ecsponent Limited

Newsletter ▪ July **2018**

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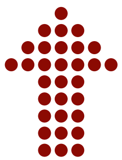
Ecsponent benefits from streamlined operations

On 29 June Ecsponent announced interim results for the 12 months ended 31 March 2018. The period was characterised by continued strong financial performance, as the group looks to further expand and grow its business operations in line with its strategic focus.

Key features

The group's March 2018 interim results reflect the impact of the rationalisation on its operations in the previous financial period. The current interim period comprises 12 months ending 31 March 2018, while the comparative period is for the 15 months ended 31 March 2017. During this time:



- Total assets increased by **60%**
- Revenue from continuing operations increased by **17.9%**
- Headline earnings per share (HEPS) increased by **787%**
- Share price improved by **260%**
- **30%** of the group's total assets are held outside of the Common Monetary Area, offering significant currency hedging opportunities.

Commentary on results

Ecsponent CEO Terence Gregory believes the strategic focus of the group's operations has provided it with a strong basis to continue providing stakeholders with significant growth, and thereby generating wealth.

Since 2012 the average annual compounded growth of the group's assets has been 104% per annum. Operating profit increased by 131% per annum and revenue by 66%.

> "All our efforts in the reporting period were intended to provide the group with further momentum for growth. The platform created for future dynamic growth is already evident in the group's operations," Gregory said.

In terms of its fund raising activities, the group secured an international funding facility for $10 million from a UK-based corporate financier at the end of 2017. This dollar-based funding is deployed to expand its operations in Africa.

Its Credit business unit, which deploys secured credit to fund the business operations of qualifying entities, has benefited from a buoyant African SME sector resulting in an increased demand for credit. Total assets in this business unit increased by 20.9% with operational profit increasing by 143%.

Additionally, the Equity Holdings business unit (which invests strategically in companies operating in high-growth sectors) saw its total assets increase by 18.7%. At 31 March the group held 12% in the Frankfurt-listed Fintech company MyBucks SA that provides it with a foreign currency hedge against the rand's frailty.

"Ecsponent has a strong operational footprint, not only in South Africa, but also in Swaziland and Botswana with representation of local staff members in each country. In Zambia the group holds a 25% stake in the local GetBucks entity which is a deposit-taking financial institution. However, we are keen on expanding our operations throughout the continent with the streamlined operations now allowing for this," said Gregory.

Post 31 March the group has announced transactions with a cumulative value of R1.2 billion, intended to provide it with significant growth opportunities and offer a balance between its short term cash generative assets and longer term growth assets. These transactions will provide further momentum to its growth strategy, realising results within the next reporting period.

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Financial Services

The effect of costs on unit trust investment returns

Every investment has costs associated to it, even if you don't realise you're paying it. There are many different types of costs, but they all have one thing in common: That money is going somewhere else, and not to you.

Why do costs matter?

Investment costs might seem unimportant, but they add up, compounding along with your investment returns. In other words, you don't just lose the small percentages you pay in costs, you also lose all the growth that money might have had for years into the future.

How will costs affect your investment?

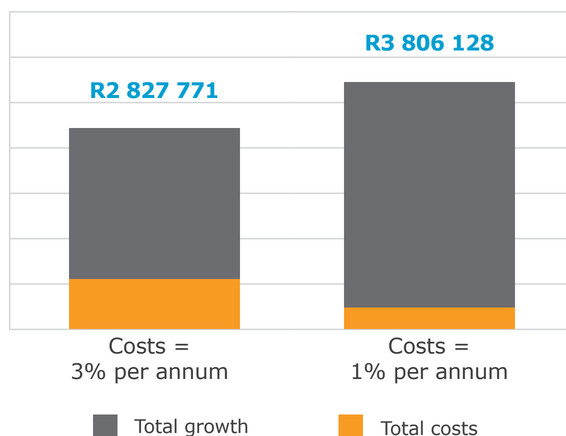
Let's say you have invested R500 000 in two unit trust investments on the same day*.

Both earn 10% per annum in growth before costs. On the first, your total annual cost is 3% and on the second it is 1%.

After 30 years, the first investment will be worth R3 806 128. The second, R6 633 839. That is a difference of R2 827 771, or 42.6%.

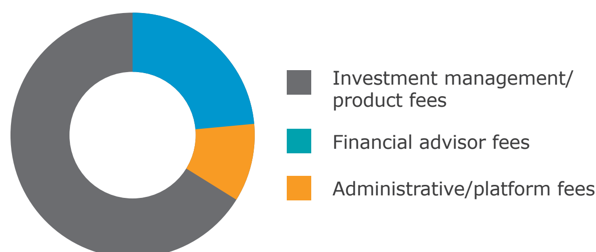
That's right: The 2% you paid every year would wipe 40% off your final investment value. 2% doesn't sound so small anymore, does it?

The impact of cost on your investment



* Example relates to an investment in a collective investment scheme (a unit trust) on a LISP (Linked Investment Services Provider). It excludes additional fees associated with wrappers or fund of funds fees. Source: GraySwan Investments http://grayswan.co.za/cost-drag-on-investment-performance/

What are the costs you are likely to pay on your unit trust investments?



Financial advisor fees

Services performed by a financial advisor, including performing, drafting and implementing a financial needs analysis, investment manager selection, portfolio construction and performance monitoring. On average, financial advisors charge a once off fee for the initial work to define an investment strategy and financial plan, and 0.50% to 1.0% as an annual advisory fee.

Administrative/platform fees

The administrative or platform fees are related to a Linked Investment Service Provider (LISP)*. LISPS also charge an annual administration fee expressed as a percentage of the assets on behalf of the client. On average, LISPS charge a minimum annual administration fee of 0.50% but it can in some instances be as low as 0.10%.

Investment manager/product fees

Investment managers charge an annual fee (as a percentage of assets) for the day-to-day management of the investment or fund. On average, for a balanced multi asset class unit trust, the total investment manager fees amount to 1.50% per annum, but could be as high as 3.0%.

Total Expense Ratio (TER)

This ratio reflects the charges, levies and fees relating to the management of an investment portfolio, expressed as a percentage of the average net asset value of the portfolio.

In the end, it is the little things that have a great impact, so be sure you consider investment returns and costs when you choose your next unit trust investment.

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Diversification - could it be too much of a good thing?

Distributing investments between and within different asset classes is generally considered one of the keys to investment success. The aim is to compile a portfolio of different investments, reducing the risk of the overall portfolio. Or simply, it comes down to not putting all your eggs into one basket.

Diversification reduces risk

Firstly, what is risk? Investment risk is the probability that an investment will permanently lose its value, or its returns will be less than expected.

Without a crystal ball, only an investment in cash, like a bank deposit, guarantees your returns to be exactly what you anticipate.

Typically, a permanent loss of value arises as a result of an investment in a fraudulent scheme, or if one commits the cardinal investment sin of buying high and selling low. Once wealth is lost in this way, it cannot be recovered. What is worse, the remaining base from which you can earn returns is diminished, which in itself can only lower future return expectations.

Spreading your wealth across different investments, including over different asset classes and geographies, can help you avoid unforeseen catastrophic risk that may arise from a single investment only. While it is not a guarantee against loss, it is a prudent strategy for achieving long-term financial objectives.

Diversification improves your access to funds

Diversification can help to give you access to your funds during times of need. The ease with which you can buy and sell an investment, known as liquidity, plays an important role in your strategy. This varies between assets and introduces a new form of risk of being unable to trade your investment at a fair price at short notice - or you may have to accept a lower price to sell it. For example, a property investment can be more illiquid than equities, which, in turn are more illiquid than cash investments.

Diversification smooths the ups and downs

An investment in cash may reduce volatility, but also comes at a cost and many investors underestimate the eroding power of inflation.

In South Africa, National Treasury aims to keep the inflation rate between 3% and 6%. If you consider an average inflation rate of 5.5% per annum (the average has been 5.6% over the last 100 years), then R10 000 in today's value will have the same purchasing power in ten years' time as R5 584. In twenty years it will be R3 118, which means investors cannot afford to ignore it.

Equities have outperformed all other asset classes over the past 90 years but are prone to market fluctuations, especially in the short term.

By blending different asset classes, it is possible to reduce periods of negative returns. While you can never get rid of risk completely, you can at least smooth out the ups and downs of your investment.

So, if ignoring the necessity of diversification within an investment portfolio is considered another cardinal sin of investing, is it possible to have too much of a good thing?

Diworsification

Investment experts agree that there is indeed a point where the cost of adding another investment to a portfolio can exceed its marginal benefit.

This concept is neatly summed up in a word coined by Peter Lynch in his book *One Up On Wall Street (1989)* – diworsification. An over-diversified portfolio can confuse you, increase your investment cost, and add layers of due diligence, leading to below-average returns.

More eggs in the same baskets

A common mistake among investors is to diversify their investments across a range of financial managers. South Africa has a small investment universe and many balanced funds' top ten holdings will include shares such as Naspers, Anglo American, Sasol and a few financial services companies. As a result, the biggest balanced or multi-asset funds in South Africa have similar investment holdings and overall strategies. For an investor, this means that your investment is still in the same basket, but your exposure is even greater. When their performance before costs is compared, their returns are similar over the long run.

Multimanager investment products like funds of funds, can be a simple way for small investors to reach instant diversification. This diversification comes at a high cost, however, with a financial advisor monitoring an investment manager that is, in turn, monitoring other investment managers, with little prospect of earning a return that is better than average.

Over-diversification may also introduce increased trading costs as large portfolios are rebalanced from time to time, and such costs simply unnecessarily erode wealth. Investors should seek to capture the benefits of an astute investment selection process without forfeiting all such potential gains by diversifying them all away.

Invest with a purpose

At the end of the day, having a diversified portfolio is prudent. However, diversification is not without specific risks, such as higher overall costs, more accounting for and tracking of investments, and most importantly, potential risk of significant underperformance.

Rather than focusing exclusively on diversification, consider the basic principles of risk management:

1. Invest for the long term. Risky speculation involves a short holding period and an uncertain result. True investment necessitates a long holding period and a less risky, more probable result.
2. Spread your risk mindfully through diversification across asset classes to maximise returns and minimise volatility, but without adding unnecessary investment costs.
3. Make investment decisions based on your goals, genuine market information and proper advice. Always buy low, sell high and when you sell, do not base your decision on emotion.

Tax Season 2018

The annual tax season has arrived, meaning it is time for taxpayers to submit their returns for income earned between 1 March 2017 and 28 February 2018.

We have compiled answers to some of the most common tax questions investors may have.

What are the submission deadlines for income tax returns?

Channel	Deadline	Type of taxpayer
Manual - Post or drop at SARS branch drop box	21 September 2018	Non-provisional and provisional
eFiling or electronic filing at SARS branch	31 October 2018	Non-provisional
eFiling	31 January 2019	Provisional

Who must submit their income tax returns?

- Every individual who is a resident and had capital gains that exceeded R40 000;
- You become liable to pay income tax when you earn more than:
  - R75 750 (if under 65 years);
  - R117 300 (if older than 65 but under 75 years); or
  - R131 150 (if older than 75).

Tax and your Ecsponent preference share investment

If you are invested in Ecsponent's income generating preference shares, i.e. you receive a monthly dividend payment, you will receive an IT3B certificate from us. The IT3B certificate will reflect the value and the nature of income you have generated from your investment.

These dividend payments are subject to a dividend withholding tax of 20%. In other words, the 20% tax has already been paid on your behalf and it reflects on the IT3B certificate as proof.

When completing your tax return you must disclose the total amount you received in dividends from South African companies in the field "Exempt local and foreign dividends" in the section of the return headed "Amounts considered non-taxable." You do not have to include the value of the dividend withholding tax paid on your behalf.

If you are invested in the capital growth provider, Ecsponent's Class B preference shares, and you are not receiving a regular payment from us but have invested for a five-year term, you will not receive an IT3B. Only once your investment reaches the end of its five-year term will you receive an IT3C certificate.

The IT3C certificate reflects capital gains, or the growth you received on your investment. Depending on your personal tax circumstances, you may be liable for capital gains tax in the tax year when this investment matures. Until then, there is no need to reflect any information on your tax return and you will not receive a tax certificate from Ecsponent.

General tax filing tips

- Make sure you have the correct supporting documents organised and available for verification purposes. You will only need to submit these documents to SARS upon request and they don't need to be filed with your original tax return.
- Use only the actual values that are reflected on your supporting documents and complete your return honestly, correctly and submit it on time.
- Keep your information safe from opportunists and remember that SARS will never:
  - request your banking details or other personal details in any communication that you receive by post, email, phone or SMS.
  - send you any hyperlinks to other websites - even those of banks.

For more information about Tax Season 2018, visit the SARS website. If you need information from Ecsponent, or a copy of your IT3B certificate, please contact us.

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