Chairman's letter

Dear Stakeholder

It is a great pleasure and privilege for me to reflect on the 2018 financial year, and to provide you with insight into PSG Group Ltd ("PSG Group" or "the Company") and our thoughts on the future.

With the recent failures of corporate governance in South Africa and the attacks on one of our own brands still fresh in everyone's minds, we are acutely aware of the challenges facing South Africa and in particular corporate South Africa. The actions of a few have unfortunately led to many being painted with the same tainted brush, and the reputational damage to corporate South Africa will take some time to repair. As Warren Buffet has said: "*It takes 20 years to build a reputation and five minutes to ruin it.*" Throughout all of this we chose to stand by our belief that, to be successful, we should focus on being experts in finding and pursuing opportunities, not experts in finding fault and pointing out negativity.

Since PSG Group's establishment in November 1995, our aim has been to create value – not only for our shareholders but for all the people of South Africa. We believe in conducting sustainable businesses that make a positive contribution to society. Our investments continue to provide solutions to some of the greatest challenges faced by our country, such as quality education, sustainable energy and low-cost banking. Such solutions improve people's lives, reduce the burden on government, and benefit the country as a whole.

WHO WE ARE

PSG Group is an investment holding company consisting of underlying investments that operate across a diverse range of industries including banking, education, financial services and food and related business, as well as early-stage investments in selected growth sectors. Our market capitalisation (net of treasury shares) is approximately R47bn, while we have influence over companies with a combined market capitalisation of approximately R170bn.

There are seven main business units on which we report, namely:

- Capitec Bank Holdings Ltd ("Capitec") (retail banking);
- Curro Holdings Ltd ("Curro") (private basic education);
- PSG Konsult Ltd ("PSG Konsult") (wealth management, asset management and insurance);
- Zeder Investments Ltd ("Zeder") (investments in food and related business);
- PSG Alpha Investments (Pty) Ltd ("PSG Alpha") (early-stage investments in selected growth sectors);
- Dipeo Capital (RF) (Pty) Ltd ("Dipeo") (BEE investment holding company); and
- PSG Corporate (investment management and treasury services), including PSG Capital (corporate finance).

OUR OBJECTIVE

Our long-term economic goal remains to continuously create wealth for our shareholders through a combination of share price appreciation and the payment of dividends. To achieve this, we have invested in a well-diversified portfolio of businesses with high-growth potential that consistently yield above-market returns, while contributing positively to society.

OUR INVESTMENT PHILOSOPHY

The investment universe is complex with a myriad of variables. Astute investors base their decisions on sound fundamentals and proven investment principles. PSG Group aims to be a disciplined investor, remaining committed to its core philosophy of simple, good and ethical business.

- We invest in:
  - Enterprises with uncomplicated business models, operating in large markets;
  - Industries that exhibit either a fragmented market dynamic or one with large inefficient incumbents; and
  - Honest, focused, talented, hard-working and passionate management that we believe are the best in their respective fields.

- We are long-term investors with no predetermined exit strategy.
- Sound corporate governance is non-negotiable – we believe in accurate, transparent and succinct information.
- A key tenet of success is trust – without trust, companies lose clients and leaders lose their teams. We advocate trust through our philosophy of ultimate empowerment. We employ smart, competent individuals, and empower them through trust.
- We believe in co-investing with management. Management as co-owners are generally more focused and dedicated to growing their businesses. This also applies to PSG Group – the board of directors owns 25,2% of the Company.
- We provide our high-growth investments with the necessary capital to enable management to focus relentlessly on growing their business rather than on meeting debt funding requirements. As such businesses mature, they will be able to leverage their balance sheets when needed.

OUR STRATEGY

PSG Group has always excelled at early-stage investing by building businesses alongside entrepreneurs from the development stage. Both Capitec and PSG Konsult were started from within PSG Group's offices, and the investment in Curro was made when they only had three schools:

- We acquire large influential stakes in businesses we believe in and offer investees our strategic input, helping them to establish and drive ambitious plans.
- We provide access to capital that helps expedite future growth, both organically and through acquisitions.
- We participate actively at board level, and often also at an executive committee ("Exco") level.
- We either serve on or attend audit and risk committee meetings as a measure of ensuring good corporate governance.

PSG Group historically employed various strategies in response to ever-changing circumstances:

- PSG Group grew substantially during its early years from 1995 to 1998, essentially striving to build a financial services business.
- Following the Asian crisis in 1999, and the South African A2-banking crisis and dot-com bubble of the early 2000s, PSG Group employed a strategy called *Project Unlock Value* whereby surplus capital was used to repurchase approximately 38m PSG Group shares representing a then 27% interest, and to pay special dividends.
- By 2004, we had suitably positioned PSG Group and embarked on *Project Growth*. This strategy comprised various arbitrage investments, e.g. acquiring and subsequently disposing of 15% of the JSE Rights in issue (effectively representing a 15% interest in what is today the JSE Ltd ("JSE")), and the establishment of Zeder and PSG Alpha.
- Since the global financial crisis in 2008/9, we have operated in accordance with *Project Internal Focus*, a strategy whereby our focus has been primarily directed at the optimisation, refinement and growth of PSG Group's existing investment portfolio.
- While *Project Internal Focus* remains effective, we are continuously focused on identifying and investing in new growth sectors.

Looking back, all these strategies have ultimately been focused on the continued creation of wealth for shareholders. How has this paid off?

Albert Einstein said: *"Compound interest is the eighth wonder of the world."* PSG Group has historically achieved superior returns, with a *total return index ("TRI")* of 46% since establishment. The *TRI* is the *compound annual growth rate ("CAGR")* of an investment and is calculated by taking cognisance of share price appreciation, dividends and other distributions. Given our current size, it will be difficult to achieve similar returns in future. However, rest assured we have ambitious growth plans to help provide our shareholders with satisfactory returns going forward.

Our core investments are all among the best in their respective industries with quality management, strong corporate governance and attractive growth prospects. Given among other their relatively low market shares, I am confident that these investments should provide us with strong "base" growth going forward, even in a low GDP growth environment. We are confident of expanding our market share:

- *Capitec* currently has a 2,4% share of the total South African consumer credit book, while its recently launched credit card offering has approximately a 1% market share.
- *PSG Konsult* has less than 5% of the wealth management, less than 2% of the asset management, and less than 3% of the short-term insurance markets.
- The *Curro* opportunity remains significant. Despite being the leading provider of private school education in South Africa with an 8,1% market share, Curro has a mere 0,4% share of the total school-going learner market.

In addition, the PSG Group Exco and our management team will continue to help build smaller investments in the PSG Alpha and Zeder portfolios into sizeable businesses, thereby adding further growth to the "base". Shareholders should, however, bear in mind that it is often a slow and steady climb that yields the greatest returns – PSG Konsult and Curro took 17 years each before making its first R100m annual profit.

EVALUATING OUR PERFORMANCE

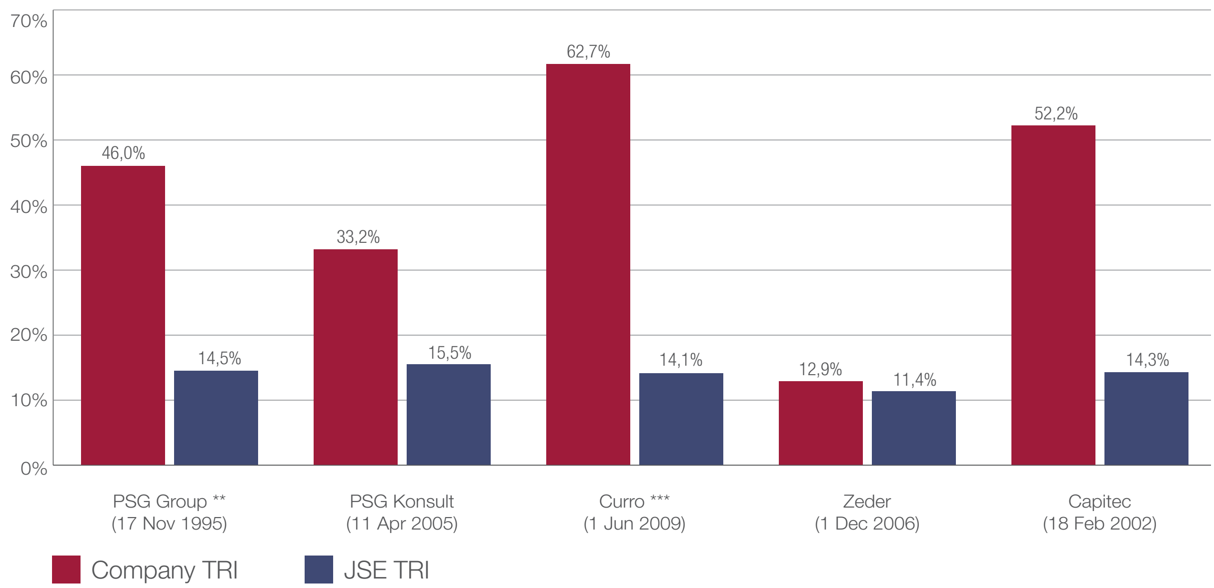
We believe that performance should be measured in terms of the return that an investor receives over time, with a focus on *per share* wealth creation.

When evaluating PSG Group's performance over the *long term*, one should focus on the *TRI* as a measurement tool. This is a sound measure of wealth creation and a reliable means of benchmarking different companies.

PSG Group's *TRI* as at 28 February 2018 was 46% over the approximately 22-year period since establishment. Had you purchased R100 000 worth of PSG Group shares in November 1995 and reinvested all your dividends, your investment would be worth around R460m today. The same investment in the JSE All Share Index ("JSE ALSI") over this period would only be worth R2m. We are proud of the wealth we have created for our shareholders.

The graph below illustrates that all our core investments have also outperformed the JSE ALSI over their respective measurement periods:

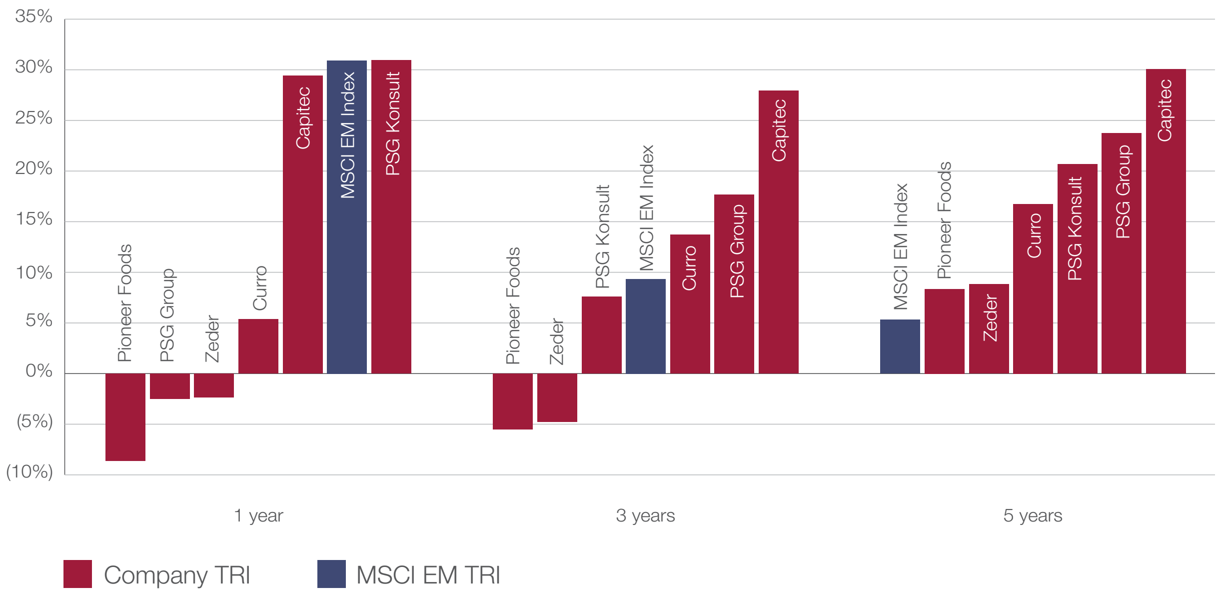
PSG Group companies' TRI vs JSE ALSI TRI *



* *Measured since the respective dates set out above until 28 February 2018.*
** *Capitec unbundling in November 2003 treated as a dividend.*
*** *Stadio unbundling in October 2017 treated as if the investor retained the share.*

Following the Steinhoff debacle late last year, the majority of its 25,5% interest in PSG Group was placed by means of an accelerated book build. The PSG Group shares on offer were 3,9 times oversubscribed, being a good indication of investor appetite for PSG Group exposure. Steinhoff no longer holds any PSG Group shares. As a result, PSG Group's overall foreign ownership increased to 18%, with its share trading liquidity for the year ended February 2018 being 68%. Given the increase in PSG Group's foreign shareholding, it is appropriate to benchmark the *TRI* of PSG Group and its core investments (expressed in US dollar terms) against the MSCI Emerging Markets Index ("MSCI EM Index") over one, three and five years, respectively.

PSG Group TRI vs MSCI EM Index TRI *



* *Measured until 28 February 2018.*

It is evident from the graph above that the group also performed well in US dollar terms, with most of our companies outperforming the MSCI EM Index over the medium to long term. The approximate 10% appreciation of the rand against the US dollar during the past year should be considered when evaluating our companies' performance in US dollar terms over one year.

WHERE WE FIND OURSELVES

For the most part, South Africa's macroeconomic fundamentals have not changed significantly in the past year. Although the recent political changes have lifted overall investor confidence, the uncertainty surrounding the expropriation of land without compensation has dampened optimism somewhat. Over the near term, until the various structural issues have been addressed, the outlook for South Africa remains one of low GDP growth and high unemployment. Furthermore, the corporate governance failing at Steinhoff has resulted in large swathes of corporate South Africa being treated with suspicion. Add in the recent attacks on Capitec and it is understandable why investors are nervous.

This is not to say that there have not been any positives. The political shift and the renewed focus on fiscal consolidation has provided Moody's with enough comfort to maintain South Africa's sovereign debt rating at investment grade, the only rating agency to do so. The immediate changes at state-owned enterprises ("SOEs"), foreign investor interaction and "state capture" crackdown have also instilled a sense of optimism among business leaders and consumers alike.

No one knows how long the current weak economic circumstances will prevail or how long the political changes will take to become effective. During tough conditions, it is easy to be consumed by the negatives. Unfortunately, this type of mindset can lead to one missing the boat by waiting for improvement before acting. Another great Einstein quote comes to mind: *"In the middle of difficulty lies opportunity."* – I firmly agree and consider South Africa to present many opportunities!

PSG Group has been built on positivity and relentless focus on opportunities, irrespective of the economic or political conditions. As turbulent as the past year has been, the group completed two sizeable transactions:

- October 2017 saw the unbundling of *Stadio* from Curro. Stadio started out as a division within Curro focusing on private higher education. However, the differences in business models and the desire to keep management focused on their respective businesses, led to the decision to list Stadio separately.
- The group made its single largest initial investment to date by acquiring a 50% interest in *Evergreen*, a company that owns and operates retirement lifestyle villages, for R675m at the end of 2017. Catering for a growing and ageing population of retirees, with a unique business model, this business presents a compelling investment opportunity.

CAPITEC IS OUR LARGEST INVESTMENT

We often get asked whether we are concerned that Capitec forms such a large part of our investment portfolio. The answer is a resounding "no"!

Capitec remains PSG Group's largest investment comprising 51% of the *sum-of-the-parts ("SOTP") value's* total assets as at 28 February 2018. While this is significant exposure to a single company, we remain confident that Capitec will continue to grow and deliver impressive results. One of the advantages of being an investment holding company is that we are not bound by prudential limits and can therefore have unlimited exposure to a single company, unlike the asset management industry. This has produced significant returns for us as we have been able to hold on to our winners, such as Capitec.

OUR THOUGHTS ON INTERNATIONAL EXPANSION

I did communicate our views on international expansion in last year's *chairman's letter*; however, it remains a heavily debated subject given the current economic, political and corporate climate in South Africa, and I therefore again share our thoughts on the matter.

PSG Group has significant competitive advantages here in South Africa:

- We are born and bred South Africans and understand the fundamentals of the country from a political, economic and cultural perspective;
- We have well-established professional relationships with key role players, including financial institutions, regulators, and the like;
- PSG Group is a large player in a South African context, but relatively small in international terms; and
- PSG Group has a good reputation in South Africa and is well respected.

In addition, the PSG Group executive team may not necessarily have in-depth knowledge of all sectors, but fundamentally understands banking, education, financial services, and the like. Therefore, as generalists, it is imperative that we operate in an environment that we understand and are familiar with.

There are always exceptions. Many investment companies have, however, expressed how difficult they find investments abroad – not being country/sector experts, and not having reliable contacts in those countries. They are also not able to effectively assist management in those countries should the need arise since they are simply too far removed from the action.

That said, we do encourage our underlying companies who are specialists in their respective industries to continue investigating sensible overseas expansion opportunities that will enhance their business. They are able to mitigate sector-specific risk by integrating such acquired overseas businesses into their existing operations.

According to the international asset management community, at least part of our higher market rating can be explained by the "pure" South African focus of our investments. They do not approve of "ignorant" diversification strategies. A deal should always be value enhancing rather than to simply earn hard currency, which often results in diverting management's focus. Asset managers rightly argue they can do the diversification themselves at a fund level, if so desired.

OUR CONTRIBUTION TO SOCIETY

PSG Group subscribes to the notion that a great company can never be a burden on society. We contribute to the development and upliftment of South Africans by creating jobs and contributing financially by way of paying our taxes, donations and sponsorships. The group's contribution to society through the payment of salaries, taxes and dividends amounted to approximately R17bn during the past financial year.

We also embrace the opportunity and privilege to contribute beyond this as a company. The *corporate social investment ("CSI")* section of this annual report deals with the group's various CSI initiatives. It is by no means a comprehensive list but illustrates our dedication to making South Africa a better place.

BEE remains integral to the continued success of our country. To date, we have created significant value of approximately R20bn for thousands of broad-based BEE shareholders through various BEE transactions undertaken by us (e.g. Arch Equity, Thembeka Capital and Dipeo) and our underlying companies (e.g. Pioneer Foods and Capitec).

The success of these BEE transactions can be ascribed to one thing only – the phenomenal success of our underlying investee companies.

BOARD OF DIRECTORS AND PSG GROUP EXCO

The PSG Group board comprises three executive and seven non-executive directors. I have served as non-executive chairman since 2010. As you may well know from my recent public letter, I have been diagnosed with an early form of dementia. The implication of this is that my short-term memory does not always function as it should, the result being that I sometimes forget people's names, repeat myself, or may appear somewhat disorientated. This does not happen every day, but I cannot ignore it.

After consultation with my senior colleagues, we feel that I still have a contribution to make as PSG Group's non-executive chairman, given that PSG Group's executive management team is very strong with the necessary depth, experience and knowledge. Furthermore, our board always acts with the best interest of all stakeholders at heart.

PSG Group's day-to-day operations are managed by the senior executives, namely Piet Mouton (41) (CEO), Wynand Greeff (48) (CFO) and Johan Holtzhausen (47) (CEO: PSG Capital). They have respectively worked in the group for 14, 16 and 20 years, and have built the Company with us. They fundamentally understand the business and the direction it requires to ensure PSG Group keeps delivering on its objective of shareholder wealth creation.

The PSG Group Exco is a subcommittee of the board and the chief operating decision-maker. It comprises the three senior executives and myself, with Piet acting as chairman. Our non-executive directors and Chemus Taljaard, our in-house tax advisor, are permanent invitees. The PSG Group Exco:

- Is responsible for determining and implementing strategy, as approved by the PSG Group board of directors;
- Acts as the PSG Group investment committee;
- Provides strategic input as members of the Zeder Exco;
- Manages PSG Alpha;
- Acts as PSG Group treasurer by monitoring and managing the capital requirements, gearing and liquidity of PSG Group, and it allocates and invests PSG Group's resources;
- Monitors the group's performance and provides strategic input and direction to the underlying companies;
- Is the custodian of good corporate governance; and
- Assumes overall responsibility for the growth and performance of PSG Group.

OUR FUTURE

These are exciting times for PSG Group – we have a diversified and well-established core investment portfolio together with early-stage investments in selected growth sectors, all with promising growth prospects. As always, we will continue to look for "the next big thing".

Regardless of the economic and political environment, we as PSG Group are proudly South African, we are positive about the future of this great country and will continue to play our part in its development.

A WORD OF THANKS

The success of any business is always owing to the hard-working individuals throughout such an organisation. I would therefore like to thank all the people within the broader group for their efforts and dedication – without you, we would not have enjoyed the success we have.

To my fellow directors and members of the PSG Group Exco – thank you for your continued commitment in building this group.

To all our clients, shareholders, family members and other stakeholders – thank you for your loyal support and belief that we are creating something really exceptional.

I cannot say it better than Napoleon Hill: *"Your big opportunity may be right where you are now."* I invite you to join PSG Group in celebrating South Africa as a land of opportunity!

Jannie Mouton

17 May 2018
Stellenbosch