

# Chairman's letter

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Dear shareholder

It gives me pleasure to report on the 2016 financial year, as it certainly was one of milestones for PSG Group Ltd ("PSG"). Not only did we celebrate our 20th anniversary, but PSG was also included in the JSE's Top 40 and the MSCI Indices for the first time. We furthermore raised R2,2bn in cash in the single largest bookbuild in PSG's history, putting us in a strong position to capitalise on future investment opportunities.

The past year has also seen PSG's share trading liquidity improve from 12% five years ago to 50% as at the end of the 2016 financial year, and our foreign shareholding increase to 10%.

PSG remains a truly South African company with its primary focus on the local market. South Africa, in particular, currently finds itself in challenging times and it is easy to become pessimistic and distracted as a result. Here at PSG, however, we prefer to stay optimistic and focus on the many opportunities this country has to offer.

**"The pessimist sees difficulty in every opportunity. The optimist sees the opportunity in every difficulty."**  
*Winston Churchill*

## WHO WE ARE

PSG is an investment holding company consisting of a diverse portfolio of underlying investments that operate across a wide range of industries including banking, education, financial services, food and related business, and private equity. Our market capitalisation (net of treasury shares) is approximately R40bn, while we have influence over companies with a combined market capitalisation of approximately R140bn.

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

- Capitec (retail banking);
- Curro (private school education);
- PSG Konsult (wealth management, asset management and insurance);
- Zeder (investment in food and related business);
- PSG Private Equity (early-stage investing in high growth sectors);
- Dipeo (BEE investment holding company); and
- PSG Corporate (investment management and treasury services), including PSG Capital (corporate finance) and Grayston Elliot (tax advice).

Since PSG's establishment in November 1995, our aim has been to create value for our shareholders and for 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 challenges experienced in our country such as education, energy and low-cost banking in order to improve people's lives and our country as a whole.



### 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. In order to achieve this, we have invested in a diversified portfolio of businesses with high growth potential that consistently yield above-average returns, while contributing positively to society.

### OUR INVESTMENT PHILOSOPHY

The investment universe is complex with a myriad of variables. Good investors base their decisions on sound fundamentals and proven investment principles. PSG aims to be a disciplined investor, remaining committed to its philosophy:

- We invest in:
  - Enterprises with uncomplicated business models operating in industries that we understand;
  - Industries and businesses with attractive growth prospects and high barriers to entry;
  - Focused, talented, hard-working and passionate management.
- 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 owners are generally more focused and dedicated to growing their businesses. This also applies to PSG – the board of directors owns 29,7% of the company.

### OUR STRATEGY

PSG has always been good at early-stage investing by building businesses (such as Capitec, Curro and PSG Konsult) alongside entrepreneurs from the development stage:

- We acquire large influential stakes in businesses we believe in and offer investees our strategic input, helping them 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, and often also at an executive committee level.
- We either serve on or attend audit and risk committee meetings as a measure of ensuring good corporate governance.

#### ***Project Internal Focus***

*Project Internal Focus*, our strategy the last couple of years, has primarily been directed at the optimisation, refinement and growth of PSG's existing investment portfolio. This strategy continues to yield positive results and should remain in place for the foreseeable future. We are, however, continuously investigating new investment opportunities in an attempt to find "the next big thing".



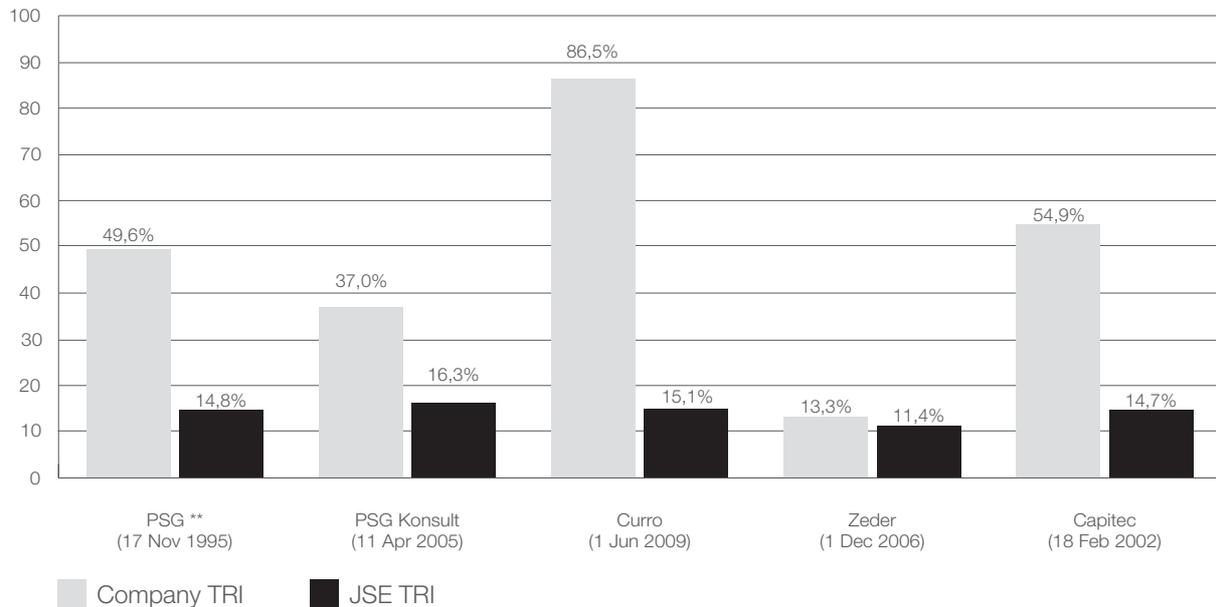
## EVALUATING OUR PERFORMANCE

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's performance over the *long term*, one should focus on the *total return index (TRI)* as a measurement tool. The *TRI* is the *compound annual growth rate (CAGR)* of an investment, and is calculated by taking cognisance of share price appreciation, dividend and other distributions. This is a sound measure of wealth creation and a reliable means of benchmarking different companies.

PSG's *TRI* as at 29 February 2016 was 49,6% per annum over the 20-year period since establishment. This means that had you purchased R100 000 worth of PSG shares in November 1995 and reinvested all your dividends, your investment would be worth around R357m today. The same investment in the JSE All Share Index over this period would be worth R1,6m. We are proud of the wealth we have created for our shareholders.

TRI of PSG group companies vs JSE All Share Index TRI \*



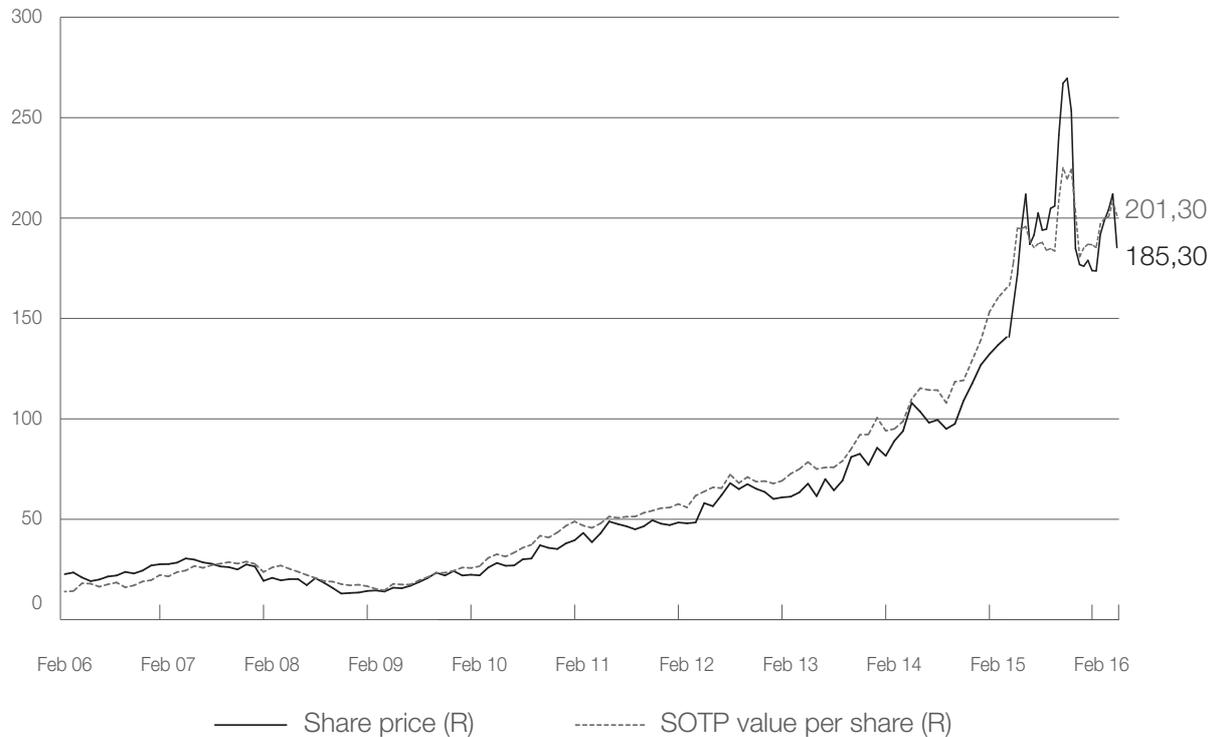
\* Measured since the respective dates set out above until 29 February 2016.

\*\* Capitec unbundling in November 2003 treated as a dividend.

When evaluating PSG's performance over the *short to medium term*, we focus on the growth in PSG's *sum-of-the-parts (SOTP) value* per share and *recurring headline earnings* per share. History confirms that PSG's share price tracks its *SOTP value* per share. Positive growth in PSG's *SOTP value* per share thus ultimately leads to an increase in the share price. However, an increase in PSG's *SOTP value* per share and share price over time will ultimately depend on sustained growth in the profitability of the underlying investments. Consequently, we use the *recurring headline earnings* per share concept to provide management and investors with a more realistic and transparent way of evaluating PSG's performance from an earnings perspective.



PSG share price vs SOTP value per share  
(4 May 2016)



At 29 February 2016, the *SOTP value* per PSG share was R186,67, which equated to a 32% *CAGR* over the last five years. At 4 May 2016, the *SOTP value* per share was R201,30.

Capitec remains PSG's largest investment comprising 39% (2015: 41%) of the *SOTP value's* total assets as at 29 February 2016. While this is significant exposure to a single company, we remain confident that Capitec is well positioned to continue gaining market share and deliver impressive results.

*Recurring headline earnings* per share for the year ended 29 February 2016 increased by 33% to 787,8 cents, following commendable earnings growth from all our core investments.

## OUR INVESTMENTS

When evaluating PSG's core investments, each has definite characteristics which are representative of our aforementioned investment philosophy.

### Capitec (30,7%)

- *Simple and focused business model*
  - lending and transaction banking
- *High barriers to entry*
  - regulatory requirements and funding
- *High growth potential*
  - increase in transaction banking clients and growth in loan book
  - significant growth potential given its current market share:
    - 20,6% of the primary banking market
    - 2,5% of the unsecured credit market



We are proud of our investment in Capitec. The *Lafferty Group* recently rated it as “the best bank in the world”, while the *SA Customer Satisfaction Index* rated Capitec as “the best bank in South Africa” for the fourth consecutive year.

Capitec’s relentless focus on clients and service saw the largest increase in client numbers in its history during the past year. Active clients increased by 1m to 7,3m, while primary banking clients (those clients who make regular deposits, mainly salaries) increased by 0,6m to 3,3m. According to the independent *AMPS* survey for the period to June 2015, 20,6% of South Africans regarded Capitec as their primary bank, up from 18,9% for the period ended 31 December 2014.

Capitec delivered stellar financial results with a 26% increase in *headline earnings* per share for the year ended 29 February 2016. Growing client numbers, combined with increased activity per client, resulted in net transaction fee income increasing by 16% to R3bn (despite the reduction in card processing fees earned since March 2015), now covering 66% of operating expenses (2015: 65%). Capitec managed to grow its gross loan book by R4,6bn to R40,9bn, while maintaining conservative provisioning practices. The average term of the outstanding book decreased from 43 months as at 28 February 2015 to 40 months as at 29 February 2016, while the level of provisions to arrears increased from 196% in 2015 to 223% in 2016.

New regulations aimed at enhancing the sustainability of the credit industry while reducing the cost of credit for consumers, pose real challenges for credit providers. The reduction in the maximum interest rate chargeable on unsecured loans came into effect on 6 May 2016. In addition, new draft regulations regarding the capping of costs on credit life and retrenchment insurance have been issued for comment. However, these new regulations should have a limited impact on Capitec’s earnings – its average book yield is in line with the new maximum rate and it only started charging credit life and retrenchment insurance for the first time this month at rates well within the new draft prescribed limits. The introduction of Capitec’s credit card offering later this year will likely assist it in gaining further market share and will add another revenue stream for further growth. Competitors on the other hand, who in the past had levied interest on loans at the maximum rate and charged credit life and retrenchment insurance above the new cap, will struggle going forward.

With a strong brand, a simple and cost-effective product, a conservative approach to credit and a healthy capital adequacy position, Capitec remains focused on the financial needs of South Africans. PSG remains a loyal Capitec supporter and we look forward to sharing in its continued success.

#### **Curro (58,3%)**

- *Simple and focused business model*
  - private schooling
- *High barriers to entry*
  - capital intensive
- *High growth potential*
  - Curro has less than 10% of the private school market and 0,34% of the total school market in South Africa
  - the local private school market will grow substantially in the next 10 years

Curro is the largest for-profit private school group in Africa, operating 47 campuses with 110 schools and 41 864 learners. Curro is changing the private school industry, with only 20% of learners paying more than R4 000 per month, while 30% of learners pay less than R2 000 per month. With only 0,34% of the total school market occupied by Curro, there is significant room for further growth as Curro continues to pursue its 2020 target of 80 campuses/200 schools with 80 000 learners.



Curro reported pleasing results for the financial year ended 31 December 2015 with *headline earnings* having increased by 79% to R100m.

Education remains key to South Africa's long-term growth and wellbeing. When a business has such exciting growth prospects and contributes to society in a positive way, supporting them is easy. Curro will raise R1,071bn in cash by means of a rights issue this month to help fund further development and acquisition opportunities. PSG has underwritten the rights issue and will invest at least R624m in Curro.

### PSG Konsult (61,9%)

- *Simple and focused business model*
  - the provision of financial advisory and insurance services
- *Key competitive advantage*
  - an extensive distribution platform across the country
- *High growth potential*
  - significant growth potential given its current market share:
    - less than 5% of the wealth management market
    - less than 2% of the asset management market
    - less than 1% of the short-term insurance market

With 206 advisory offices and 711 advisors nationwide, PSG Konsult continues to increase its footprint across South Africa, playing a large role in ensuring PSG remains a household name.

The legal and regulatory environment within the industry has become increasingly onerous, which bodes well for our unique 70/30 revenue-sharing model in terms of which the advisor receives 70% of revenue and PSG Konsult 30%. In return, PSG Konsult is responsible for marketing and maintaining the brand, and manages all the necessary compliance, financial and administrative functions on the advisors' behalf. This model ensures that the PSG Konsult offices remain owner-driven and allows the advisors to focus on what they do best.

PSG Konsult is equity-market dependent and despite the challenging economic climate, continued to produce pleasing results. It reported solid growth with a 19% increase in *recurring headline earnings* per share for the financial year ended 29 February 2016, emanating from strong growth by the *PSG Wealth* and *PSG Insure* divisions. Despite the decline in the local equity market in the past financial year, PSG Konsult managed to increase its total assets under management by 16% to R154bn.

PSG Konsult has a talented, committed management team who is determined to continue growing the business in years to come.

### Zeder (34,6%)

- *Simple and focused business model*
  - investment in food and related business
- *Strong and focused management throughout the underlying investments*

Zeder continued to effectively execute our *Project Internal Focus* strategy within its portfolio of companies in the past financial year. The drought, constrained consumer spending and currency volatility resulted in a challenging trading environment for food and related business in general. However, despite these challenges, Zeder managed to increase its *recurring headline earnings* per share by 20% and dividend per share by 64%, with the majority of the underlying investments having contributed to the improved performance.

During the 2016 financial year, Zeder's share price consistently traded 20% to 40% below its *SOTP value* per share, largely due to the existing PSG management fee structure. PSG has been working hard to find an alternative



to the existing fee structure, that is fair to both Zeder and PSG shareholders. Such alternative will be presented to shareholders in due course for formal approval.

Although trading conditions are likely to remain challenging, Zeder will attempt to capitalise on acquisition opportunities it may present.

### PSG Private Equity (100%)

- *High growth potential*
  - early-stage investments in high growth sectors

PSG Private Equity serves as an incubator for the businesses of tomorrow by investing in companies with high growth potential. Its investment portfolio currently consists of 10 companies spanning across various industries and in different stages of maturity. Currently, energy (*Energy Partners*) and education (*Impak*) are considered priority industries as we believe they offer significant growth prospects and have the potential for listing.

*Project Internal Focus* has played its part in ensuring that the portfolio companies are well capitalised, have good management in place and are positioned to deliver on its growth potential. PSG Private Equity reported encouraging results for the year under review with a 75% increase in *recurring headline earnings* per share, albeit from a low base following challenging trading conditions at select investments in the prior year.

### Dipeo (49%)

Black Economic Empowerment (“BEE”) remains integral to South Africa and is an important part of PSG. The Stellenbosch BEE Education Trust (of which all beneficiaries are black individuals) owns 51% of Dipeo, with PSG owning the remaining 49%. PSG has provided Dipeo with R800m in preference share funding to acquire select investments, the most significant being interests of 6% in Curro, 4,4% in Pioneer Foods, 4% in Quantum Foods and 20% in Kaap Agri. These investments are all subject to BEE lock-in periods. The Stellenbosch BEE Education Trust will use its share of the value created from these investments to fund gifted but needy black students’ education. As at 29 February 2016, Dipeo’s *SOTP value* amounted to R1,1bn.

## OUR CONTRIBUTION TO SOCIETY

**“Education is the most powerful weapon which you can use to change the world.”**

*Nelson Mandela*

PSG subscribes to the notion that a great company can never be a drag on society. We contribute to the development and upliftment of South Africans by creating jobs and contributing by way of paying our taxes, donations and sponsorships. We believe in the multiplier effect of investing in and supporting education, and therefore we are involved in the following education-related initiatives:

- *The PSG Group Bursary Loan Scheme at the University of Stellenbosch*
  - We started this initiative in 2007 when PSG and I each donated 100 000 PSG shares, and we have since offered financial support to a number of gifted but needy students. Their fields of study include medicine, law, actuarial science, accounting and investment management. To date, 59 students have been funded through this scheme, with bursaries totalling R2,9m.
- *Akkerdoppies*
  - PSG continues to financially support this pre-primary school, which is part of the Sibusisiwe charity. Akkerdoppies is committed to early childhood development, and provides essential education and skills to children from the disadvantaged communities of Stellenbosch. The school is attended by 160 children and now employs 19 people. We are committed to a long-term relationship with this initiative and anticipate a significant positive contribution to the community.



## CHAIRMAN'S LETTER

continued

- *Curro*
  - Following the aforementioned rights issue, PSG would have invested in excess of R2,3bn cash in Curro, which plays an important part in educating the South African youth. With the existence of Curro, government can increase its focus on those areas where the availability and quality of education are particularly poor, and in so doing provide proper educational facilities to the disadvantaged. It is with this in mind that we urge government to work alongside Curro, and consider implementing a school voucher system, which has proven to be very successful abroad. Vouchers could be issued by government to subsidise Curro fees. This would relieve pressure on government given the schooling backlog. Curro has also offered extensive bursaries of approximately R28m to its learners.
- *Impak*
  - This company provides grade R to 12 educational products and services to home scholars and learners enrolled at its 418 support centres across the country. Through our investment in this company, we look to further contribute to education in South Africa while also creating business opportunities for entrepreneurs/educators who wish to open a support centre – embracing their passion for education while building a profitable business. We are excited about the growth prospects for this alternative form of education.
- *Stellenbosch BEE Education Trust*
  - We established and initially funded the Stellenbosch BEE Education Trust with R102m in funding, which was subsequently repaid in full. The trust owns 51% in aforementioned Dipeo, which in turn holds interests in various investments associated with PSG. We look forward to seeing this trust assist previously disadvantaged learners in obtaining quality education.
- *PSG BEE Trust*
  - This trust owns 2,5m PSG Group shares and has R5m in cash. This cash, together with future PSG Group dividends, will be used to grant bursaries to disadvantaged learners. It is anticipated that the PSG BEE Trust will fund more than 100 disadvantaged Curro learners next year alone.

It is evident from the aforementioned that PSG makes a significant direct contribution to society. However, as an investment holding company, with each of our underlying investments also having various social development initiatives, we also make a substantial indirect contribution to society. Below are some of the *corporate social investment (CSI)* projects undertaken by investee companies:

- *Kaap Agri*
  - Kaap Agri's CSI projects focus on training and skills development. Through the Kaap Agri Academy, the company runs a Farmer Development Programme that trains approximately 25 students per year who are emerging farmers in the Western and Northern Cape. Since its inception, the academy has already produced two AgriSETA award winners for *Best Performing Learner of a Skills Programme*. The top student for 2015 was selected as the vice chairperson of Grain SA. The academy also trains farm workers in various practical skills including welding, chemical handling, equipment maintenance and productivity management.
  - The company offers bursaries and scholarships to students studying agricultural sciences at the University of Stellenbosch, the Cape Peninsula University of Technology (CPUT) and other selected schools. 34 learners are currently benefiting from this programme.
  - Kaap Agri's Care & Grow initiative is aimed at making a difference in the communities within which it conducts its business. This outreach by its various business outlets and employees, is shared with stakeholders in a company newsletter called "Care & Grow".
  - In 2014, Media24 recognised Kaap Agri's contributions to society by awarding them the top prize in the *Unlisted Company Corporate Social Responsibility Investment Awards*.



- *Capespan*
  - Capespan follows an integrated approach in developing its *CSI* initiatives, based on its assessment of the socio-economic, health and educational needs of communities. *CSI* initiatives are developed in partnership with local communities, local government and industry stakeholders. *CSI* projects include support to:
    - Place of Mercy Pre-school Centre, Eastern Cape Province;
    - Thembalethu HIV/Aids Trust, Eastern Cape Province – providing community preventative health and educational programmes to high school learners;
    - Eastern Cape Occupational and Primary Health Care programme, in partnership with local government and export fruit producers;
    - Partners for Possibility (#P4P500) – an Education Leadership Development Programme in partnership with Symphonia for South Africa;
    - Early language and literacy development of children from historically disadvantaged communities in South Africa, in partnership with Wordworks;
    - Financial support to schools located in key fruit production and needy rural areas;
    - Northern Cape Province Occupational and Primary Health Care programme, in partnership with the local government;
    - School Aid UK and RSA, in partnership with Capespan UK and Maersk Shipping Line; and
    - Various community life skills, sport and socio-economic development projects in rural areas and/or needy communities.
  - Staff volunteering is supported by funding allocations based on welfare/NGO projects nominated or sufficiently motivated for, but not covered by the company's *CSI* mandate. This expands the reach of the company to beyond what can be done at a corporate level.
  - In 2015, approximately 5 000 people benefited from projects developed and supported as part of the company's *CSI* initiatives.
- *Zaad*
  - Agricol and Klein Karoo Seed Marketing continue its involvement in training and mentoring of small farmers across South Africa. Currently the projects provide training and supply equipment and resources to 147 small farmers. Several additional *CSI* projects are at an advanced stage of planning. It is estimated that these projects will increase the number of small farmers to approximately 400.
- *Pioneer Foods*
  - Pioneer Foods is involved in various community projects in education, environment and food security. These projects focus on vulnerable groups, such as women and youth in township and rural communities. Pioneer Foods also invests in feeding schemes. Below are a few of the *CSI* projects:
    - Mbekweni Youth Centre – financial assistance of R7,7m for the construction of the Mbekweni Youth Centre;
    - World Wildlife Fund South Africa – 395 hectares of invasive alien plants have been cleared since February 2014;
    - Heart of Kayamandi – township agricultural hub with the capacity to produce approximately 76 800 vegetable bunches every year;
    - School Breakfast Nutrition Programme – breakfast cereals are provided to over 5 300 learners in 10 primary schools;
    - The African Children's Feeding Scheme – about 31 000 children benefited from milk purchased to support 13 feeding centres in Soweto and the surrounding informal settlements; and
    - Food Rescue Projects – include donations to organisations such as Foodbank, as well as CEO contributions (e.g. Ebola Fund and Tyranus Church).



## CHAIRMAN'S LETTER

continued

- *Capitec*
  - Capitec's primary CSI focus is on improving financial literacy and education through the Capitec Foundation, an independent non-profit organisation.
  - The foundation operates a bursary fund that targets public school learners in grades 10 to 12, with mathematics as a matric subject. The bursaries cover tuition fees for one year.
  - A major project sponsored by the foundation is the Ikamva Youth initiative. This is a volunteer-based group that gives high school learners access to skills, networks and resources that enable them to reach tertiary education and employment opportunities post-matriculation. While more than half of the volunteers are ex-learners, Capitec employees also volunteer their time to this initiative.
  - The eduCate revision programme for grade 12 learners provides learners from disadvantaged backgrounds revision tutoring in mathematics and science. During 2015, 5 800 learners from 116 public schools participated in the programme.
  - Through Capitec's 5-week training programme, 200 to 240 employees (mostly matriculants from humble backgrounds) are trained each month. Given Capitec's rapid growth, more than 15 800 people have been trained to date.
- *PSG Konsult*
  - PSG Konsult invests in educational and social programmes that create future employment and economic empowerment prospects. Below are a few of the CSI projects:
    - Adopt-a-School Foundation – during the year under review, PSG Konsult adopted two schools and has committed to increase the contribution towards more schools during the 2017 financial year;
    - Childcare and children homes – centres and homes are provided with monthly food parcels and funding;
    - ASISA Enterprise Development Fund – initiative aimed at driving job creation and economic growth. PSG Konsult has invested R10m in this fund;
    - Bursary and internship programme – this programme is open to students from previously disadvantaged backgrounds. PSG Konsult currently has 17 interns in this programme and a further four interns will be appointed in the next few months;
    - Santam Industry Development Programme – aims to train previously disadvantaged individuals in the short-term insurance environment. As part of this programme, PSG Konsult is providing training to 11 individuals within its short-term administration and Western business units.
- *PSG Private Equity*
  - The investee companies under PSG Private Equity run various projects and make a wide range of contributions in the communities and areas in which they operate. The prevalent themes relate to early childhood development and care, education (particularly pre-school and primary) and youth development.

### BOARD OF DIRECTORS AND PSG EXCO

The PSG board comprises three executive and 11 non-executive directors. I serve as the non-executive chairman. Our board has a wealth of knowledge and experience and always acts with the best interest of all stakeholders at heart. Bridgitte Mathews is a new appointee to the board. She is a chartered accountant and will serve as an independent non-executive director. We welcome her and look forward to her contribution.

PSG's day-to-day operations are managed by the senior executives, namely Piet Mouton (CEO), Wynand Greeff (FD) and Johan Holtzhausen (CEO: PSG Capital). They are talented, hardworking individuals with big ambitions for PSG. They have been with PSG for many years and I am excited to see them and their team grow PSG to new heights.



The PSG Executive Committee (Exco) is a subcommittee of the board and the chief operating decision-maker, and comprises the aforementioned three senior executives and myself as chairman. Our non-executive directors and Chemus Taljaard, our in-house tax advisor, are permanent invitees. The PSG Exco:

- Is responsible for determining and implementing the PSG strategy, as approved by the PSG board of directors;
- Acts as the PSG investment committee;
- Acts as the social and ethics committee;
- Is the appointed manager to Zeder;
- Manages PSG Private Equity;
- Acts as the PSG group treasurer, monitors and manages the capital requirements, gearing and liquidity of the group and allocates and invests the 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 throughout the group; and
- Assumes overall responsibility for the growth and performance of PSG.

### OUR FUTURE

South Africa's forecast GDP growth for 2016 is below 1% compared to an average historical annual growth rate of 3% since 1994. Given rising inflation, we can expect further interest rate hikes, which will put additional pressure on the consumer, and ultimately the economy.

However, PSG's companies are well positioned to weather the more challenging environment and to continue growing given their relatively small market share within their respective sectors. This, coupled with a strong balance sheet, should see PSG continue delivering above-market returns.

### A WORD OF THANKS

PSG is a group of companies, consisting of a team of smart, talented individuals with complementary skills and a common goal of being the best. I would like to thank each and every one of my colleagues throughout the group for their hard work and devotion during the past year – it remains a privilege to work with you.

To my fellow directors and members of the PSG Exco – thank you for your contribution to making PSG the success it is today.

Last but not least – thank you to all our clients, shareholders, family members and all other stakeholders – your loyal support has allowed us to create significant value over the past 20 years.

I turn 70 this year and have never been more excited about PSG's future than now!

**Jannie Mouton**

13 May 2016  
Stellenbosch