EQUITY INSIGHTS

PSG Group: A Superior Blend Of Quality And Value

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PSG GROUP

Founded in 1996, the PSG Group is a holding company with a portfolio of well established businesses, most started by PSG over a decade ago and which are now separately run and listed. PSG maintains control or influence at all established investees. PSG's investment philosophy is simple and effective, targeting large and growing markets with either fragmented competition or large and inefficient incumbents. Capitec Bank is the primary growth engine of the group, representing 69% of estimated net asset value (NAV). Other established businesses and their estimated contribution to NAV include PSG Konsult (11%), Curro Holdings (10%) and Zeder (6%). Early-stage investments are made through PSG Alpha (5%). Net funding accounts for (-1%). The group receives regular dividends from PSG Konsult and Capitec, passing through much of these to PSG Group shareholders.

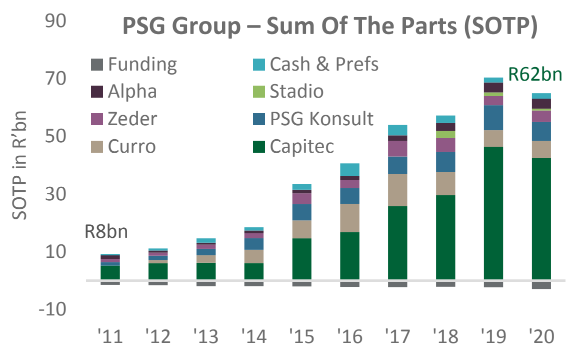
CAPITEC BANK

Capitec has evolved from a simple and well run unsecured lender which generated revenues from relatively short term loans and related fees, to a far higher quality bank with more durable growth prospects. Loan terms are on average much longer and more balanced, the client base has grown 10 times in 10 years and Capitec has achieved a formidable scale advantage, where non-interest revenue now covers 86% of operating costs. Capitec has a strong credit writing track-record, and in recent years has gradually and deliberately shifted its loan book toward higher quality clients, also entering secured lending. This process has caused net interest revenue growth to slow. Fees are highly competitive and high interest offered on deposits supports the acquisition of clients and funding. Despite the tough domestic economy and lower net interest income growth, the bank has sustained earnings growth and returns through consistently gaining transactional market share. Primary banking clients now number 11.4 million. Transactional banking volumes have grown with the expanding client base, supported by a structural industry shift from cash to card. The bank is leveraging its superb distribution platforms across digital, mobile and branch networks to cross-sell banking and other financial products to its customers. Significant market share in credit card and funeral policies has been gained in this fashion. Capitec has recently entered business banking through the acquisition of Mercantile Bank.

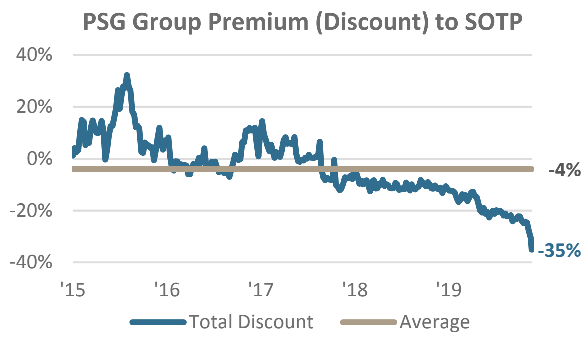
The average return on assets for banks both in South Africa and abroad is around 1.3%. Capitec has sustained an average return on assets of 5.5% for a decade. At a conservative leverage ratio, this has translated into average returns on equity of 25%. A sustained reinvestment rate of 15% after dividends has resulted in compound balance sheet growth, with assets increasing from R5bn in 2009 to R100bn in 2019. With some moderation anticipated over the next few years, we expect high returns on equity and reinvestment to continue, resulting in sustainable shareholder value creation.

	PSG Group Limited
Market Cap	R 41.3bn
Current Share Price	R 189.2
5 Year Total Return in ZAR	48.0%
Dividend Yield	2.4%
Financial Year End	29 February 2020

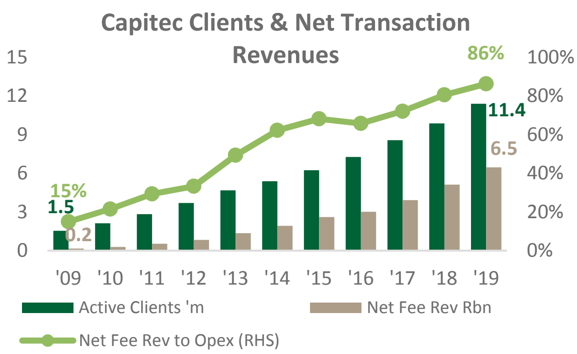
Sources: FactSet, March 2020



Sources: PSG Company Filings & SF Estimates, March 2020



Sources: FactSet, March 2020



Sources: Capitec Company Filings, February 2019

OTHER BUSINESSES

PSG Konsult is a financial services group with a growing market share in wealth management (5%), asset management (3%) and short term insurance (4%). Assets under management have grown from R81bn to R220bn in 6 years as PSG Konsult consolidates fragmented competitors under its brand and onto its platform.

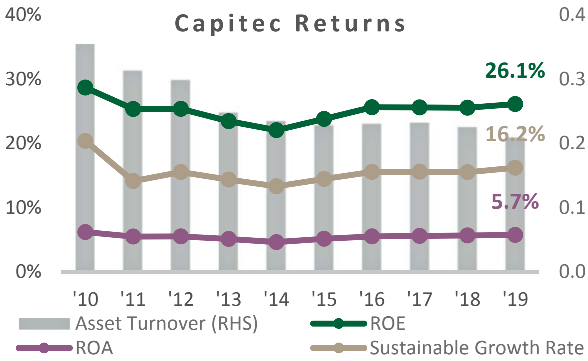
Curro is a private school education business with 57 000 learners across 166 schools in South Africa. Curro has focused on building capacity, scale and capturing attractive locations. Utilisation of new facilities is low due to an estimated 8 year maturity period for a new school. As this improves, returns and cash flows will rise significantly.

Zeder is a holding company of agriculture linked businesses. The sector is experiencing difficult operating conditions. Zeder will likely return most of its NAV to shareholders after selling its largest holding, Pioneer Foods to Pepsi.

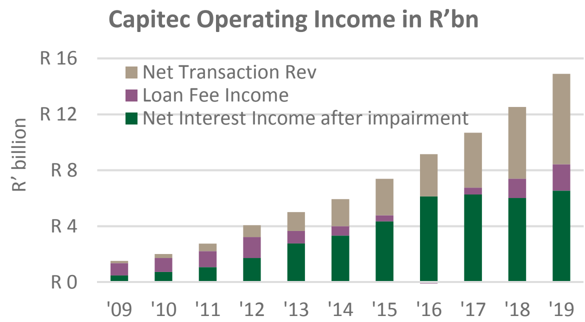
PSG Alpha owns emerging businesses with the potential to be substantial in size and profitable in the long run. Targeted sectors are energy (Energy Partners), education (Stadio & FutureLearn) and retirement villages (Evergreen).

CONCLUSION

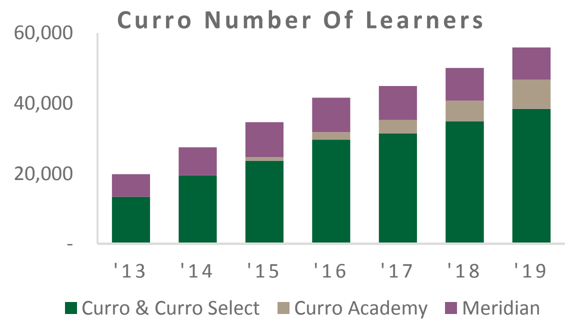
We estimate that PSG Group's underlying assets are worth R62bn, similar to the present combined market value of underlying businesses. After an appropriate holding company discount, we value PSG's NAV at R51bn, 25% above the current PSG Group market cap of R41bn. PSG's trailing dividend yield of 2.4% is relatively attractive, as a lower underlying dividend yield is magnified by the 35% discount to underlying assets. The group's market cap has grown in value from R2.5bn in 2009 to R41bn today, and we expect the portfolio of businesses to deliver sustainable future growth for shareholders. As such, we have initiated a small stake at the present valuation.



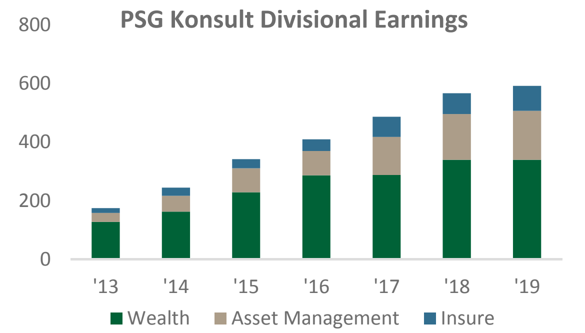
Sources: Capitec Company Filings, February 2019



Sources: Capitec Company Filings, February 2019



Sources: Curro Company Filings, December 2019



Sources: PSG Konsult Company Filings, August 2019

FOR MORE INFORMATION PLEASE CONTACT:

JP DU PLESSIS

Director – Equity Management

t: +27 21 446 2106

e: jp.duplessis@stonehagefleming.com

JEREMY GORVEN, CFA

Senior Analyst – Equity Management

t: +27 21 446 2172

e: jeremy.gorven@stonehagefleming.com

RYAN DE KOCK, CFA

Analyst – Equity Management

t: +27 21 446 2112

e: ryan.dekock@stonehagefleming.com

Stonehage Fleming Investment Management (South Africa) (Pty) Ltd,

First Floor, North Block, Waterway House

3 Dock Road, Victoria & Alfred Waterfront

Cape Town 8001 South Africa

t: +27 21 446 2100

e: enquiries@stonehagefleming.com

stonehagefleming.com