered Voice analytics in the validation process. It has software in this domain and is one of only two certified companies in SA using this tech. The current global demand for Cyber security and threat analysis makes this offering high in demand.

This cluster also operates call centres for a global client in appliance repairs. Furthermore, there are two companies with their own IP that provide payroll and wage bureau services with long established clients. To augment the proposition there is a legal business that provides outsourced legal services across the spectrum.

NEXTEC – 24% of group revenue

Figure 6 NEXTEC Divisional Structure

NEXTEC

Intelligent Infrastructure Solutions



Engineering design & consulting services
 Distribution & logistics design
 Environmental
 Power & Water
 Security & Building technology solutions

People Outsourcing Solutions



Recruitment & Headhunting
 Supply & Management of skilled & semi-skilled personnel
 Change Management
 Training Education & Skills Assessment



Source: Company data

NEXTEC consists of a variety of businesses that are focused on business process outsourcing and technology infrastructure. Its two main pillars include People Outsourcing Solutions and Intelligent Infrastructure Solutions.

NEXTEC has undergone a significant restructuring with many of its business sold given either their capital-intensive nature (projects in solar, rail, water etc) or simply not core to the group offering. Some of its businesses were moved into iOCO and vice versa. A base has now been established off which to grow and focus and an improved financial performance is anticipated.

Key OEM partners include: Cisco, Fortinet, Huawei, GE Digital and SAGE VIP.

Intelligent Infrastructure Solutions

This the more dominant division in NEXTEC. Designing, installing, managing and creating bespoke data platforms using the latest OEM technology solutions in the infrastructure environment across numerous sectors. While consulting is a lead source for business the fit of such businesses in NEXTEC (and the group) remains under review.

Contracts are largely fixed price based (a preferred route) but an element of variable revenue exists from variation orders. Certain contracts also allow for the sharing of cost savings (e.g. water leakage reduction targets).

OEM relationships were not damaged throughout the transformation period and NEXTEC was not blacklisted by any of its customers. It is a niche solutions provider and highly regarded by its over 3 000

customers. A small component (circa 5%) of NEXTEC's revenue is derived offshore, predominantly in Africa. The strategy is to follow OEM's or customers.

It has five business units:

- Engineering design and consulting services (consulting)

Mechanical and electrical engineering design and consulting services.
- Distribution and logistics design (consulting)

Designing intelligent warehousing and distribution centres as well as distribution processes using leading technology.

Brands include ILS (Industrial Logistic Systems)
- Environmental (consulting)

A full spectrum of environmental consulting services is offered including environmental impact assessments (EIA's) as well as social impact studies. An example would include the provision of air monitoring solutions to industry and government to curtail chimney emissions and surrounding air pollution.

Brands include CES (30-year history)
- Power & Water

Assisting clients in optimising their use of finite resources such as power, water and gas. Leak detection, monitoring of pipes, metering, substation management, backup power are examples of what is offered. With climate change and ESG becoming ever more important there is scope for strong growth. Utilities, telcos and mining are key sectors of focus.

Brands include IST, Energy Insight, GLS Consulting, Compu Power, JOAT
- Security & Building technology solutions

Advising clients on optimising the use of their existing infrastructure with digital as well as build new smart infrastructure.

This would include consulting on and installing point of entry systems at offices, camera systems, Wi-Fi systems, workplace technology and building management systems like fire detection. Intelligent green building design is a further example. This is a competitive space with numerous small operators.

Communication and connectivity solutions are also provided through Scan RF - network design and implementation to physical infrastructure deployment (e.g. masts)

Brands include SBT (security and Building Technologies)

People Outsourcing Solutions

Supplying solutions around recruitment, staffing, training and development and change management. Help clients with B-BBEE scorecards by finding the correct talent and training them. There are four business units:

- Recruitment and headhunting

A niche operation that assists in the placement of IT staff (from low level to executives) at clients.
- Supply & management of skilled and semi-skilled personnel.

Different to recruiting in that staff are employed by NEXTEC but are outsourced to clients providing flexibility and efficiency. These are generally back-to-back contracts in that staff are only sourced and placed when required. Staff could be placed to manage a specific function at the client. Over 3000 people have been placed.
- Change Management

Consulting on B-BBEE (improving scorecard levels through optimal staff composition) and employment equity. It also includes assisting staff with new system implementations (like SAP & Oracle).

- Training education and skills assessment.

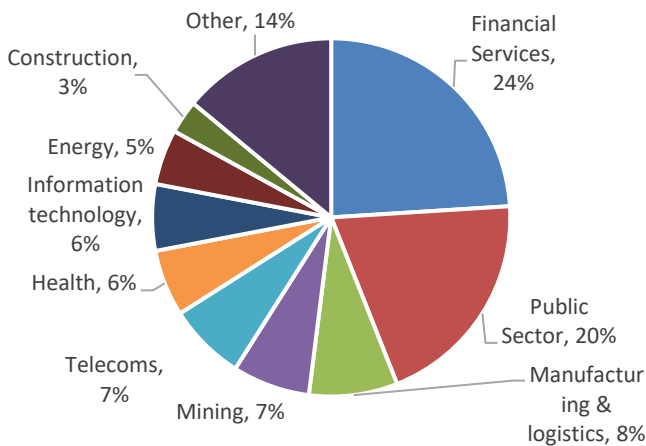
Facilitation of skills development and digital learning to assist the client in turning its technology and disruption into opportunities.

Operating landscape

Management indicates that there are no other SA based competitors that offer such a holistic IT solution to clients. iOCO has little client concentration risk as per Figure 9. NEXTEC has more concentration in its Top 20 clients, but this would be expected given the presence of large infrastructure projects. EOH is predominantly SA focused at present and has a broad and non-concentrated industry focus as per Fig 7 below. There is scope for the business to gain greater exposure to the retail industry as it only accounts for 3% of revenue at present.

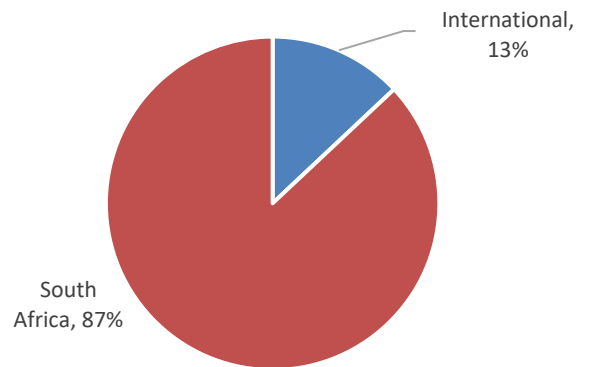
There are numerous competitors across the various business units with many being niche operators. There is a growing list of SMME operators, particularly BEE based operators which are focusing on the public sector. Many niche players opt to partner EOH given its OEM relationships and level of expertise. As indicated, there are no exclusive agreements in the hardware and enterprise application space. From a consulting perspective Deloitte and Accenture are primary competitors. EOH is a top 3 ICT company in South Africa with BCX and DiData. Other competitors include Altron, Pinnacle, Datatec and Adapt IT.

Figure 7 1H21 Revenue by industry



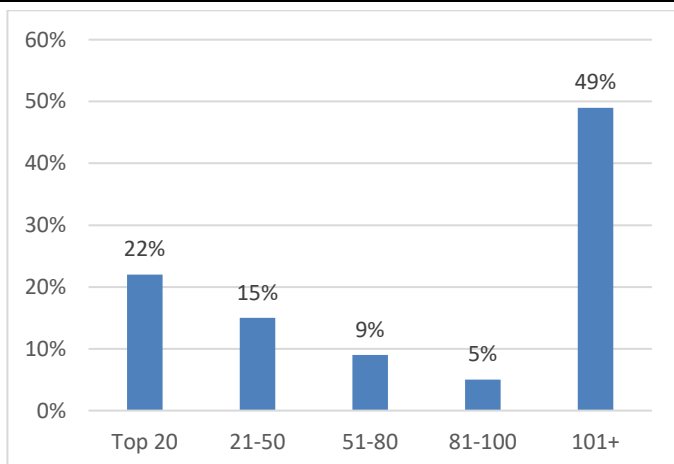
Source: Company data, Chronux Research estimates

Figure 8 1H21 Revenue by geography



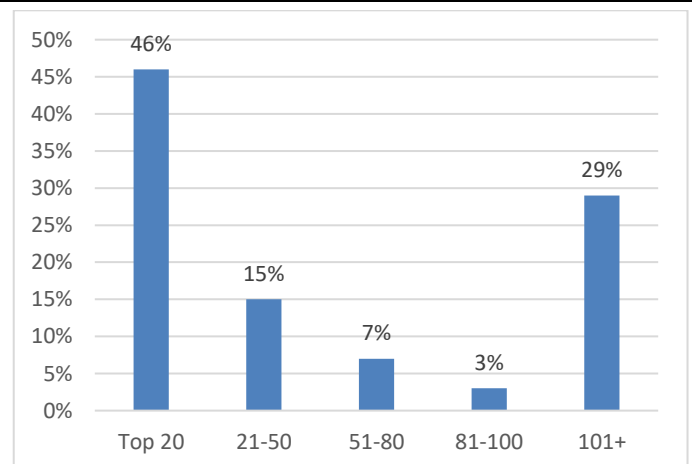
Source: Company data, Chronux Research estimates

Figure 9 iOCO – Contribution of top clients to revenue – FY20



Source: Company data, Chronux Research estimates

Figure 10 NEXTEC – Contribution of top clients to revenue – FY20



Source: Company data, Chronux Research estimates

Financial

Whilst a thorough review of the financials will not be conducted in this note it would be stating the obvious that the events described above have not had a material negative impact on the results. Accounts are messy to say the least with discontinued operations, write downs, once off restructuring costs, tax anomalies and various other abnormal items. Add the further impact of Covid 19. Features from the 1H21 results:

- Headline loss per share from continuing operations 69c, down from 391c in the prior period.
- Operating profit from continuing operations of R8m, up from a R758m loss.
- Group revenue from continuing operations of R3.8bn, down from R4.7bn.
- GP margin of 27.6%, up from 24.2%
- EBITDA margin of 8.3% up from 7.8%.
- Debt continues to decline from a peak of R4bn to R2bn.

Areas of focus to improve the financial performance:

- Improving NEXTEC's margins from 2% to 10% now that the business is stabilised and focused.
- The tax rate needs to normalise. This is a structural issue as there are too many entities in the group and tax offset between profitable and loss-making entities is not happening.
- Further reduce the debt and interest burden. Debt is targeted to be in the 1-1.5x EBITDA range – its currently at 2.8x on annualised 1H21 numbers.
- Further reduce costs. Head office costs to decline further as the number of entities decline and administration improves. Further reductions in property costs are envisaged when the leases are up for renewal in 2023. Advisory costs will fall sharply as the turnaround concludes. There is scope to digitise and automate their own business and processes which will offer further cost savings.

1H21 was the first reporting period since the turnaround where an operating profit was generated. The momentum is anticipated to improve as management is targeting a rebound in EBITDA margins from 8.3% to 10% in the short term.

Financial features from EOH's recent pre-closing trading statement:

- Group profit margin improvement of 4-6% expected in FY21E.
- The group expects to post a positive operating profit and reported EBITDA in FY21E.
- The gap between normalised and reported EBITDA continues to narrow
- iOCO continues to see a decline in hardware sales given the impact of Covid 19. However, it continued to post an operating profit and positive EBITDA driven largely by iOCO Services.
- NEXTEC revenue remained resilient in 2H21 despite tough economic conditions. The People solutions business had a strong 2H with wider margins. The Infrastructure business remains under pressure given project delays across municipalities, construction, water and energy sectors.
- Net cash balance of R605m at 28 July 2021.
- Debt remains around R2bn but the finalisation of the Sybrin deal post year end results will see this decline further (sold for a R334m cash consideration).

Opportunities

- Management focussing all its attention to the business instead of dealing with legacy issues. The new management team is very competent with a strong historical presence in the SA IT industry.
- The streamlined business structure will reduce costs and avoid further tax leakage.
- Focus on GTM teams to push the groups holistic service offering to clients, an approach that has lacked up until now. Increasing the cross sell has significant revenue benefits.
- Focus on the digital transformation where growth rates are strong as companies migrate away from inefficient legacy systems. Covid 19 has expedited this journey for many corporates.
- Expand the international business through in country expansion whilst leveraging off the SA platform.
- Customers are more willing to enter longer term (5 year) contracts as governance issues are resolved.
- Hardware spend should bounce back after a temporary halt on replacement by customers during Covid 19.
- More effective and focused branding allowing the market to appreciate the diversity of the groups offering and its market presence.
- Reduce debt and the interest payments – post 1H21 it has sold Sybrin for a cash consideration of R334m. Lower interest and tax payments will allow EOH to invest these savings into growing the business.
- Management is targeting EBITDA margins to rise from 8.3% to 10% in the short term.

Risks

- The current SITA (State Information Technology Agency) recommendation to the Department of National Treasury on blacklisting EOH for public sector business for a period of time. It relates to EOH involvement in the Department of Home Affairs ABIS project. Management believes it would be wrong to penalise the new management team as they have been very co-operative with the public sector and addressing the wrong doings. The blame should lie with the prior management team and therefore EOH is taking civil action against them. Management is confident that EOH won't be blacklisted but this remains a risk as the public sector accounts for approximately 20% of revenue.
- Ongoing negative media commentary relating to numerous ongoing legal matters that are in the process of being finalised. Whilst most likely relating to past events these do inhibit EOH from moving on.
- The lender group waived the R1.6bn debt repayment requirement on 28 February 2021 (R950m was paid). In part asset realisations have been delayed due to Covid 19. The recent Sybrin sale should bring approx. R300m of further debt reduction closing the outstanding gap from R650m to R350m. EOH does, however, require the ongoing support of its lenders.
- Elevated reputational risk is an impediment to investors and customers. I feel that the risk has subsided significantly given the transparency of the group, the involvement of ENSafrica and the Zondo Commission testimony. However, the recent SITA events is not positive as it brings EOH back into the media for the wrong reasons. Customer and supplier numbers are actually increasing which further supports reputational risk declining.
- Covid 19 – This has reduced hardware and other IT related spend as well as hamper economic growth which is key to IT spend. On the positive side it's benefiting spend on digital transformation.
- B-BBEE score card changes. Currently a Level 1 contributor and highest among its peers on the JSE. Its scorecard is broad based which mitigates some of the risk.

Conclusion

In 2015 EOH had a R23bn market capitalisation, it traded on >30x P/E and was located in 31 countries across the globe. Today its market capitalisation is R1.1bn and it produced a headline loss per share in 1H21. Despite these metrics, what the company has achieved in the past two and a half years is remarkable and underestimated. It has remained listed, it has retained most of its clients and suppliers, it continues to be a leader in many of its markets, it has provided the investment community with incredible transparency, it has managed to pay down R2bn of debt and it has restructured itself into a leaner, more client focused business.

Despite its challenges it has attracted high quality management that has delivered this outcome. We envisage this team to continue to deliver a compelling financial turnaround in the short to medium term as it puts the legacy issues of the past behind it and focuses on providing a world class service to its customers.

One can only assume that the barrage of media and SENS reports over the past two and a half years has created some investor fatigue. Following numerous discussions with management and pending clarity on SITA's stance on public sector participation (management is confident a status quo will be maintained), we believe that news flow will turn positive on EOH as it demonstrates its returned path to financial growth with significantly better earnings visibility.

With management more focused on the future of the business and reputation risk dissipating, we anticipate the business pipeline to grow and on more favourable contract terms. This combined with EOH's strong market presence, energised management team and world class service offering in a strong growth sector, its likely to see investors once again being attracted to the company.

We believe FY21E should bring a more stable earnings base from which the company and its management can be measured going forward.

Annexure: Management Team

Executive Directors

Stephen van Coller (CEO) – appointed 1 September 2018.

Prior to joining the EOH Group, Stephen was with the MTN Group and served as Vice President: Digital Services, Data Analytics and Business Development. He was a member of the MTN Group Executive Committee, Group Transformation Board and the Group Operations Committee.

Stephen has over 20 years' experience within the Banking Sector; at Deutsche Bank South Africa from 1996 -2006, he was Managing Director, Head of Investment Banking, a member of the Executive Committee and a trustee on the foundation; at Barclays Africa Group from 2006-2016, he was Chief Executive of Corporate and Investment Banking (CIB), a member of the Executive Committee and chaired the Citizenship and Innovation Committees across Africa, a member of the Barclays Plc Global Investment Committee, the Barclays Social Innovation Fund and was Chairman of The Absa Foundation Trust

Megan Pydigadu (Chief Financial Director) – appointed 15 January 2019.

Megan is qualified as a Chartered Accountant in 1999 and completed her Articles at Deloitte. She stayed on as a manager for a further 2 years. In 2002 she joined De Beers as a Senior Divisional Financial Manager in the head office function. In 2005 she joined Bateman Engineering Group which had recently listed on the AIM exchange in London serving as Group Financial Controller until 2010. From August 2010 to January 2017, she served as Group CFO at MiX Telematics where she was involved in the successful listing of MiX on the New York Stock Exchange including a \$100m capital raise.

Fatima Newman (Chief Risk Officer) – appointed 1 August 2019.

Fatima has a diverse experience across a range of industries including Stockbroking, Asset Management and Private Banking, Financial Services, Government and Parastatals in both front office and infrastructure functions, some of which were Macquarie First South, Absa CIB and the MTN Group prior to going the EOH Group.

Executive Management Team

Ziaad Suleman - Chief Commercial Officer

Ziaad spent 13 years at IBM, with the initial seven years as the Head of Legal and the last six years as the Chief Operations Officer across Southern Africa, being on both IBM South Africa's Board of Directors and Executive Committee. In addition, Ziaad chaired the company's Social and Ethics committee as well as the Disciplinary board. In his role, he was integral to the successful growth and development of IBM's business in the region.

Brian Harding - Group Executive - iOCO Digital

Brian has extensive experience in the ICT industry spanning over 25 years, having worked in various management and executive positions. He was co-founder and owner of Airborne Consulting, a successful software development company which was acquired by EOH in 2011. Brian continued at the helm of Airborne Consulting for a number of years and more recently took on a new regional role as Head of the Western Cape and one which he will continue going forward.

Natasha Andrykowsky - Executive Head of Strategy and Change

Natasha joined EOH from the Absa Group, where she was the head of International Banking for the South African region. During her banking career, she has held a number of strategic and operational roles including head of strategy for Corporate and Investment Banking (CIB) in Africa. Natasha was also the project lead for CIB with respect to its separation from Barclays Plc. Prior to joining investment banking Natasha worked at the Monitor Group, a global strategy consulting firm where she worked with clients in South Africa, London, Sao Paolo, Moscow and Hamburg.

Marius de la Rey - Interim COO, iOCO

Marius is an entrepreneur. His professional disposition is defined by a passion for the quality and consistency of the customer experience at every interaction. He prides himself on having a customer-centric eye for every detail and how it imparts value to the customer experience. This is a skill and strength that he has developed and fine-tuned over multiple years as a pioneer, owner and operator of retail operations. These include diverse businesses such as King Pie and Mugg & Bean. The sheer scale of his portfolio at ABSA encompassed all his prior expertise with the digital landscape augmenting his historical exposure.

Sean Bennet - Interim COO – NEXTEC

Sean is a qualified Chartered Accountant in England and Wales. After qualifying Sean joined UBS in Investment Banking. During that time Sean was a Managing Director in the UK mid-market team, the recognised number 1 team in the UK. In addition, he was co-head of the UBS restructuring team. Sean moved to South Africa in 2008 as the joint Head of HSBC Global Banking (Investment and Corporate Banking) for Africa. In 2011 Sean moved back to UBS as CEO of South Africa and Head of Sub-Saharan Africa. In 2015 Sean was appointed as CEO of Kore Potash an Australian listed potash mining company which he restructured, redomiciled, refinanced and relisted in the UK and South Africa. Sean stepped down in 2018 as the business moved towards the construction phase. In October 2019 Sean joined the EOH management team, as interim head of NEXTEC and a member of the EOH group Exco, with the purpose of assisting the group CEO in turning the business around. In addition, Sean is also responsible for all asset sales across the group.

Tsepa Ramoriting - Executive – iOCO Technology

Tsepa is an IT professional with over 25 years of experience in the field of technology and systems. He joined EOH five and half years ago with the primary focus of building the Oracle E-Business Suite Applications business a job he successfully executed for over 15 months before he was asked to take over the leadership of Oracle Services Cluster. Prior to that, Tsepa ran his own business for 11 years providing Oracle applications management and implementation services to private and public sector clients. His vast IT experience includes 6 years with IBM Software Group as sales executive across industries and 5 years with Oracle Corporations in sales leadership, mainly utilities and public sector.

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