

Issue no. 14 **CAPITAL** **IDEAS** June 2015

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**SPECIAL  
EDITION:**

2015 group  
performance

Focus on Risk  
Services Division

How we're deploying  
our capital

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# FOREWORD

from David Hurwitz

Transaction Capital delivered a solid 22% organic growth in headline earnings per share for the first six months of the 2015 financial year.

While it's true that both the asset-backed lending and risk services divisions perform better in a positive economic environment, they are also highly defensive businesses which are still able to thrive despite the current challenging operating context, as demonstrated by this excellent overall performance.

I'm confident in the forward-looking prospects of the group's underlying businesses. We've demonstrated this confidence to the market in the group's updated financial guidance, in which we state our expectation that we'll be able to sustain this level of earnings growth over the next few years.

We continue to focus on finding opportunities to invest our excess capital such that it enhances the scale and entrenches the leading market positions of our businesses. In asset-backed lending, our entry into the adjacent bakkies market segment is delivering encouraging growth, and we are already looking at further opportunities as discussed further in my article on deploying our capital.

The reconstituted risk services division has performed in line with expectation, and capitalising on the strengths of the underlying businesses continues to be the primary focus of the management team of that business. Dave McAlpin, who was appointed from Principa Decisions to lead the risk services division, takes us through his plans for achieving this goal.

With the bulk of the divisional restructuring work behind us and a much simpler head office structure, the group is in an excellent position to move forward confidently, and to be receptive to and act circumspectly on opportunities that arise. As we enter the final stretch of this financial year, let's continue to play to our strengths, using our two existing businesses as platforms to expand into new markets with new products.

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# PERFORMANCE UPDATE

Mark **HERSKOVITS**

- CONTINUING HEADLINE EARNINGS PER SHARE **UP 22% TO 31.1 CENTS**
- CONTINUING HEADLINE EARNINGS **UP 20% TO R177 MILLION**
- CONTINUING RETURN ON AVERAGE EQUITY **UP TO 11.9% FROM 9.4%**
- CONTINUING RETURN ON AVERAGE ASSETS **UP TO 3.7% FROM 3.2%**
- CONTINUING GROSS LOANS AND ADVANCES **UP 15% TO R7 056 MILLION**
- NON-PERFORMING LOAN RATIO **IMPROVED TO 24.3% FROM 28.6%**
- CREDIT LOSS RATIO **IMPROVED TO 4.8% FROM 5.3%**
- NON-INTEREST REVENUE **UP 10% TO R573 MILLION**
- INTERIM DIVIDEND **UP 67% TO 10 CENTS PER SHARE**

During the first half of the 2015 financial year, Transaction Capital reconstituted its divisions to support its strategic objectives.

The reconstituted portfolio consists of two divisions of scale, being asset-backed lending and risk services, both with leading market positions. We are pleased with the current composition of the portfolio and the defensive positioning of the divisions, which enable the group to prosper despite South Africa's challenging macro-and socio-economic context.

## FINANCIAL HIGHLIGHTS FOR THE HALF YEAR ENDED 31 MARCH 2015

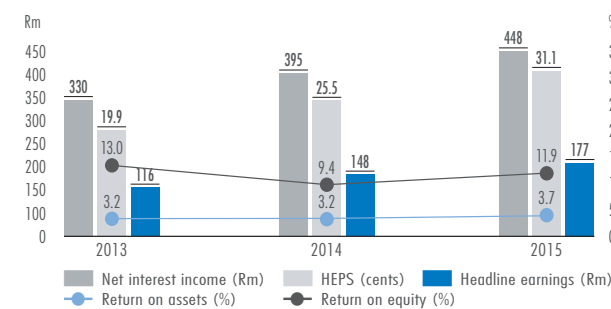
Transaction Capital's continuing operations delivered pleasing results ahead of expectations, despite challenging market conditions. Headline earnings grew by 20% from R148 million to R177 million. Net interest income increased by 13% to R448 million, driven by a 15% growth in gross loans and advances to R7 056 million although offset in part by a higher average cost of borrowings of 10.8%, up from 10.3% the year before. Non-interest revenue increased by 10% to R573 million, mostly driven by MBD's improved agency and principal book

collections. The cost-to-income ratio has remained stable at 62.3% (61.9% for the comparative period).

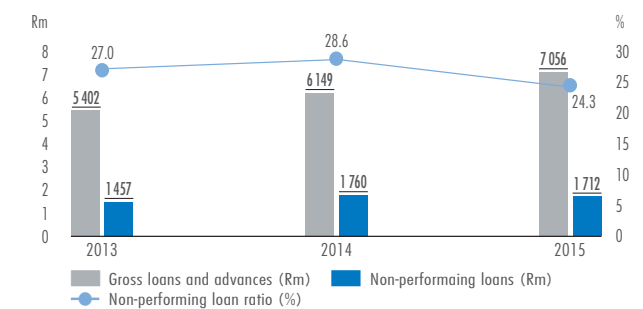
In line with Transaction Capital's strategy to grow gross loans and advances in the mid-teens while focusing on credit quality, the group achieved gross loans and advances growth of 15%, while reducing the rand value of non-performing loans (NPLs), thus improving the credit quality of loans and advances. Consequently, the group NPL ratio showed significant improvement, reducing from 28.6% to 24.3% as a result of effective collection strategies, stricter credit origination criteria and a decrease in repossessed stock held via the accelerated write-off of entry-level stock.

Return on average equity increased by 27% from 9.4% last year to 11.9% in the current period driven by the increase in earnings, efficient capital deployment, and the improved capital structure following the capital distribution of R1.2 billion in March 2014. Transaction Capital's equity and debt capital position remains robust with a capital adequacy level of 45.4% and uninterrupted access to the debt capital markets.

GROUP PERFORMANCE



GROUP – BOOK GROWTH AND IMPROVEMENT IN CREDIT QUALITY



**Asset-backed lending comprising SA Taxi**

**FINANCED  
24 391  
TAXIS**

**"SME BAKKIE" FINANCE:  
306  
DEALS ON BOOK**

**DIRECT SALE OF  
REFURBISHED  
TAXIS INTO THE MARKET:  
2 116  
DEALS ON BOOK**

**"CONSUMER BAKKIE"  
PILOT COMMENCED:  
R50 million  
ALLOCATED**

**OPERATIONAL HIGHLIGHTS**

The asset-backed lending division operates as an unconventional asset-backed lender, currently focusing predominantly on the financing of independent SMEs mainly in the minibus taxi industry, but with the intention to expand into other unconventional adjacent markets or asset classes.

The division increased headline earnings by 34% to R99 million from R74 million in the prior year, by way of a 14% increase in gross loans and advances, a 3% increase in the impairment expense due to the improved credit quality of its loans and advances and a continuing diversification of its revenue streams.

Growth in gross loans and advances has stabilised at 14% as new vehicle origination is now entirely comprised of premium vehicles with credit-lending criteria remaining conservative. The exposure to entry-level vehicles continues to decrease resulting in improving credit quality for the remaining portfolio.

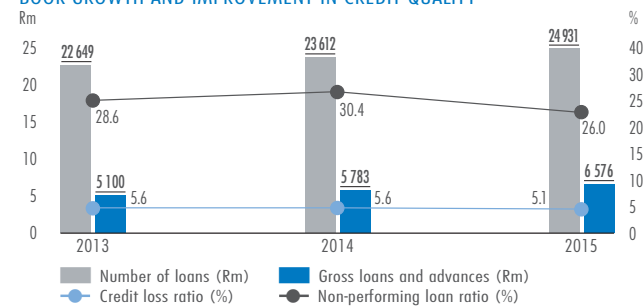
The credit loss ratio has improved by 9% from 5.6% to 5.1%. The efficiency of the procurement, repair and resale operations of Taximart (now one of the largest Toyota repair centres in southern Africa) assists in maintaining these low levels of ultimate credit loss.

Continued strong collection trends, together with the accelerated write-off of entry-level repossessed stock and the improved quality of repossessed vehicles produced by Taximart, has resulted in an improved NPL ratio of 26.0% from 30.4% at 31 March 2014.

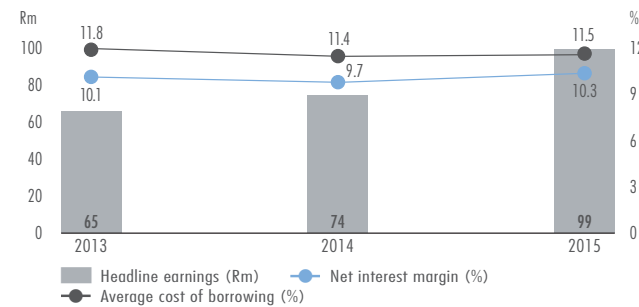
The net interest margin has remained stable at a healthy level of 11.5%, while the cost of borrowings increased slightly from 9.7% to 10.3% due to the recent focus on raising offshore funding which is priced more expensively.

"Bakkie" advances have grown to R81.2 million. In addition to this portfolio, Transaction Capital has allocated R50 million towards SA Taxi's introduction of a pilot project to fund bakkies utilised by consumers for utility purposes.

**ASSET-BACKED LENDING — BOOK GROWTH AND IMPROVEMENT IN CREDIT QUALITY**



**ASSET-BACKED LENDING PERFORMANCE**



**RISK SERVICES comprising MBD, Principa and Rand Trust**

**R31.7 billion  
ASSETS UNDER MANAGEMENT**

**ADDITIONAL STRUCTURED  
CAPITAL INVESTMENT INTO  
MUNICIPAL  
SECTOR AGENCY COLLECTIONS  
UP 20%**

**MORE THAN  
70  
AGENCY CLIENTS**

**10 CALL CENTRES; MORE THAN  
2 700  
COLLECTION AGENTS**

**OPERATIONAL HIGHLIGHTS**

The newly established risk services division is a provider of a comprehensive range of structured credit risk management, debtor management, data management, collection, customer engagement, call centre and capital solutions to South Africa's largest credit providers, focusing predominantly on the consumer credit lifecycle as well as commercial solutions for SMEs.

The reconstitution of this division has yielded the desired results, with headline earnings increasing by 20% to R61 million. Non-interest revenue increased by 14% from R401 million to R457 million as the risk services division continues to make good progress within its existing and newly identified agency clients, with further benefits being realised from historical and recent investments including traditional principal books as well as structured capital transactions, funded with Transaction Capital equity.

A continued focus on effective cost management has resulted in a stable cost-to-income ratio of 82.4%.

The business continues to make progress within the municipal sector, gaining further traction within existing and new municipal clients.

Rand Trust experienced growth of 37% in gross loans and advances, yielding improved earnings and allowing the business to achieve greater economies of scale. As the business targets larger clients in an expanded geographic region with new tailor-made products aimed at improving the value

proposition to clients and extending the client's lifecycle with Rand Trust, management is applying the necessary caution to mitigate any resultant credit and operational risk

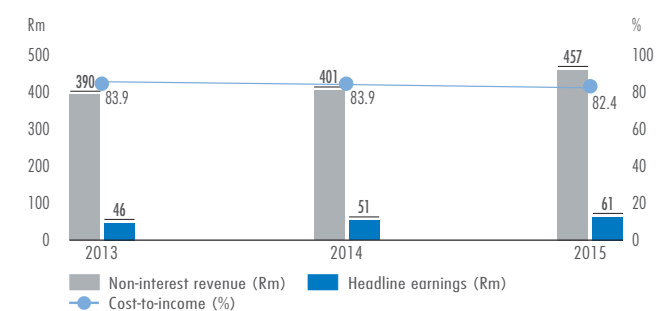
**GROUP EXECUTIVE OFFICE**

The group executive office structure has been simplified, with most group office functions being devolved into the businesses or reduced, enabling cost savings. Total costs have reduced significantly compared to the prior year. However, earnings have reduced due to lower recoveries being earned from group subsidiaries, following the disposal of Bayport and Paycorp.

**LOOKING AHEAD**

With the release of the interim results, the group also updated its financial guidance to the market. The main change is the expectation that the current level of earnings growth i.e. 20% is sustainable in the medium term. This is a bold statement of excellent expected performance which reflects our confidence in the group's underlying businesses.

**RISK SERVICES PERFORMANCE**







## Q&A WITH DAVID MCALPIN

### Q: TAKE US THROUGH HOW YOU CAME TO BE IN THE POSITION YOU'RE IN TODAY – WHAT EXCITES YOU ABOUT THIS OPPORTUNITY

I headed up Principa for six years so I knew the group well. David Hurwitz presented this idea to me – of bringing MBD CS, Principa and Rand Trust together – and asked me to consider heading up this broader risk services division. It's a really compelling vision considering the current consumer credit environment, especially when you start to think about the opportunities that taking a joint approach and finding synergies between these businesses presents in this environment.

That's one part of it. The other is that I enjoy working with smart entrepreneurs who think and act – the decision-making process at Transaction Capital is quick, which is the benefit of that entrepreneurial spirit. But at the same time we need the corporate governance and formality of a larger business, and the group structure makes that possible. So it's about the people in the business and the fact that we get on with doing things – that's what I like about the culture. The only downside for me is having to commute to Joburg from my home base in Cape Town, but I'm prepared to do that because I think it's a fantastic opportunity, and the positioning of this group in the current environment is opportune. I believe we're going to be able to do a lot of great things and we've already started doing those things – that's why I'm here.

### Q: WHAT'S BEEN THE GROUP'S APPROACH TO BRINGING THESE BUSINESSES TOGETHER

Let me answer by first stating what we're not going to do – we're not going to just force these businesses together. They are all separate companies that are very good at what they do, and we want them to remain that way. What we are wanting to do is drive collaboration between them with respect to markets and clients, as well as in developing new verticals. So we'll collaborate where there is opportunity to do so.

We've already started doing this practically. One project between Principa and MBD will see Principa devising a strategy for managing one of our call centres. Their analytical and consulting capabilities and experience in advising other clients and call centre operations will definitely help to improve the performance of this call centre. We'll also look to roll out the lessons from this collaboration to other MBD call centres. So really it's thinking about what we can do differently, what we can learn and how we can maximise our revenue and earnings capability as a group. Principa is also very strong in systems and software, and there will definitely be more opportunities to collaborate with MBD going forward – both in terms of updating MBD's core system and devising new collection solutions for consumer credit clients.

Those are two early collaborations we've kicked off. In time what we do want to do is have common approaches and client strategies, and develop go-to-market plans for clients together where it's appropriate, and work to our individual strengths where not. Rand Trust's SME focus might be different to the larger business-to-business or corporate credit focus of MBD and Principa, but we're confident that Rand Trust will be able to leverage the expertise we've got or are bringing in, especially from a technology perspective.

### Q: HOW DO YOU SEE YOUR ROLE IN STRENGTHENING THE UNDERLYING BUSINESSES – WHAT ARE YOUR FOCUS AREAS

As I said earlier, these are all strong businesses individually, so from a culture perspective I think it's about enhancing and nurturing that willingness and ability to collaborate. It's still early days, but what we're driving for is an openness to being flexible and responding to a changing environment – to break out of old ways of doing things. That's not to say there's something wrong with how we've done things before – we continue to do those things very well – it's more that you become less able to adapt to change the more set in your ways you are.

I'm new here so I'm a change agent, and there are a number of new people who have come into the organisation. That's not to take away from the current people in the organisation – they're very good at what they do, but what we're doing is expanding the frame of reference in the organisation with this new talent. So it's taking the good parts and enhancing those. We have to constantly be re-inventing ourselves or else we're going to wake up one day and find that there's some smart technology out there that's disrupted us.

It was the Irish writer Charles Handy who spoke about the paradox of success – so the things that made you successful are not the same things that will keep you successful going forward. The environment has changed fundamentally, and we need to be able to respond to that. So in MBD for example, we're introducing new senior executives into the business to work alongside existing executives. So it's about getting the best of both – of the deep institutional knowledge and market experience of people who have been in the business a long time, and augmenting that with new skills that can see things differently and bring innovation.

We've brought in a new chief information officer because of the importance of technology to MBD. We should be at the cutting edge of technology because it will increase our revenue and drive down our costs. But we haven't invested in technology for a while so there's some big technology decisions to be made. We've also brought in a data expert – we have so much data here at MBD, so we need to ask ourselves what can we do with those data sets and how can we turn them into an asset from which MBD and its clients can benefit. We've brought in an insurance expert to strengthen our position in that industry too.

So what we've tried to do is bring in people with very specific knowledge and deep experience outside our comfort zone, because that's what will drive innovation – access to different thinking, new ideas, approaches to different industries. And around them we'll make strategic choices about what it is that we want to do, that we don't want to do. An entrepreneurial environment like this, and bringing in new skills, means there's no shortage of ideas; it's a matter of distilling those ideas and making choices about which ones we'll pursue.

### Q: SOMETHING THAT RUNS DEEP IN TRANSACTION CAPITAL'S PORTFOLIO IS A PREFERENCE FOR BUSINESSES THAT, THROUGH WHAT THEY DO, CREATE VALUE FOR SOCIETY OR ADDRESS A SOCIAL NEED. HOW WOULD YOU DESCRIBE THE SOCIETAL RELEVANCE OF THE RISK SERVICES DIVISION

Broadly, I'd say we contribute to making the credit system more efficient and effective. For Principa and MBD the focus is largely in the consumer credit space, whereas for Rand Trust it's about supporting the sustainability of SMEs by offering cash flow and other solutions – and it's in that SME space that a lot of job creation is happening.

In MBD we prefer rehabilitation over being punitive. We do this by encouraging people who have defaulted on their debt to make their repayments, which allows them to keep a good debt record. The simple truth is that you can't function in society without access to credit. We're also looking at consumer education – how we can help people who have been successfully rehabilitated not to fall back into a debt trap. It's very early days, but it's something we're very excited about – working with our clients and other businesses to educate people about using debt responsibly.



## HOW WE'RE DEPLOYING OUR CAPITAL

David HURWITZ

*“Over the past few years Transaction Capital has reconstituted its portfolio into two divisions of scale, being asset-backed lending and risk services. I am pleased with the performance, strategic positioning and composition of our portfolio of companies.”*

While both the asset-backed lending and risk services divisions perform better in a positive economic environment, they are also highly defensive businesses which are still able to thrive despite South Africa's current challenging macro- and socio-economic context, as is evidenced by the strong half year financial performance. Transaction Capital delivered a solid 22% organic growth in headline earnings per share for the first six months of the 2015 financial year.

As a result of the sale of Bayport and Paycorp in 2013, we still have excess capital of approximately R800 million available for investment. One of the most frequently asked question by stakeholders is “what are you going to do with the cash?” Holding excess cash results in a suppressed return on equity, and thus needs to be invested efficiently. Our objective remains to deploy this capital in a manner that generates the best risk-adjusted profit and improves the return on shareholders' equity.

### INCREASING THE SHORT-TERM YIELD ON OUR EXCESS CASH

The first challenge is to invest this cash safely to achieve improved short-term yields. To this end, in the first half of 2015 we repaid about R150 million of expensive debt and delayed some of the group's external funding requirements. These initiatives are temporary in nature and are not a sustainable home for our excess capital.

For this reason, we remain committed to investing significantly in both organic capital deployment opportunities and in bolt-on acquisitions within our divisions, to further enhance their scale and entrench their leading market positions.

### ACQUISITIVE GROWTH

The group is well positioned and suitably capitalised to complete significant acquisitive activity. However, with asset values being historically high, we are being particularly circumspect in our search for acquisitions.

During the first half of the 2015 financial year Transaction Capital made offers on a few businesses, none of which have been accepted due to an inability between ourselves as buyers and the respective sellers to agree on pricing. Despite this, our acquisition search continues in earnest.

### ACCELERATING ORGANIC GROWTH

Our asset-backed lending and risk services divisions hold leading market positions, employ experienced and skilled management teams, have performed very well, and thus provide Transaction Capital with efficient platforms to develop new products and expand into new markets. This, particularly against the backdrop of a low-growth South African economy with many challenges, has allowed us to focus in particular on organic growth prospects.

Considering the attractive risk-adjusted returns being generated organically from our established businesses, we believe that the best use of our excess capital would be to fast-track organic growth, reinvesting significantly in organic capital deployment opportunities available to each division.

### ASSET-BACKED LENDING

The replacement of the aging national minibus taxi fleet continues to create robust demand for SA Taxi's services. The minibus taxi industry still accounts for an estimated 80% of all public transport trips, and South Africa's commuters' use of minibus taxis has remained consistent.

SA Taxi continues to augment its skills-set and diversify its revenue streams, achieving strong organic growth. Today SA Taxi procures, sells, finances, insures and installs car tracking devices into new taxi and bakkie vehicles via its motor dealership. In addition, it is able to refurbish, re-sell, re-finance, insure and track repossessed vehicles, again via its motor dealership. Another organic growth prospect for SA Taxi is our short-term insurance business which continues to grow, providing insurance products to both our financed and non-financed clients.

We are also using our excess capital to enter into new adjacent market segments, financing asset classes such as bakkies used by SMEs as income-producing assets. Loans and advances in this regard have grown to R81.2 million, with debt capital as well as equity now financing this portfolio. In addition, Transaction Capital has allocated R50 million towards SA Taxi's introduction of a pilot project to fund bakkies utilised by consumers for utility purposes.

Other new markets could include the financing of Uber taxis, and we would even consider expanding internationally.

### RISK SERVICES

The depressed local consumer economy provides our risk services division with substantial opportunity as the major South African banks and credit retailers display increased demand for its services, products and capital to better manage consumer credit risk, aggravated by the adverse environment.

We have always done well in our traditional markets, servicing the credit retail and banking sectors, and still plan to do better. We have become more innovative in the products that we offer and in the way we interact with these clients. For this reason, revenue from agency collection services grew by 20%.

A large component of the risk services division's organic growth strategy is to enter new markets, such as the public (i.e. municipal), insurance and SME sectors.

During the first half of this financial year, the division again made further progress within the public sector. Many of these municipal clients display an increased demand for our services to better manage their credit and operational risks, reduce costs, simplify processes, improve operational infrastructure, facilitate skills transfer, raise capital and improve working capital cash flow. We have used some of our excess capital to fund a further structured investment in the municipal sector. Our first structured investment pilot concluded last year has proved successful, with an additional investment made this year.

The above, together with further benefits being realised from historical and recent traditional principal books, has assisted in growing revenue from purchased book debts by a very pleasing 32%.

The focus on the SME sector continues to yield desired results, with Rand Trust doubling its profit for the first six months of this financial year. We are also excited about the prospects available in the insurance market, and have acquired executive skills to penetrate this sector further.

### CONCLUSION

Taking all of the above initiatives into account, Transaction Capital is confident and excited about its future prospects. Our businesses are defensively positioned and serve as a solid foundation for organic growth into vertical market segments as well as for bolt-on acquisitive opportunities. We believe that the current level of performance and growth is sustainable in the medium term.