



Trustco [TUC] FY10 results

29 October 2010

Event

Trustco released FY10 results and also recently announced the granting of a loan from the IFC and the implementation of Trustco Mobile in Zimbabwe.

Impact

Trustco's FY10 results were in general quite impressive. The Group reported total revenues of N\$550.4m, which indicates revenue growth of 14%. This is substantially lower than growth over the previous two years, although one has to take into account the difficult business conditions that prevailed in the financial industry over the past year. The group did however still manage to open up margins – the gross profit margin was 49% from 47% the previous year, and the net profit margin was 25% compared to 19% last year.

	<u>2009</u>		<u>2010</u>	
Revenue	484,514	70.66%	550,448	13.61%
Gross Profit	227,342	37.80%	271,361	19.36%
Profit before Tax	66,526	13.62%	161,498	142.76%
Profit after Tax	93,378	19.85%	137,544	47.30%
Net Profit Margin	19.27%		24.99%	

1. Income Statement

Table 1: TUC income statement (selected items)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>			
Revenue	182,295	283,911	55.74%	484,514	70.66%	550,448	13.61%
COS	-54,325	-118,928	118.92%	-257,172	116.24%	-279,087	8.52%
Gross Profit	127,970	164,983	28.92%	227,342	37.80%	271,361	19.36%
GP Margin	70.20%	58.11%		46.92%		49.30%	
EBITDA	63,074	107,675	70.71%	107,189	-0.45%	196,303	83.14%
Profit before Tax	30,799	58,551	90.11%	66,526	13.62%	161,498	142.76%
Taxation	692	19,364		26,852		-23,954	
Profit for the year	31,491	77,915	147.42%	93,378	19.85%	137,544	47.30%
Net Profit Margin	17.27%	27.44%		19.27%		24.99%	

Source: TUC annual reports; SSS Research

Trustco Group reported total revenue of N\$550.4m, which indicates revenue growth of 14%. This is substantially lower than growth over the previous two years, although one has to take into account the difficult business conditions that prevailed in the financial industry over the past year. The “financial services outside Namibia” segment contributed largely to the slowdown in top-line growth, with revenue from this sector growing at a more sustainable rate of 8.9%, compared to more than doubling in the previous year.

The group did however still manage to widen margins – the gross profit margin was 49% from 47% the previous year, and the net profit margin was 25% compared to 19% last year. Contributing to this was cost of sales that were only 8% higher for the year and also a better loss ratio being realised from the insurance segment. Total claims and benefits paid as a percentage of insurance premium revenue came down to 16% from 23% last year. Together these factors enabled the group to realise a 47% growth in profit for the year to N\$137.5m. Micro-insurance and micro-finance (which makes up the group’s core business) contributed about N\$108m (20%) and N\$34m (6%) of total revenue, respectively.

The group’s after-tax profit increased by 47.3%, resulting from a 143% increase in pre-tax earnings, as the group recorded a tax expense for the first time since 2006. By using an expanded version of the Du Pont formula, the different effects weighing on the NP margin can be illustrated as follows:

Table 2: Du Pont formula extract

	<u>2009</u>	<u>2010</u>
Adj operating margin	18.40%	17.03%
× Impact of FVG	1.03	1.94
= Operating margin	18.97%	33.06%
× Tax burden	1.4	0.85
× Interest burden	0.72	0.89
= Net profit margin	19.27%	24.99%

Source: TUC annual reports; SSS Research

The adjusted operating profit margin used above is the EBIT adjusted for the fair value gains. There are 2 important conclusions that can be made from the above analysis:

1. The adjusted operating profit margin actually declined and it was the fair value gain that caused the operating margin to increase significantly. A value of 1.94 means the impact of the fair value gain almost doubled it; the NP margin when excluding the fair value gain is only 12.88%.
2. The effect of the first tax expense in a couple of years being recorded caused the tax burden to decrease from 1.4 (a positive effect on the NP margin as a result of a tax income) to 0.85, having a significant negative effect on the NP margin. In previous years tax assets were used to offset tax expense.

We also expect the effective tax rate of the group to increase in the next period (2010: 15%), as the group currently has no unrecognized tax asset available to set off against future taxable profits.

Table 3: EPS summary

Earnings per share:	2007	2008	2009	2010			
Basic EPS	5.73	13.01	127.05%	14	7.61%	20.31	45.07%
Diluted EPS	5.73	12.33	115.18%	13.49	9.41%	20.31	50.56%
Headline EPS	4.69	7.77	65.67%	10.81	39.12%	12.6	16.56%
Diluted HEPS	4.69	7.36	56.93%	10.42	41.58%	12.6	20.92%
Dividends paid per share		0.5		1		2	

Source: TUC annual reports; SSS Research

Basic EPS were 45% higher for the period at 20.31 cps, while HEPS was only 17% higher at 12.6 cps due to a fair value gain of N\$88m included in basic earnings. This fair value gain came as a result of part of the Lafrenz property being reclassified as an investment property at fair value, where it was previously held at cost price as inventories. The Lafrenz property was bought for N\$1/square meter and is currently valued at N\$1200/square meter. This revaluation is reported as a gain and constitutes more than half of the total profit before taxation. Also included in the income statement is a realisation of a contingent asset that came as a result of the DexGroup purchase agreement being finalised, which resulted in an income of N\$20 million.

The group did not distribute any dividends for the period, which management prescribed to uncertainty regarding the availability of funds at the time of deciding on a dividend. This decision is bound to be reviewed later this year and the recent loan granted to Trustco by the IFC may free up enough cash for them to reinstate a dividend for the next period.

2. Balance sheet (selected items)

Table 3: Balance sheet (selected items)

	2007	2008	2009	2010
ASSETS				
Non-current assets:				
Property, plant and equipment	125,217	142,529	154,210	139,366
Investment property	32,627	36,812	33,753	143,233
Intangible assets	12,688	174,605	186,942	194,718
Deferred income tax assets	7,994	18,296	45,147	50,855
Educational micro loans advanced	40,074	61,579	79,003	106,840
Total non-current assets	355,090	433,821	524,519	673,047
Current assets:				
Assets at fair value through profit and loss			10,035	18,274
Short-term portion of educational micro loans advanced	23,773	32,404	54,024	71,463
Inventories	30,818	30,972	30,244	18,677
Trade and other receivables	24,279	33,358	31,018	46,549
Cash and cash equivalents	27,580	98,927	108,496	91,047
Total current assets	108,115	202,119	237,805	248,057
Total assets	463,205	635,940	762,324	921,104
EQUITY AND LIABILITIES				
Capital and reserves:				
Share capital	141,920	141,448	162,645	162,645
Deemed treasury shares	(45,051)	(35,359)	(19,137)	(18,731)
Revaluation reserves	7,513	12,801	16,851	16,098
Distributable reserves	33,220	107,862	194,416	316,731
Total capital and reserves	135,873	260,836	370,477	478,645
Non-current liabilities:				
Long-term liabilities	216,727	109,503	117,832	111,090
Deferred income tax liabilities	21,091	25,466	27,062	57,082
Amounts due to related parties		32,849	15,786	20,834
Total non-current liabilities	242,465	170,755	164,742	197,055



Current liabilities:

Current portion of long-term liabilities	9,281	14,854	15,700	15,367
Trade and other payables	40,568	159,353	179,368	187,572
Technical provisions	11,596	12,379	15,834	17,189
Bank overdraft	21,334	15,511	14,947	21,626
Total current liabilities	84,867	204,349	227,105	245,404
Total equity and liabilities	463,205	635,940	762,324	921,104

Source: TUC annual reports; SSS Research

Trustco's asset base grew by 21% in the year mainly as a result of good growth shown by the value of the student loan book and the revaluation of the Lafrenz property, shown in investment property jumping by over 300%. The student loan book is set to show even more growth in the next couple of years, with the N\$80m loan from the IFC earmarked exclusively to finance it. The balance sheet showed a slight weakening in liquidity as the current ratio decreased slightly from 1.05 to 1.01, which can be largely explained by the decrease in inventories and cash. The quick ratio, which excludes the effect of inventories, thus increased from the previous year. The cash ratio fell from 0.48 to 0.37, highlighting the poor cash flow experienced over the period. Net cash flow from operating activities was only slightly positive at N\$1.2m and the net change in cash and cash equivalents was -N\$24.1m.

The overall health of the balance sheet improved with the group's ability to meet long term debt obligations. The debt/equity ratio decreased to less than 1, which is the first time in at least 4 years that the company has fewer liabilities than equity. Total debt and debt/capital ratios also decreased over the period as distributable reserves increased by 63% from N\$194m to N\$316m.

3. Segmental analysis

Table 3: Segmental analysis

	Micro Insurance	Micro finance and education	Financial Services Outside Namibia	Private Equity	Group
Revenue		104,542	291,699	151,795	548,036
Inter segment revenue				-105,953	-105,953
Insurance Revenue	108,365				108,365
Total	108,365	104,542	291,699	45,842	550,448
Profit for the year	44,985	39,342	19,937	33,280	137,544
Profit margin	41.51%	37.63%	6.83%	72.60%	24.99%
Assets	29,668	150,795	195,822	386,019	762,304
Liabilities	21,174	31,977	130,209	208,487	391,847
Capex		892	11,832	14,476	27,200
Depreciation	83	190	495	13,423	14,191
Ammortisation	112	290	695		1,097
ROA	152%	27%	10%	9%	18%

Source: TUC annual reports; SSS Research

The high ROA of the company's core business, the N\$80m IFC loan earmarked for education and the N\$20m invested in the micro insurance sector to develop Trustco mobile should be seen as positive developments, as the group is applying capex to the areas with the highest return.

3.1 Micro Insurance

Micro insurance forms part of Trustco's core business. Over the past 5 years it has shown a steady and reliable stable increase in insurance premium revenue at an average growth rate of about 17% per year, although its contribution to total group revenue has decreased from almost 50% in 2005 to 20% for the year ended 31 March 2010. We believe this segment, together with micro finance & education, to be the group's most sustainable.

Figure 1: Insurance revenue

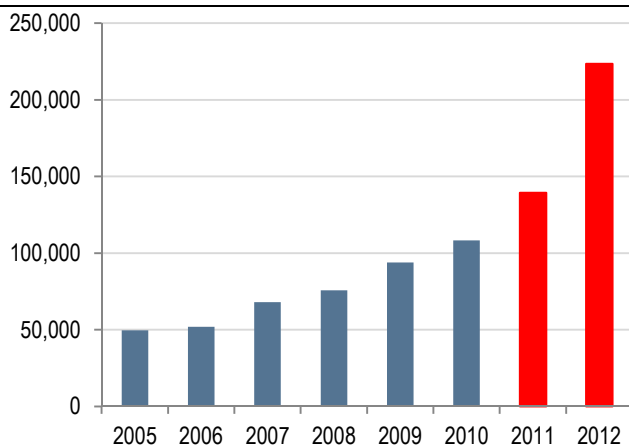
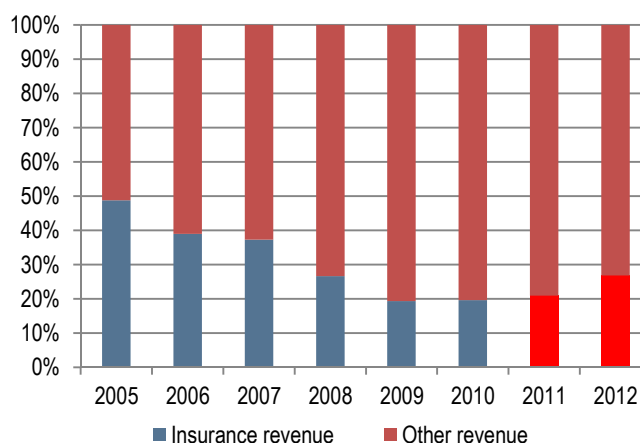


Figure 2: Sector revenue as % of total



Source: TUC annual reports; SSS Research

Trustco recently announced that it had reached an agreement with Econet Wireless, the largest mobile phone operator in Zimbabwe, whereby Econet will pay Trustco US\$1 p/month p/subscriber to use the Trustco-mobile Concept. This concept involves providing free life-insurance as an added benefit to Econet subscribers when they buy airtime. Econet Wireless currently has about a 73% share of the Zimbabwean mobile market, with about 4 million subscribers. We believe this endeavour will have a significant impact on the revenue from this segment once fully rolled out, but is also very dependent on customer acceptance. Econet reported 30,000 customers registering for the product in the first two days. Management has stated that it expects to realise a loss ratio of about 30% on the product, which we think is reasonable, given that Trustco's other insurance products' loss ratios over the past 4 years have varied between 15% and 26%. The deal has been implemented as of 7 October.

Furthermore we expect the current low interest rate environment to persist for a while, having a dampening effect on the growth of current business revenue (excluding the Econet agreement) which we expect to grow by about 15% for the next year. In total we expect the segment to grow substantially in the next two years and contribute relatively more to the total profit of the group.

3.2 Micro finance and education

94% of students enrolled at IOL in 2009 used Trustco micro finance services to pay for their tuition. The low interest rate environment has put pressure on the margins achieved from interest on the loan book, which is evident in the interest income as a percentage of the loan book value dropping from 22.7% down to 19.3% over the reporting period.

Figure 3: Micro finance and education revenue

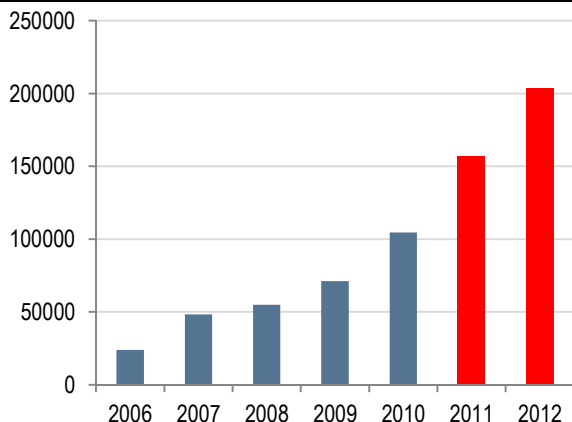
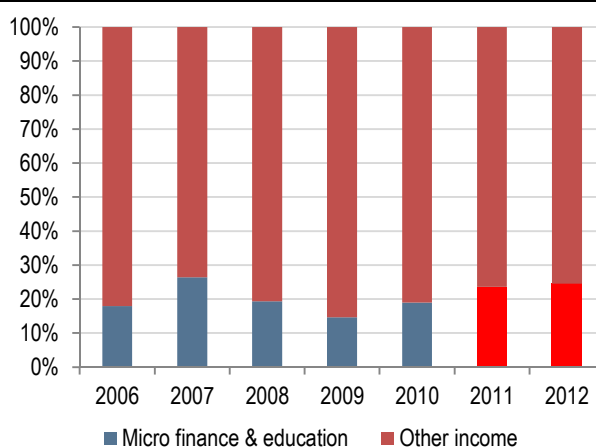


Figure 4: Revenue as percentage of total



Source: TUC annual reports; SSS Research

Trustco recently announced an N\$80m loan granted by the IFC for expanding the loan book, which will likely boost revenues from this segment in the coming years. The loan will be applied exclusively to expand the student loan book which is currently standing at about 22,000 students. The group aims to grow the value of the loan book to N\$500 million by 2014 from about N\$178 million at the end of March 2010. This would require a compounded growth rate of 30% over the next 4 years, which is achievable, given the 33% growth experienced over the last reporting period and a 70% annual growth from 2006. Management has stated that key constraints in growth of the loan book have come only from funding availability and not from a shortage of demand, which implies that their target growth is realistic.

Since the company had to advance student loans from own funding in the past, the loan will result in some cash being freed up which in turn will strengthen the company's currently weak cash flow situation. Although it will also result in more finance costs, we believe the net effect on the cash flow statement will be positive.

3.3 Financial services outside Namibia

Trustco Financial Services (Pty) Ltd: South Africa (TFS) currently has about 750 brokers registered in South Africa to which they provide mostly administrative services and IT systems. This segment contributed over half of total group revenue in FY10, but due to a relatively small 7% profit margin, contributed only 14% of total after-tax profits. Management has indicated that the low (and decreasing) margin is acceptable at this stage as this business segment is important to the group from a strategic point of view. Trustco plans to expand in the South African market and TFS will provide a solid launching pad.

Figure 5: Revenue from segments

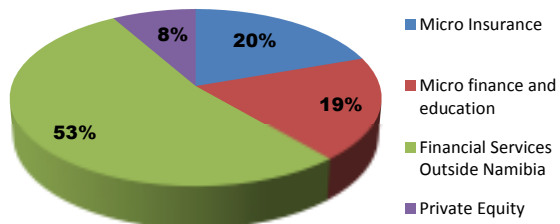
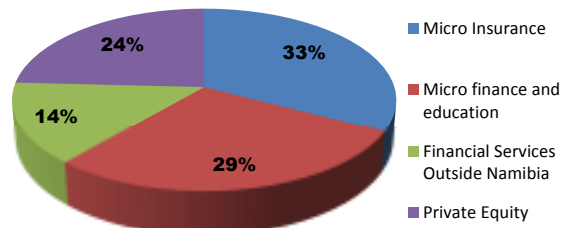


Figure 6: Profit from segments



Source: TUC annual report; SSS Research

The group plans to increase the number of brokers in South Africa (currently 750), although low interest rates and a sluggish economic growth outlook for South Africa could dampen the revenue from this sector.

3.4 Private Equity

The group's private equity segment consists of a property portfolio, the Informante newspaper, the head office operations and Trustco Air Services. Head office operations consist mostly of the groups centralized costs, e.g HR costs, IT costs and irregular income items (e.g. fair value gains) are also realised through this segment.

The property portfolio currently amounts to N\$206.9m of which N\$88m results from an adjustment to fair value in the reporting period. The Lafrenz property was bought in April 2004 at N\$1p/m² cost price. In the reporting period a portion of this property was taken out of inventories, and reclassified at fair value as investment property. The property is currently valued at about N\$1200p/m², which means that there is significant value yet to be unlocked.

The Informante is Trustco's free weekly newspaper, which they have recently decided to start selling. Currently the Informante distributes about 65,000 copies a week and plan to charge a price of about N\$5, which is more expensive than the daily newspapers. Management however believes that the weekly Informante does not compete with the daily newspapers, thereby justifying the higher selling price. We do not believe that this endeavour will have a significant impact on profits, at least not initially. The Namibian Sun is an established newspaper that recently evolved from a weekly paper to become a daily. It's popularity grew quite well since its launch three years ago and the weekly edition most recently had circulation of about 22,000. The Observer is another established weekly; therefore the Informante could find it difficult to attract significant market share, especially at the suggested price of N\$5 (Namibian Sun, N\$2; Observer, N\$5).

4. Corporate Governance

Table 4: Analysis of shareholders

Number of shares per shareholder	Number of Shareholders	Number of shares	% of shareholders	% of shares
1 – 9999	2,559	4,080,046	91.62%	0.58%
10000 +	234	703,062,044	8.38%	99.42%
	2,793	707,142,090	100.00%	100.00%

Source: TUC annual reports; SSS Research

Mr. Q van Rooyen owns 55% of the shares, and has recently stated that he does not intend to lower his shareholding in the near future. Furthermore, 8.38% of the shareholders own 99.42% of the shares and only 30% of the group's shares are free floating, which limits liquidity. In August the trading volumes of the stock on the JSE started picking up as news of the loan from IFC and the Zimbabwean deal surfaced. It is also worth noting that from 22 – 29 September, 1.554 million shares were purchased by directors of the group or directors of its subsidiaries. The stock also recently traded on the NSX for the first time since January this year, as the share price on the JSE converged to the NSX price.

Also, 85% of investors in Eastern Europe and Africa said that corporate governance issues are equally or more important than financial issues when making investment decisions. Corporate governance has become increasingly important over the years and this is even more so in emerging markets, because the legal framework is not always as structured and developed as in advanced economies.

Below are some key factors investors consider when evaluating corporate governance, together with global best practice for each of these factors and Trustco's specific situation with regard to these factors.

- Independence of the board – according to global best practice, at least 75% of the members of the board should be independent members. Trustco has recently appointed 4 new independent directors, which means the board now consists of 6 independent- and 3 executive directors (67% independent). This is a major improvement – from 43% as per the last annual report.
- Independent chairman of the board – global best practice recommends that the chairman of the board should not be a senior executive in the corporation. In Trustco's case, the current acting chairperson (M. Nashandi) is an independent non-executive member.
- Qualifications of directors – the board of Trustco has substantial and relevant skills and experience in business, legal and financial matters.
- Annual election of directors – members of the board are elected by shareholders at the Annual General Meeting, which is in line with global best practice.
- Annual Board Self-Assessment – There is currently no formal evaluation in place by which the board's performance and effectiveness is measured, although the group plans to link director remuneration to financial performance.
- Separate sessions of independent directors – Best practice requires that independent directors of the board have meetings separate from management or other related parties at least annually. Trustco's independent directors in the past have met separately only when they felt there was a need for this.
- Board's independent expert and legal counsel – The board should have the ability to hire outside legal or expert counsel when necessary. Trustco states that any director may obtain independent professional advice at the expense of the group.
- Audit committee – Corporate governance best practice recommends that the auditing committee should consist of only independent directors. Trustco has one independent member and one executive on the auditing committee.
- Nominating committee – this committee should be comprised of only independent members, which is the case with Trustco.
- Statement of governance policies – Trustco regularly supplies a statement of their governance policies, which is in line with global best practice recommendations.
- Insider or related party transactions – All transactions of Trustco with related parties are disclosed in the annual report.



Company Details

Telephone	+264 (61) 254 194	
Fax	+264 (61) 254 193	
Address	4 Koch St. Klein Windhoek P. O. Box 3970 Windhoek, Namibia	
Website	www.sss.com.na	
Managing Director	Andrew Jansen	aj@sss.com.na
Research	Emile van Zyl	ez@sss.com.na
	Ngoni Bopoto	nb@sss.com.na
	Romé Mostert	rm@sss.com.na
	Rudolf Kuschke	rk@sss.com.na
Dealing	Kobus Thorburn	kt@sss.com.na
	Lyndon Sauls	ls@sss.com.na
Money Market	Bruce Hansen	bh@sss.com.na
	Shinine Jansen	sj@sss.com.na
	Amanda Meyer	am@sss.com.na
	Fazley Stramiss	fs@sss.com.na
Finance	Alexia Tjiroze	at@sss.com.na

Disclaimer

The report is provided by Simonis Storm Securities (Pty) Limited ("SSS") solely for the recipient's information. The user assumes the entire risk of any use made of this information. Its contents are based on information obtained from sources believed to be reliable. SSS makes no representation and accepts no responsibility or liability as to its completeness or accuracy of any information, facts and/or opinions contained in the report.