ecsponent Limited

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Creating extraordinary investment opportunities

The South African government has identified small and medium-sized entities (SMEs) as a major contributor to future economic growth. However, one factor that continues to hamper SME growth is a lack of access to equity funding.

To help remedy this, Government introduced Section 12J investments in 2009 to stimulate private sector investments in SMEs and as a result, the SA economy. This introduced tax incentives for investors via venture capital companies (VCCs), registered in terms of Section 12J of the Income Tax Act.

Section 12J investments are available to individuals, corporates and trusts and provide investors with a 100% deduction against taxable income in the year of investment, with the caveat that they must hold the investment for a minimum period of five years. There is no prescribed minimum investment.

The full investment amount can be offset against all types of taxable income, which makes it particularly attractive to those who have incurred capital gains tax during the year.

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What is a Venture Capital Company (VCC)?

A VCC, in terms of Section 12J, is a company established to provide investors with access to a range of companies that have the potential for significant growth but need funds to unlock that potential.

The VCC identifies these opportunities and raises the funds required by the smaller companies by issuing equity shares to investors/tax payers (individual, trust or company).

The money is then allocated to those businesses that the VCC's management judge to have the best prospects for growth. The VCC will issue a certificate to the taxpayer for the investment amount and manages the pool of investments.

The taxpayer is then allowed to deduct their full investment against their taxable income in the relevant tax year. This creates an incentive for taxpayers to invest indirectly in SMEs.

Managing to maximise returns

Each VCC will determine the type of qualifying investee company in which it invests its funds. The returns are dependent on the performance of the Section 12J's underlying investments, which is why these investment funds are controlled by experienced investment managers.

The investment manager's role is to ensure that the best opportunities for investment growth are selected from the dozens of privately-owned businesses that may apply for capital. Additionally, they must ensure that all conditions of the S12J investments are met so as not to jeopardise the initial tax benefit.

Ecsponent invests in Capitis Section 12J

Ecsponent recently announced its own investment in a Section 12J VCC, which will expand the Group's capability to stimulate the growth of South Africa's small and medium enterprises (SME) sector.

It is a proposed investment of up to R400 million in Capitis Equity (Pty) Ltd, a black women-owned VCC, which will give Ecsponent access to an effective and professional investment vehicle and expanded investment opportunities.

This investment is proposed in line with Ecsponent's strategic focus, which includes investing in assets that provide the Group with medium to long-term capital growth.

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Financial Services

Quiet before the storm

Economists' warnings of looming local and global market changes, which will affect both the market and economy severely, are increasing.

The world economy is performing well, especially in the US (which accounts for 20% of the world economy), where unemployment is at the lowest levels in years while share prices are reaching new highs.

Similarly, in South Africa confidence is slowly being restored due to positive political changes, while the rand is strong, inflation is under control and interest rates remain low.

We have seen the local stock market rise for close on nine years or 107 months, mirroring US markets, in one of the longest bull market phases ever. The average duration of a bull market before a correction or collapse is 85 months, usually followed by a market collapse of an average of 44%.

Analysts are also arguing that a storm is looming in the US that will disrupt global markets. In addition, the outcome of three scenarios pose major threats to the local economy and markets.

A recession in America?

The 2008 world recession was preceded by US-interest rates breaking through certain test levels. The same is happening now, with short-term rates rising faster than long-term rates. This is an indicator of a possible recession next year, which will result in significant ramifications for the global economy and for South Africa.

The major risk is systemic, which can lead to the collapse of the entire financial system, rather than only certain parts of it.

A good example of such a systemic risk is the collapse of the Lehman Brothers Investment Bank in America, which had a negative domino effect on banks across the world in 2008 and led to a world recession.

Recessions often happen without warning and the Lehman example shows just how quickly bad weather can become a storm. Just like when the bad weather of the subprime housing crisis caused a global financial storm and resulted in losses close to $2 trillion.

What could bring about the next storm?

All parties must come to an end and the levels at which US stocks are trading likely necessitates some correction. Inflation is increasing and Pres. Trump's tariff war - and even the developments with Israel/Iran - can just be that spark.

FPI Corporate Partner™

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In South Africa there are three major issues posing a threat to the markets in general, and especially the JSE, which affects everyone's funds:

Eish Eskom

Earlier this year, claims by Malusi Gigaba, former Minister of Finance, at the Davos Summit caused fear. He claimed that Treasury simply does not have the money to act as Eskom's guarantor and that should the power utility fail, there would be no currency or economy left in South Africa.

Naspers on thin ice

The South African market is dependent on Naspers. For example, the JSE's positive performance over the past twelve months was largely due to its 15.45% share price increase.

Naspers makes up around 20% of the JSE's total market value. Any events on the scale of the Steinhoff saga, or that affects Tencent (Naspers Chinese investment), such as Chinese legislation or a change in technology, will have a major impact on our stock market.

A single share that drives the bulk of the market's performance is a major risk. A 50% drop in Naspers' share price could see the JSE All Share Index drop by more than 10%.

Land and reform

The way in which South Africa's land reform issues are managed will play a critical role in future investments and the restoration of business confidence. Especially while the threat of unlawful land grabs continues to loom.

How do you protect yourself?

The only defence against a financial disaster is a well-diversified portfolio. In other words, if this happens, your portfolio will experience a setback, without collapsing totally. This requires a balanced spread between asset classes, fund managers, regions and securities.

Fixed rate investments, such as Ecsponent's preference shares, are ideal for investors who want to add diverse assets to their portfolios while enjoying the benefits of fixed dividend rates.

Personal financial survival is all investors' goal and planning, coupled with risk mitigation strategies will ensure that you sleep warm and peacefully during a chilling financial winter.

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Is tax-free best for you?

We often hear about tax-free or other tax-efficient investments and assume these present profitable opportunities because we want to minimise our tax burden.

Taxation is often a hidden investment cost and most smart investors aim to maximise returns by minimising tax as far as possible.

However, a tax efficient investment is not necessarily a good option for you. Tax benefits should never be the main reason or motivation behind your investment choices, because the risk, return, cost and, among other things, the positioning of the investment in your portfolio, play a far more important role.

Tax-free savings accounts

Treasury introduced tax-free savings accounts a mere three years ago. Since then, around 460 000 tax-free savings accounts have been opened and attracted investments in excess of R5 billion.

The investment growth in these accounts is tax-free and you do not pay dividend withholding tax, capital gains tax, nor tax on the interest, which could boost investment returns. However, there is an annual contribution cap of R33 000 and R500 000 in your lifetime.

Government's objective in introducing these accounts was to encourage savings and financial institutions wasted no time to start marketing their products to consumers. Banks, specifically, were quick to grab the opportunity, often advising clients to invest in money market funds, instead of equity-linked investments.

Under the banner of a tax-free investment (only growth is tax-free, not the entire investment), uninformed, and especially low-income investors, are led to invest in an unsuitable product with returns that barely beat inflation.

Likewise, people who do not make use of interest rate exemption are also encouraged to invest in tax-free savings products, but with no apparent tax benefit.

The threshold for tax-free interest income is R23 800 per annum, or R34 500 if you are older than 65. Under 65 years, a tax-free investment will only make sense for investments over R400 000 and R575 000 for those over 65.

In addition, there are many tax-free savings account investors who do not pay tax because of the age-related tax rebates they receive. Under 65 years, you only pay tax if your taxable earnings exceed R75 750 per year; between 65 and 75 years it is R117 300 and 75 years and older R131 150.

Some of the tax-free savings accounts also attract excessive costs of up to 1.5%, depending on the financial advisor/cost of the investment.

Retirement Annuities

Taxpayers can deduct all contributions, up to R350 000 per annum, to a retirement annuity from their gross income to reduce taxable income and thus pay less tax. All growth earned is tax-free.

However, after retirement, you will still be taxed on income from your annuities at your marginal rate.

Venture Capital Investments

Your entire investment amount is tax deductible when you invest in a Venture Capital Company (VCC) registered in terms of Section 12J of the Income Tax Act.

Donations

Individuals can donate up to R100 000 per year tax-free to their trust or dependents to reduce the personal estate value for tax purposes.

Does this suit your situation?

Investments in tax efficient products must always be compatible with your overall investment plan and your financial needs.

For example, a retirement annuity is ideal for someone saving for retirement. A tax-free savings account is more versatile and a better solution for long-term savings, especially for children.

Capital growth investments, such as preference shares, only attract capital gains tax, which is payable when you sell and realise a capital gain. In addition, an exemption of R40 000 per annum is applicable, which means only gains exceeding R40 000 are taxable at your marginal rate.

So, while tax is an important consideration, tax-free or tax efficient does not guarantee a good result. Make sure you choose wisely to suit your unique circumstances so that you are the winner and not the other way around.

FinTech facts you should know

In 1994 Bill Gates predicted the end of traditional banks. Two decades later, FinTech innovators are leading the drive to achieve financial inclusion.

FinTech companies are reinventing the banking experience by creating the innovative, transparent and inexpensive financial services that banks have failed to offer to their customers. The application of FinTech cuts across multiple fields, including payments, lending, wealth management, mobile banking, crypto currencies and the blockchain, alternative financing, insurance, security and risk management, data analytics and financial trading.

FinTech companies are on a mission to make financial services and products accessible to everybody by improving accessibility and reducing costs.

The opportunities FinTech offers:

Banking the unbanked across borders
About 2.5 billion people globally have no access to bank accounts and formal financial services. While this number has fallen in recent years, those without access to banking services are mostly from poorer countries.

In Africa 34% of adults have a bank account and only 16% have formal savings in place. South Africa fares better with 70% of adults owning a bank account, but only a third has formal savings.

Research published as part of the World Economic Forum on Africa indicates that this is primarily due to a perception of high banking fees and a lack of access to financial services. These factors continue to prevent higher levels of financial inclusion from becoming a reality.

FinTech is on the rise
The scope of innovation is rapidly growing as new products and services are introduced to make financial management easier and quicker.

Nearly $100 billion has flowed into FinTech ventures since 2010.

Since 2014, the funding received by the global FinTech industry has nearly doubled and reached an impressive $38.9bn in 2017. This suggests that FinTech is playing an increasingly important role in financial markets.

Disrupting the financial world
While both start-ups and traditional finance companies are active in FinTech, the start-ups are leading the wave of innovation by providing more online and digital solutions for customers, much faster and this is not just in the personal financial management space.

FinTech is also helping small companies in many ways - from innovative accounting software to financial management, insurance and business valuation services.

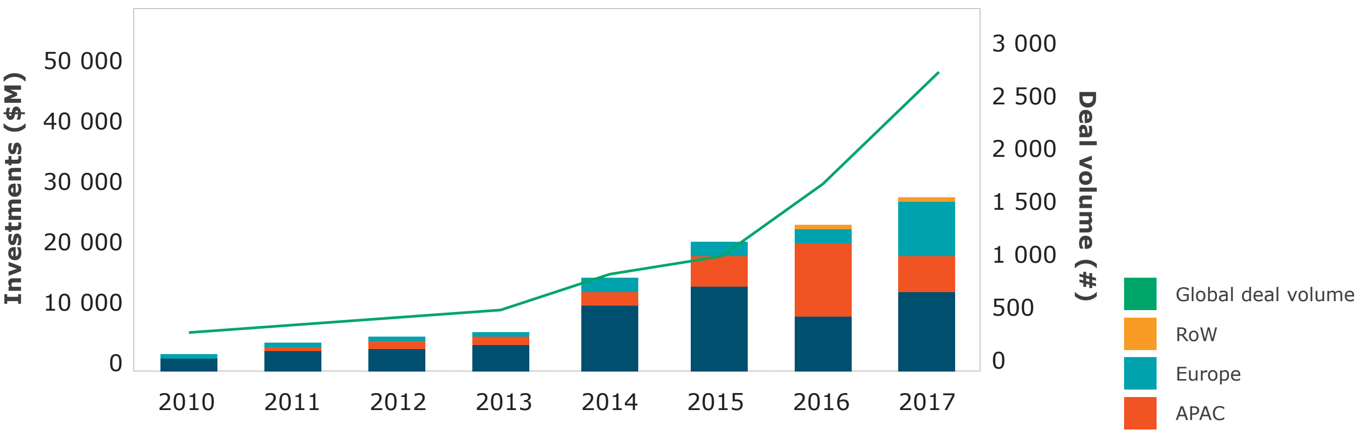
Digital finance is going to play an increasingly important role in driving financial inclusion on the continent -- making the role of FinTech innovators even more critical.

Commenting on Ecsponent's investment in FinTech, Group CEO Terence Gregory says,"We believe that our FinTech investments will give us access to financial services and related technology, providing quantifiable value for the Group. Additionally, the strategic nature of the investment will unlock real value in the long-term."

Ecsponent invests in FinTech through the Luxemburg-based FinTech innovator MyBucks SA, listed on the Frankfurt Stock Exchange.

MyBucks has shown extraordinary growth since 2012 and has a global footprint of seven MFI operations, five banking operations, with operations in eleven African countries as well as operations in Europe and Australia offering credit, banking, and insurance products.

FinTech is on the rise: Global fintech financing activity by region (2010 - 2017)



Source: Accenture Research analysis of CB Insights data.

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