

PSG GROUP LIMITED

ANNUAL REPORT  
2009

# PSG GROUP

Annual Report  
2009



PSG GROUP LIMITED



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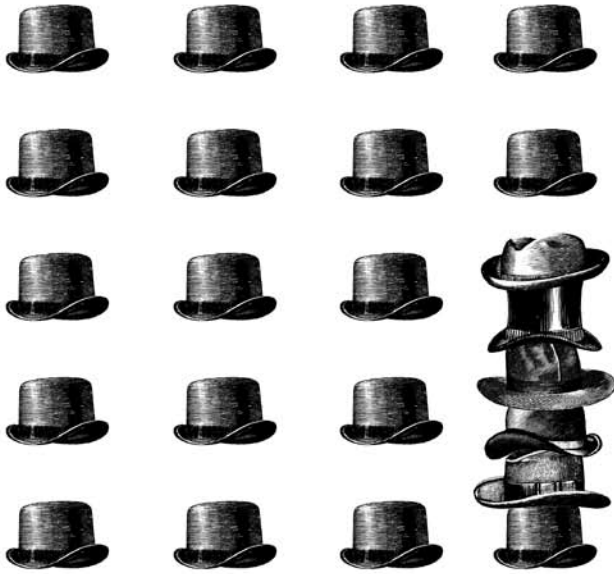
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## Contents

Chairman's letter	1
Group structure	8
Board of directors	10
Review of operations	11
Stock exchange performance	20
Our track record	20
Value added statement	22
Group employee statistics	23
Corporate governance	24
PSG Group Limited	
– Annual financial statements	26
– Share analysis	100
– Notice of annual general meeting	101
– Form of proxy	<i>Attached</i>
PSG Financial Services Limited	
– Annual financial statements	108
– Preference share analysis	129
– Notice of annual general meeting	130
Administration	134
Shareholders' diary	134



# Chairman's letter



**T**o the shareholders of PSG Group. I do not blame you if you complain that PSG Group's financial statements are difficult to understand. We have a simple but diversified group. It is unfortunately the way IFRS requires us to disclose the financial standing and results of our more than 35 underlying investments (consolidated, equity accounted and marked to market) in financial services and across a number of other industries.

## BUT WHAT ARE PSG'S MAIN OBJECTIVES?

- To invest shareholders' money wisely;
- To manage our investment portfolio to the benefit of all stakeholders; and
- To enhance shareholders' wealth over time through PSG Group's share price appreciation and the payment of dividends.

## ENHANCING SHAREHOLDERS' WEALTH

Since inception, PSG has always aimed to increase shareholders' wealth. We use a total return index to measure this. The compound annual growth rate of an investment in PSG since 25 November 1995 is 54%.



	PSG total return index* R	Change year-on-year %
25 November 1995	100	
29 February 1996	643	543
28 February 1997	1 440	124
28 February 1998	4 682	225
28 February 1999	3 580	(24)
29 February 2000	3 157	(12)
28 February 2001	2 202	(30)
28 February 2002	1 700	(23)
28 February 2003	1 977	16
29 February 2004	3 818	93
28 February 2005	9 727	155
28 February 2006	28 364	192
28 February 2007	36 658	29
29 February 2008	31 655	(14)
28 February 2009	27 052	(15)

\* Total return index is measured by:

- investing R100 on 25 November 1995, the day of PSG's establishment, and
- reinvesting all ordinary and special dividends paid, as well as
- taking into account the effect if the unbundled (November 2003) Capitec shares had been kept and dividends received reinvested.

## HOW SHOULD A READER OF FINANCIAL STATEMENTS GO ABOUT EVALUATING OUR PERFORMANCE?

The same way we as management (who are also major shareholders) do. We evaluate it twofold by looking at the growth in PSG Group's *recurring headline earnings* and the *intrinsic value* (i.e. PSG Group's sum of the parts value, calculated using market prices for listed assets/liabilities, and market-related valuation techniques in the case of unlisted assets/liabilities) of the business. The sustainable earnings from subsidiary and associated companies are included in *recurring headline earnings*, whereas marked-to-market movements and once-off items are disclosed as *non-recurring headline earnings*.

PSG Group's *recurring headline earnings* increased by 25,3% to 232,6 cents per share for the year ended 28 February 2009. *Reportable headline earnings*, however, decreased by 77,9% to 65,3 cents per share, mainly as a result of marked-to-market losses following the general decline in global stock markets.

## PSG GROUP'S INTRINSIC VALUE CALCULATION

The table on the right represents management's simplified calculation of PSG Group's intrinsic value per share as at 30 April 2009. It should be noted that it contains subjective assumptions, and that it does not necessarily represent the fair value of a PSG Group share.

Asset/Liability	Rm	Market price per share R	Valuation method
Capitec	1 119	39,00	Market price
PSG Konsult	644	1,20	OTC 90-day VWAP
Zeder (incl. management agreement)	680		Market price and DCF
Paladin	538	13,60	Intrinsic value
PSG Fund Management (incl. PSG FutureWealth)	219		7x Historic P/E ratio
Other investments (incl. cash)	697		
<b>Total assets</b>	<b>3 897</b>		
Perpetual pref funding	(486)	80,00	Market price
Other debt	(362)		Carrying value
<b>Total intrinsic value</b>	<b>3 049</b>		
<b>Intrinsic value per share (Rand)</b>	<b>17,83</b>		



## RECURRING HEADLINE EARNINGS PER SHARE

Cents per share	2009	2008	2007	2006	2005	2004
<i>Change year-on-year (recurring headline earnings)</i>	<b>25%</b>	57%	38%	45%	16%	
<b>Recurring headline earnings</b>	<b>232,6</b>	185,7	117,9	85,4	59,0	51,1
Recurring earnings	<b>237,7</b>	203,9	131,9	110,5	64,2	57,0
Head office costs	<b>(5,1)</b>	(18,2)	(14,0)	(25,1)	(5,2)	(5,9)
Funding and STC (at head office)	<b>(57,7)</b>	(54,1)	(42,7)	(22,6)	1,3	11,9
<b>Recurring headline earnings (after funding and STC)</b>	<b>174,9</b>	131,6	75,2	62,8	60,3	63,0
<i>Change year-on-year (recurring headline earnings after funding and STC)</i>	<b>33%</b>	75%	20%	4%	(4%)	
Non-recurring items	<b>(109,6)</b>	163,5	444,1	289,0	29,7	13,3
<b>Reportable headline earnings</b>	<b>65,3</b>	295,1	519,3	351,8	90,0	76,3
<i>Change year-on-year (reportable headline earnings)</i>	<b>(78%)</b>	(43%)	48%	291%	18%	

In 2005, I wrote:

*“We are aware of the fact that the years ahead may be more volatile as a result of the new accounting standard, AC133, which requires a company to revalue its investments to market value at year-end – with the difference going through the income statement. As investors we are more exposed to the vagaries of the market and this could lead to more volatile earnings. To put it simply: in bull markets we should make more than good profits, and in bear markets we will not be able to achieve such impressive growth. We do not believe that this should concern shareholders. Project growth is still on course – the ride may just be a bit bumpy.”*

The aforementioned has been proved during the bull market run from 2004 to 2008, when PSG made in excess of R800 million in marked-to-market profits before tax of which some R600 million was realised, as well as in the current bear market in which marked-to-market losses amounted to more than R200 million. Subsequent to year-end up to 20 April 2009, PSG has made approximately R40 million in marked-to-market profits.

PSG management, through the separate disclosure of recurring versus non-recurring earnings, has endeavoured to simplify both the consolidated income statement and balance sheet by distinguishing recurring headline earnings from marked-to-market movements and once-off items (refer *Contribution to Headline Earnings* table on page 11).

## FINANCIAL CRISIS

The financial crisis has now been with us for more than 18 months. It arguably reached its peak in September 2008. Retief du Toit, manager of PSG's *Black Swan Hedge Fund* (which, incidentally, achieved an annual return of 31%), aptly highlighted it in his fund commentary at the time:

“It is not often that one summarises one single month as follows:

- An unexpected change in the South African presidency.
- The resignation of twelve members of parliament, amongst them the minister of finance who revoked his decision within two hours.
- The bankruptcy of Lehman Brothers.
- The takeover of Merrill Lynch by Bank of America in order to prevent bankruptcy.
- AIG, the world's largest insurer, rescued by the US Federal Government.
- Goldman Sachs and Morgan Stanley changed to deposit taking institutions in order to have access to federal funds.
- Short selling was banned in the US, UK and other countries.
- The All Share Index down by 13,2%.

According to the normal distribution only one or two of these events should take place once in several life times, yet we have seen all of them materialise within the span of 30 days!”

Since establishment, PSG has survived numerous challenges. In 1997/98 the Asian banking and currency crisis caused jitters for emerging markets, including South Africa and PSG, with its share price trading as high as R19 and as low as R4,45 per share. In 2001/02 the run on Saambou Bank and its consequent demise resulted in the A2 banking crisis in South Africa, with a liquidity squeeze on smaller banks. At the time, PSG had controlling interests in both PSG Investment Bank and Capitec Bank. PSG Investment Bank experienced a substantial reduction in its deposit base, which necessitated a realisation of its assets and the curtailment of the banking business. PSG listed Capitec Bank amidst the ruling banking crisis. At that stage Capitec Bank did not make use of any deposit funding, yet the market sentiment drove its share price down significantly. With investments in two small banks, PSG was trading significantly below its NAV, with its share price ranging between R4,40 and R9,86, and was vulnerable to a hostile takeover. It was decided to unbundle the investment in Capitec Bank, and PSG Investment Bank was sold to Absa. The current financial crisis also affected PSG's share price with it having traded as low as R12,15 after it peaked at R30,50.

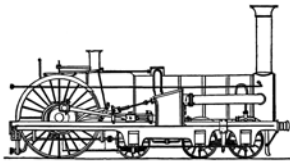
The management teams of both PSG and Capitec Bank have definitely not forgotten this experience. We remain conservative in the way we conduct our business. I quote from Capitec Bank's recent results announcement:

- “When we started our own bank, we decided that Capitec Bank should never put itself in a position where a bad day in the markets can destroy a bank built up over a life-time.”
- “At year-end we (Capitec) would have been able to repay all our saving deposits immediately and on average throughout the year, within two weeks. Internationally, retail savings deposits are considered to be least likely to be withdrawn in a crisis.”
- “At year-end Capitec had R1,4 billion of equity and R3,5 billion in assets, excluding cash. Our risk-weighted capital adequacy ratio was 43% at year-end. We have plenty of capital and this is a source of comfort to our depositors.”

Having experienced tough times in the past and in anticipation of what the current market and economic environment might hold for businesses, the following action has been taken:

- We remain focused on increasing *recurring headline earnings*, and being less dependent on equity market movements;
- We have raised cash and put funding lines in place to ensure adequate liquidity;
- We have extended our overnight facilities to longer term funding;
- We have ensured that all companies within our group are properly capitalised; and
- We have made certain that the group has no sub-prime exposure. The PSG Money Market Fund has since last year taken the conservative route of not investing in conduits.

**EVOLVEMENT OF PSG’S BUSINESSES**



*“In the PSG Group we understand speed, energy and the value of rapid, informed decision making. We have built a dynamic, ever-changing group with clear intent.”*  
**Jannie Mouton (2002 Annual Report)**

In 1995, I had a dream of establishing a listed financial services company. We acquired a controlling stake in PAG Ltd, a personnel placement agency, for R7 million. A year later we sold the agency for R107 million. The reverse listing of PSG into the Servgro cash shell followed, which further increased PSG’s capital base. In later years, PSG sold its 15% interest in the JSE Ltd (which it acquired for R82 million) for R679 million. The aforementioned and other investments enabled PSG to fund current and new investments, and pay dividends.

We are proud of our investments, the largest of which are the following:

**PSG Konsult**

PSG Konsult was started with R2 million in seed capital in 1998. Willem Theron, who ran a successful audit practice consisting of 11 offices in the Eastern Cape, approached PSG. That was after we had tried to get private wealth management off the ground. He enacted a model which encompassed the entrepreneurial spirit of PSG. PSG Konsult offices are each run as an independent unit with the majority of fees written (in excess of 70%) allocated to the consultants/brokers.

PSG Konsult in turn provides the brand, compliance and selected administration services, and it is in a position to negotiate competitive short- and long-term insurance rates for clients as a result of its strong

relationships with product providers. People are happy and they seldom leave.

**Capitec Bank**

We are very proud of the Capitec Bank story. In 1998 PSG acquired the first two micro loan shops, and a further 29 stores soon thereafter. At that stage loan repayments were still effected by means of the card and pin method. We realised this was not sustainable. Michiel le Roux assembled a management team and we invested heavily in systems development. Today Capitec Bank is a successful retail bank which has shown an exceptional growth record since establishment and, even over the past year when other banks were struggling, it delivered headline earnings of R302 million representing a 42% increase.

With the aforementioned two companies operating optimally, our focus will be on growing the other companies in the group.

**Zeder Investments**

At Zeder we have followed the same philosophy of increasing our recurring earnings base. *Recurring headline earnings* increased by 56% to 24,4 cents per share in 2009. As the population and the demand for food grows, the long-term investment case for the agricultural sector remains appealing. We see great value here and are currently in the process of raising R500 million by means of a rights issue to further Zeder’s position in the sector.

**Paladin Capital**

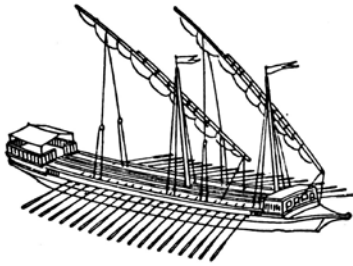
With the changes in Paladin’s management team referred to below, our strategy will be to build out the company as an investor in both private and listed companies. Paladin is well positioned to take advantage of opportunities in the current market and intends to list on the JSE.

**PSG Fund Management and PSG FutureWealth**

Following the merger of these two companies, we will focus on the existing synergies to increase the combined businesses’ assets under management and administration.

**Disposal of Channel Life**

Effective January 2009, we sold our investment in Channel Life to Sanlam. We were invested in this business for a good number of years. This business fits in with Sanlam, and it makes sense for them not to have minority shareholders at this stage. Having been offered embedded value (a fair price given current market conditions), we decided to sell same.



## OUR PEOPLE

### Changes to management

PSG Group's senior management hardly changed over the past 14 years since establishment. Succession planning remains a priority and we have reached a point in our existence where it is time to rejuvenate our management team through natural progression. We believe the combination of experience and youth will invigorate our business. We have smart, well-qualified youngsters with sound experience and integrity, who have proved themselves as leaders of the future. In view of the aforementioned, the following changes have been made during the past year:

- After 14 years as an executive director, Chris Otto (59) has resolved to become a non-executive director. We will, however, retain his experience on the PSG Exco and he continues to represent PSG on the boards of a number of our larger investments.
- Pierre Malan has left the group following his resignation as director of PSG Group and as CEO of Paladin Capital in February 2009.
- In March 2009, Jacobus van Zyl Smit (67) retired from the PSG Group board and as chairman of the PSG Group audit committee. Jaap du Toit (55), now an independent non-executive director, succeeded Jacobus as chairman of the PSG Group audit committee.
- Wynand Greeff (39), involved within the PSG Group since 2002, was appointed as financial director in October 2008.
- Piet Mouton (32) was appointed as executive director in February 2009. Over the past five years, he has been involved at a number of group companies including Thembeka Capital, Arch Equity and Quince Capital.
- The newly appointed Paladin management team includes Francois Swart (31) as CEO, Jurie Bezuidenhout (31) as financial director and Bernardt van der Linde (31) as an executive.

*I, however, have no plans to retire. PSG is my life and the people who work with me are my friends and family.*

### THE PSG GROUP EXECUTIVE COMMITTEE ("PSG EXCO")

The PSG Exco consists of myself (chairman), Chris Otto (non-executive), Jaap du Toit (non-executive), Wynand Greeff, Piet Mouton, Antonie Jacobs, Johan Holtzhausen, Francois Swart and Bernardt van der Linde, and is responsible for:

- The strategic direction of PSG Group.
- Overseeing the group's major investments in Capitec Bank, PSG Konsult, Paladin and PSG Fund Management (incorporating PSG FutureWealth as from 1 March 2009). All these companies have independent boards as well as strong management teams. PSG Group has at least two representatives on each of these company's board of directors.
- The active management of Zeder in terms of a management agreement. We believe this to be a mutually beneficial model and will look to implement a similar management structure at Paladin.
- Acting as treasurer to effectively manage and allocate capital within the group.
- Identifying and investigating investment opportunities.

### REMUNERATION

PSG remains sensitive to remuneration practices.

In 2008, Chris Otto and I both took salary cuts in lieu of shares issued to us in terms of the PSG Group share purchase scheme. These shares are currently "underwater" by some R5 per share. In 2009, I have again insisted that my salary not be increased.

During the past year, PSG Group relieved all participants, apart from Chris Otto, Jaap du Toit and myself, from their rights and obligations in respect of the PSG Group share purchase scheme relating to undelivered PSG Group shares. This deferred delivery scheme proved to be inefficient as a mechanism to incentivise key management. Having taken cognisance of current circumstances, PSG decided not to pay any discretionary bonuses to senior management and executives for the year ended 28 February 2009.

Our people remain our single-most valuable asset. It is imperative that we retain and attract exceptional individuals by, inter alia, ensuring they are well incentivised. We have consequently explored various long-term incentive alternatives, and have decided that senior management employed by PSG Corporate Services would be best incentivised by means of a newly introduced share option scheme with effect from 1 March 2009. You as shareholders will need to approve this scheme at PSG Group's annual general meeting on 19 June 2009. We have remuneration committees at all of our underlying investments

that have ensured that employees are appropriately rewarded by means of short and long-term incentive schemes.

## DIVIDENDS

PSG has continuously paid attractive dividends over the past years. Total dividends of R10,48 per share have been paid since establishment, of which R4,70 constituted special dividends. However, cash remains a sought-after commodity in a market where liquidity reigns supreme. We consequently decided it best to follow a more conservative approach to paying dividends.

In future, PSG intends to distribute as dividends 75% of free cash flow earned from underlying investments, after payment of the PSG Financial Services perpetual preference dividend and other financing commitments. The balance retained will be utilised to fund investment opportunities and/or settle debt obligations. One third will be paid as an interim and the balance as a final dividend at year-end.

Had we applied the aforementioned policy in the past year, the dividend would have been approximately 30 cents per share.

## OWNERSHIP

In 1996 PSG Group directors owned 11 million shares in the company. Today the directors own some 94 million shares comprising a 53% interest, none of which are held through derivative structures.

My wealth comprises my interest in PSG and I guard it with my life. You as co-owners of the company can rest assured that we will look after your investment.

## KING III CODE ON CORPORATE GOVERNANCE

Corporate governance best practice remains one of our cornerstones and is instilled in all our companies.

We support the majority of the proposed King III principles. However, there are certain recommendations which in our opinion do not necessarily contribute to good corporate governance. For example, the requirements that the board be led by an independent non-executive chairman and that the majority of non-executive directors are independent. I am a large shareholder in PSG. People treat their own cars better than rentals. There are a number of successful companies which have been led by executive chairmen. Take Christo Wiese, Anton and Johann Rupert, Raymond Ackerman, Harry Oppenheimer, Donald Gordon, Warren Buffett, Bill Gates and Rupert Murdoch as examples.

## CONTRIBUTING TO SOCIETY

We believe that the well-being of us as a society is inevitably dependent on education. At PSG our social responsibility efforts are predominantly directed at supporting education on a variety of levels.

We are funding the establishment of a pre-primary school, named Akkerdoppies, for underprivileged children in Stellenbosch. This project is co-ordinated by representatives of Sibusisiwe Community Care, a welfare organisation established by a group of young professionals from the surrounding area. We are excited about this initiative.

In addition, the PSG Group Bursary Loan Scheme at the University of Stellenbosch is currently assisting six gifted but needy students to further their studies.

## THE FUTURE

Unfortunately I do not have a crystal ball telling me what will happen in the future, but my gut feelings are the following:

- Times will be tough for the foreseeable future.
- I don't know when the markets and the economy will turn, but I know it will.
- The market looks cheap at current levels.
- The time to seize the opportunity is now:
  - Attract skilled people (quality available)
  - Cheap investments (at around 3 P/Es and 60% of NAV)
  - BEE opportunities for Thembeke Capital
  - Synergistic acquisitions – grow your company
- We shall prosper.

## A WORD OF THANKS

I would like to thank Chris Otto, my colleague and dear friend who has been my sounding board and partner in PSG over the past 14 years for his unwavering loyalty. You deserve more flexibility and I look forward to your continuous contribution for many years to come.

Also a word of thanks to Jacobus van Zyl Smit and Pierre Malan for their devotion over the years. I wish you all the best.

Lastly, to my fellow directors, PSG colleagues and shareholders – thank you for your loyal support over the past year.



**Jannie Mouton**  
Stellenbosch  
15 May 2009



## PSG GROUP LIMITED

### Notice

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#### Annual general meetings (“AGMs”) and investor presentations

You are invited to our PSG Group Investor Day on which the various AGMs will be held and presentations made by our group companies on 19 June 2009 at Webersburg, Annandale Road, Stellenbosch.

The timetable is as follows:

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08:30	PSG Financial Services Ltd
08:45	PSG Fund Management Group (Pty) Ltd & PSG FutureWealth Ltd
09:30	PSG Konsult Ltd
10:15	Tea
10:30	Thembeka Capital Ltd
10:35	Paladin Capital Ltd
11:30	Zeder Investments Ltd
12:00	PSG Group Ltd

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Lunch will be served after the PSG Group Ltd presentation. Kindly confirm your attendance with Jaki Nieuwoudt at: E-mail: [jakin@psggroup.co.za](mailto:jakin@psggroup.co.za)  
Fax: 021 887 9619 Telephone: 021 887 9602

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