Tap and Grow

Date: 12 August 2022

- While Capital Appreciation (CAPPREC) is a relatively new entity (listed in 2015), its underlying operations are well established in SA fintech. African Resonance, its largest digital payment business, was founded in 2003 and is the largest player in its market, procuring, securing, managing, maintaining and repairing the Point of Sales (POS) devices issued by major banks to their merchant customers.
- Dashpay that was acquired the same time as African Resonance in 2017, has its roots going back to 2013. It also operates in the digital payment industry with a strategy of partnering merchants directly, in essence acting as the banks intermediary to retailers. Its offering includes traditional merchant acquiring services and non-traditional merchants (e.g., courier companies, shopping mall operators) and SMME's that seek electronic payment alternatives.
- We believe physical POS devices have an ever-increasing role to play in retail commerce and the number of devices in the SA market will grow significantly. Independent research predicts growth of 31% over the next three years and we believe CAPRREC is well positioned to increase its market share (currently estimated at 35%). Growth is driven by increased penetration of retailers (entering the SMME space), an ongoing move towards cashless spending (SA remains very dependent on cash transacting), value-add services offered by POS devices and increased card penetration.
- The groups other focus area is software development, through Synthesis. Established in 1997 it's a key cloud provider to financial services companies through its advanced status accredited to it by AWS. It's a pioneer in internet and digital banking platforms and assists clients in digitising and analysing data. Its inhouse development of payment software, Halo Dot, has been certified by Mastercard, Visa and Amex and is currently being marketed globally. This enables CAPPREC to participate in the SoftPOS industry. Synthesis also plays a key role in automated reporting for regulators such as the SARB and SARS.
- Headline earnings growth has been erratic over the past four financial years. This reflects heavy spend on technology platforms such as cloud, the in-house development of Halo Dot, evolving the groups' operational structure and lastly COVID-19 in FY21. FY22 saw its best reporting period to date with strong growth in terminal sales and a recovery in corporate IT spend. We anticipate strong HEPS growth in the medium term - FY23E (+17%), FY24E (+30%) & FY25E (+26%) driven by renewals of POS devices and robust revenue growth and margin expansion from Synthesis. Halo Dot and Dashpay Glass development and marketing spend will weigh on FY23E margins.
- In our DFCF valuation we calculate a fair value range of R2.22-2.48/share. Cash represents 41c/share. Acquisitions in Fintech will continue - the group could entertain a R2bn transaction given its cash (R533m), treasury shares (80.9m), zero debt and an appetite to broaden its shareholder base.

ZARmn (to March)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	620	831	990	1,187	1,435
EBITDA	173	253	279	346	435
Headline earnings	127	164	193	252	318
HEPS (ZAc)	10	13	16	20	26
PE Ratio	9.6	12.0	10.2	7.9	6.3
Dividend (ZAc)	5.5	7.5	9.2	13.3	18.0

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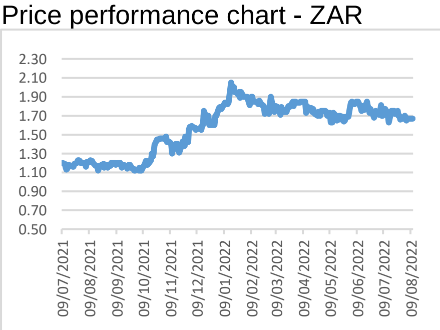
Price (2022/08/12):	R1.61
Market cap	R2109m
Shares in issue	1310mn

Sponsored Research: ASB Research is compensated by certain corporates to produce objective and impartial research. A Recommendation is not provided. Earnings forecasts and a valuation are the independent view of the analyst, based on their view of all factors that could influence earnings and peer comparisons.

Price performance chart - ZAR



Source: FactSet

Figure 1 Financial summary

Year Ending	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023 F	FY2024 F	FY2025 F
Income Statement								
Sales	508	608	701	620	831	990	1,187	1,435
Sales growth (%)	*na*	*19.6%*	*15.4%*	*-11.7%*	*34.2%*	*19.1%*	*19.9%*	*20.9%*
EBITDA	177	161	197	173	253	279	346	435
EBITDA Margin (%)	*34.9%*	*26.5%*	*28.0%*	*28.0%*	*30.5%*	*28.2%*	*29.2%*	*30.3%*
EBIT	162	139	162	138	212	235	308	392
EBIT Margin (%)	*31.9%*	*22.8%*	*23.1%*	*22.3%*	*25.5%*	*23.8%*	*26.0%*	*27.3%*
Profit before tax	200	174	206	157	233	265	346	436
Net profit	143	125	150	126	164	193	252	318
Net profit post minorities	143	125	150	126	164	193	252	318
Headline earnings	143	125	143	127	164	193	252	318
% Change		*-13%*	*14%*	*-11%*	*30%*	*18%*	*31%*	*26%*
Diluted EPS (ZAc)	9.30	8.17	11.0	10.2	12.8	15.0	19.5	24.5
Headline EPS (ZAc)	9.30	8.17	10.7	10.3	13.4	15.8	20.5	25.8
% Change		*-12%*	*31%*	*-3%*	*30%*	*17%*	*30%*	*26%*
DPS (ZAc)	4.0	4.3	5.0	5.5	7.5	9.2	13.3	18.0
Payout ratio (%)	*43%*	*52%*	*47%*	*53%*	*56%*	*58%*	*65%*	*70%*
Balance Sheet								
Cash and Cash equivalents	513	611	505	538	533	612	721	837
Current asset (ex – cash)	94	70	92	67	146	173	207	250
Net Fixed assets	15	22	29	26	24	31	43	59
Intangible assets	800	791	791	790	825	800	773	743
Investments	46	45	24	42	68	69	74	80
Other assets	3	5	7	19	4	5	7	9
Total assets	**1,472**	**1,545**	**1,448**	**1,481**	**1,600**	**1,691**	**1,826**	**1,978**
Debt	0	4	8	9	9	0	0	0
Current liabilities	44	59	90	71	86	96	113	134
Other liabilities	36	35	41	25	22	21	24	27
Total liabilities	**79**	**98**	**139**	**105**	**116**	**117**	**137**	**161**
Shareholders' equity	1,392	1,447	1,309	1,376	1,483	1,574	1,689	1,816
Minorities								
Total shareholders' equity	**1,392**	**1,447**	**1,309**	**1,376**	**1,483**	**1,574**	**1,689**	**1,816**
BVPS (ZAc)	*0.9*	*0.9*	*100*	*105*	*113*	*120*	*129*	*139*
ROE (%)	*10.2%*	*8.9%*	*10.9%*	*9.4%*	*11.5%*	*12.6%*	*15.4%*	*18.1%*

Year Ending	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023 F	FY2024 F	FY2025 F
Cash Flow								
Reported net profit before tax & interest	**162**	**139**	**162**	**138**	**212**	**235**	**308**	**392**
Change in net working capital	-13	52	24	19	-60	-16	-14	-18
Interest (paid)/received	9	-27	-22	-45	-61	-73	-112	-163
Tax paid	-61	-62	-58	-53	-57	-72	-94	-118
Depreciation	15	23	34	35	41	44	38	43
Other adjustments	2	0	-14	9	11	6	8	10
Cash flow from operations	**115**	**124**	**126**	**102**	**86**	**124**	**134**	**146**
Net Capex	-5	-15	-17	-7	-17	-20	-24	-29
Capex/sales (%)	*0.9%*	*2.5%*	*2.5%*	*1.1%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
Other investing cash flows	-583	-5	22	-51	-51	-4	-7	-7
Cash flow from investing	**-588**	**-20**	**5**	**-58**	**-68**	**-23**	**-30**	**-36**
Equity raised/(bought back)	-41	-7	-227	-1	-14	0	5	6
Net inc/(dec) in borrowings	-19	-3	0	0	0	-11	0	0
Other financing cash flows	0	0	-9	-8	-9	-11	0	0
Cash flow from financing	**-61**	**-10**	**-236**	**-9**	**-23**	**-21**	**5**	**6**
Net cash flow	**-534**	**94**	**-105**	**35**	**-5**	**79**	**109**	**116**
Free cash flow	**110**	**109**	**147**	**154**	**107**	**171**	**214**	**270**
Repayment of lease liabilities	**0**	**0**	**-6**	**-8**	**-9**	**-11**	**0**	**0**
Net Free cash flow	**110**	**109**	**141**	**147**	**98**	**161**	**214**	**270**
Valuation Summary								
Valuation Metrics								
Share Price (ZAc)	80	74	57	99	161	161	161	161
P/E (Underlying) (x)	0.1	0.1	5.3	9.6	12.0	10.2	7.9	6.3
P/BV (x)	0.9	0.8	0.6	0.9	1.4	1.3	1.2	1.2
EV/Sales (x)	3.0	2.5	2.2	2.5	1.9	1.6	1.3	1.1
EV/EBITDA (x)	8.7	9.6	7.8	8.9	6.1	5.5	4.5	3.5
EV/EBIT (x)	9.5	11.1	9.5	11.2	7.3	6.6	5.0	3.9
FCF Yield (%)	5.2%	5.2%	6.7%	7.0%	4.7%	7.6%	10.2%	12.8%
Dividend Yield (%)	5.0%	5.7%	8.8%	5.6%	4.7%	5.7%	8.3%	11.2%
Net debt	-480	-569	-436	-502	-506	-596	-705	-821

Source: Company data, FactSet, ASB Research

Company Overview

Capital Appreciation (CAPPREC), listed on the JSE in September 2015 as a SPAC (special purpose acquisition company), raising R1bn in capital. From its first acquisition, its focus was on Fintech. Its founders are all prominent SA business executives (see Appendix 1) and therefore received strong support in the capital raise. After a slow start, in 2017 the company made numerous investments. It acquired two electronic payment businesses in SA, namely African Resonance and Dashpay. At the same time Synthesis Software Technologies was acquired and created a separate investment pillar, focused on software in the financial services sector that compliments the payment operations. These three primary operations are covered more extensively in the report.

In May 2019 CAPPREC bought 35% of GovChat, a B-BBEE technology enterprise and a social engagement platform for connecting government to people and people to government, for R1 and committed to provide R20m of enterprise development funding. A further R28.8m of loans was granted in FY22 to continue the development of the technology platforms. Through digitisation, the platform enabled the application for social relief packages by more than 13.3m recipients. Synthesis developed the cloud-first hyper-scale platform for GovChat and continues to provide technical guidance and support to the company. After a year-long investigation, the Competition Commission has referred Meta Platforms/Facebook/WhatsApp (GovChat makes extensive use of WhatsApp for its messaging) to the Competition Tribunal for abuse of dominance. This action is the result of GovChat's challenge of Facebook/ WhatsApp's attempts to terminate its use of their service. This is an important milestone for GovChat and goes a long way to ensure that the GovChat service offering will remain available for use by both the Government and the citizens of South Africa.

Synthesis began the inhouse development of Halo Dot in 2020. Halo Dot is SoftPOS technology - software that enables contactless payment acceptance on any NFC enabled Android device. Halo Dot currently has three customers in SA, including Nedbank and Telkom, and is pursuing local and global expansion opportunities. There is significant upside should Halo Dot gain traction. Dashpay, through its Dashpay Glass offering (utilising Halo Dot as its underlying technology), is utilising the software application to penetrate the SMME market in SA.

The group acquired a 26.5% (currently 27.4%) stake in start-up LayUp Technologies in January 2021 with the right to increase ownership over time. LayUp is Africa's first fully digital Lay-by and recurring payments business and has PASA (Payments Association of South Africa) certification. Electronic payment functionality is making Lay-by a fast-developing purchase alternative. To date R6.4m has been invested in LayUp and a R5m loan has been provided for working capital funding to further develop its systems and grow the business. Buy now, pay later (BNPL) is a growing global industry with the likes of Apple getting involved. Its gaining traction in SA with providers like payflex, PayJustNow and mobicred. Tyme Bank also offers this service to its account holders. Whilst BNPL differs to Lay-by purchasing (in Lay-by the product is only exchanged after the final payment and no credit risk is taken), innovative ways of increasing affordability are key to growth in the payments industry.

In 2021 Synthesis opened an office in the Netherlands to expand its offering globally and to facilitate skills retention and migration. It's a small office but will work closely with the Halo Dot team to promote the adoption of Halo Dot globally.

Effective 1 March 2022, The Responsive Group, comprising three SA financial technology companies was acquired for R48.68m, settled with treasury stock and cash. A further R8.5m (20% stake) was invested in Regal Digital (as part of the Responsive transaction), a technology company in the Netherlands. These businesses provide technology solutions, services and related technical support services to financial institutions and others in the financial services and Fintech sectors. The Dutch operation has a particular focus on the next generation technologies, including Blockchain, NFTs (non-fungible tokens) and Web 3.0 advances.

Whilst owning these businesses, additional spend has occurred in increasing the scale of its operations and optimising its corporate structure to reflect that expected of a growing listed entity.

Despite these investments, and post dividends and share buy backs, the company still has R533m of cash resources at 31 March 2022 and therefore continues to look for opportunities to further expand its Fintech portfolio. The company sees on average three opportunities per month, implying very conservative acquisition criteria given the low number of transactions concluded over the past five years. Potential Fintech acquisitions can be in varying stages of development and therefore profitability is not a key determinant. Of utmost importance is the leadership team and a product or solution that has visible market traction.

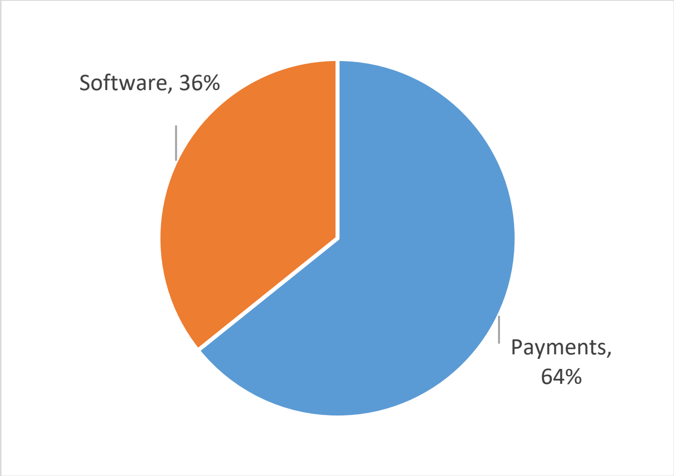
Value wise, we believe the company could acquire an asset up to R2bn in value given its cash resources, treasury stock, zero debt and its ability to access the capital markets. A capital raise could be an opportunity to broaden its institutional shareholder base.

Figure 2 Group operational structure

Source: Company data, ASB Research

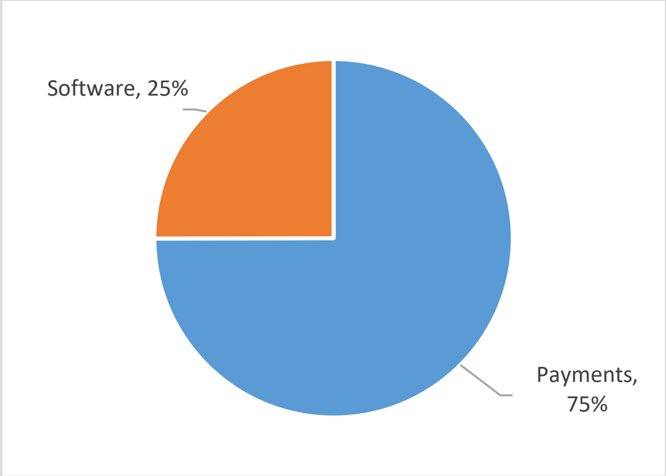
The group is segmented into four operations, Payments, Software, International and Enterprise Development (GovChat). The latter two are not contributing positively to earnings at this stage of their development and therefore we focus largely on Payment and Software. Payments accounts for 64% of revenue and 75% of EBITDA in FY22 (pre-central corporate costs).

Figure 3 Revenue split – FY22



Source: Company data, ASB Research

Figure 4 EBITDA split – FY22



Source: Company data, ASB Research

Payments Division

This division is focused on activities generally associated with "merchant acquiring" – allowing merchants to accept payment from retail customers electronically, most notably payment by credit and debit cards. Customers range from the largest banks to SMME merchants with each availing itself of a different offering.

A large element of this division is "Payment Infrastructure" – the supply and management of point of sale (POS) terminals combined with bespoke software to the large SA banks. The banks in turn provide these devices to their retail merchant clients. These terminals facilitate payment between the merchant and its retail customers and the subsequent receipt of the proceeds from the bank. These devices are evolving to become more than just a payment mechanism. Value-add services are being incorporated into them, facilitating a greater target market outside of traditional retail.

African Resonance's key differentiator is the proprietary software that resides on each device, allowing the estate of devices to be monitored and managed remotely. This solution saves its bank customers material amounts in operating and maintenance costs.

The second element of the Payments division offering is "Payment Services" – providing a range of solutions closely aligned with a purchase transaction to banks and also directly to merchants.

SoftPOS is also being pursued (primarily through Halo Dot) as it's a fast-developing market given its ability to target smaller independent retailers and SMME's that fall outside the scope of the major banks. There is no requirement for additional hardware as payment is made off phones or tablets utilising software.

The three primary payment mechanisms utilising POS devices includes debit cards, credit cards and mobile wallets.

Before we focus on African Resonance and Dashpay we provide some colour on the distribution of the devices or software as well as the payment mechanisms being used.

Distribution of POS devices

Through a bank

These tend to be established formal retailers that have a relationship with their banks and high volumes of transactions. In this model the banks acquire the POS devices from CAPPREC and make them available to their merchant retail customer. In most instances the merchants pay the bank a monthly rental fee and also a small fee based on the value of each transaction. In this instance the bank remains responsible for service and maintenance of the terminal.

The supply, software installation, security activation, management, repair and call centre assistance is outsourced to CAPPREC for a monthly fee per terminal. Relationships exist with all the major SA banks with varying degrees of service. CAPPREC derives no transactional volume-based revenue from these devices, that is solely for the banks. The average life span of each POS terminal is approximately 5 years, although this is starting to shrink as terminals emerge with new technologies and capabilities.

Management refers to this as the enterprise model and it's the primary source of revenue and focus for the payment business.

Independent Sales Organisation (ISO)

CAPPREC (predominantly through Dashpay) acts as a third-party payment processing company that's authorised to handle merchant accounts for business. ISO's have relationships with acquiring banks, allowing them to provide merchant acquiring services directly to merchant customers. In essence the ISO is an intermediary between the merchant and the bank. Terminals can either be purchased by the merchant or rented. Bespoke payment and terminal management software is installed on each device and a form of transactional revenue (commission) is earned. The ISO is responsible for the terminals and servicing of the clients' needs.

Aggregators

In this model CAPPREC (through Dashpay) is appointed by retailers, generally a micro retailer or SMME, and is sponsored by a bank to provide payment processing in bulk. Sign up is swift and involves less upfront administration. The retailer is not required to make any arrangements with the likes of a Mastercard or Visa as this is handled by the aggregator. The service offering is designed to minimise up-front friction costs and reduce challenges with initiating the service. Receipt of payment could take longer for the retailer as the aggregator receives payment from the bank and needs to make the necessary allocations. It's a very flexible and cost-effective model for SMME's and allows almost anyone the ability to accept card payments.

Within the Dashpay Aggregator offerings is a new service branded Dashpay Glass. This offering is built on the Halo Dot technology developed by Synthesis and requires no additional payment hardware. Any party with an NFC enabled Android device can sign up for this service offering. Halo Dot is a software solution that turns any NFC enabled Android device into a payment acceptance device. This is very well suited for owner operated businesses and SMME merchants. Sign-up, activation and payment acceptance is digital and streamlined.

Payment mechanisms utilising POS devices

Debit Cards

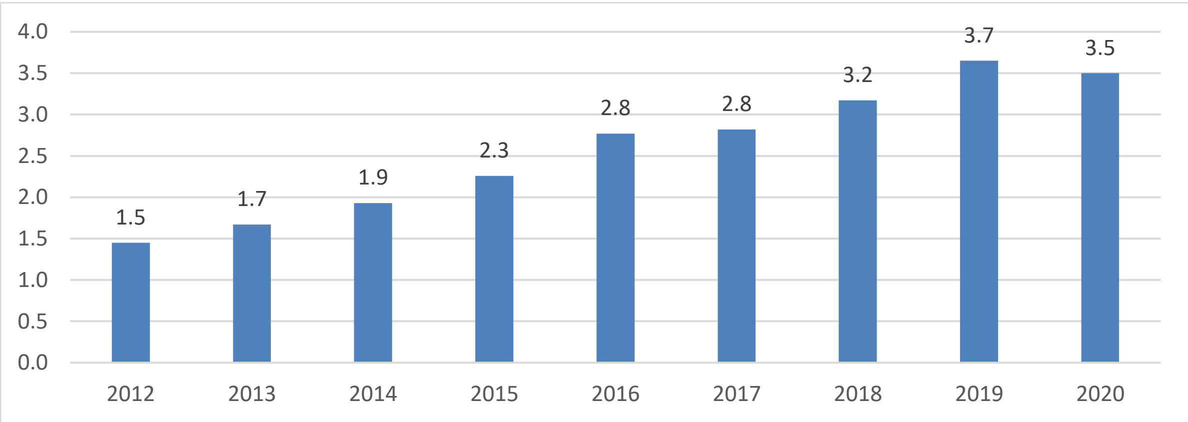
Visa and Mastercard share the debit card market almost equally in SA with Visa marginally ahead. Total debit cards issued in SA is approx. 38m (approximately 4x more in circulation than credit cards). This is likely to receive a boost from digital bank entrants and new SASSA based Visa cards issued to grant recipients by the Post Office.

SA has a high population penetration rate of debit and credit cards compared to many emerging markets, particularly in debit cards. It does, however, lag China, Brazil and Russia. This is largely due to a strong drive to bank the unbanked over the past two decades with operators like Capitec making a significant impact, attracting 8.9m active customers. It's estimated that debit card penetration is at circa. 64 per 100 individuals.

Credit Cards

Credit cards are not used as extensively as debit cards in SA, however, average transaction values are higher for credit cards given bigger ticket purchases such as travel. Visa and Mastercard account for approx. 95% of all cards issued in SA with Visa having a slightly higher market share than Mastercard.

Figure 5 SA volume of card payments – bn



Source: BIS, ASB Research

There was an estimated 3.5bn number of card payments (incl e-money) in SA in 2020, up significantly from 1.5bn in 2012.

Mobile Wallets

Due to high smart phone penetration in SA, mobile wallets have gained significant traction and it's estimated that around 40% of consumers are actively using a mobile wallet in SA. Payment is either via NFC (Near Field Communication) or QR code payments. The banks wallet offerings are the dominant forms of payment, followed by Snapscan and Samsung Pay. Since April 2021 Apple Pay has been recognised in SA. These wallets are most frequently linked to the consumers' debit card or bank account with the wallet acting merely as a substitute instrument (instead of the card itself).

African Resonance (AR)

AR deliver "Payment Infrastructure" services and deals primarily with the major banks and has limited direct merchant exposure. Its focus is therefore on the enterprise model. Revenue is not transaction based, rather gross margin from sales of devices, recurring management income during the lifespan of the device, revenue from terminal repair services and software fee income associated with payment application development.

Founded in 2003, AR is SA's leading provider of payments infrastructure and related services to financial Institutions, emerging payments service providers, the hospitality industry and retail operators. It's the local (but not exclusive) partner to Ingenico (since 2003), the world leading manufacturer and supplier of payment devices and is recognised as one if its centres of excellence. Through the relationship Dashpay has with Newland (see below), in addition to Ingenico devices, AR can offer its enterprise clients access to the Newland range of devices too. All the services AR provides with respect to Ingenico devices it can make available on Newland devices. The ultimate choice of device type rests with each individual bank.

In addition to the supply of the actual hardware device, the following activities are part of the services it offers to its clients (managed solutions):

- Payment application development and certification
- Key loading – it loads the security keys into devices to ensure safe and secure payments.
- Asset tracking – through its inhouse software each terminal communicates its hardware status, daily heartbeat status and error loggings on a regular basis.
- Estate management – AR provides a turnkey solution to financial institutions. Devices have a 5-year lifespan and throughout this period AR will support the devices ensuring the clients achieve optimal results.
- Data network and location tracking – AR has developed a high resilience MPLS data network that has been optimised for payment terminal communication ("Resonet"). Through the Resonet service each active device can be monitored through both the MTN and Vodacom networks. Resonet also provides solutions that allow connectivity through a merchant's own internet connection. This provides incremental redundancy, device tracking and facilitates additional value-add offerings. This is not a common feature from other service providers.
- Logistics and distribution of terminals – AR has developed a Rapid Relationship Response Team (R3) which differentiates it from its competitors. R3 is comprised of highly skilled technicians that provide a rapid response to client issues. In addition, it utilises a national network of couriers to ensure 24hr delivery and activation of devices nationwide.
- Call centre support – this is 2nd level support that assists with the pre-deployment confirmation, merchant validation and activation as well as merchant and technical problem analysis and resolution. Call centre agents have an 85% problem resolution rate within 15 minutes of a call being received.
- Terminal repair - AR is a certified and authorised repair centre for Ingenico terminals in SA as well as certain African countries. All repairs are performed within Ingenico guidelines and reported to them.

Through their banking partner, merchants can subscribe for value-add services on their terminals, for example remote access and management of their terminals via the cloud. This is an additional source of revenue.

Ingenico Point of Sale (POS) Devices offered by AR

Ingenico's terminal device range has two platform alternatives – the traditional payment terminals that are developed in a Linux environment and more recently payment terminals developed to operate in an Android environment.

Linux Devices
Linux is by far the most dominant (it also accounts for the bulk of AR's terminal estate) and what most retail customers are accustomed to. It allows the customer to swipe, insert or hold a credit or debit card near the device to capture the information and transmit it to the bank for authorisation and settlement. These

systems are often connected to point of sales systems (such as cash registers) so that the sale can be recorded automatically to the merchant's management system. The Linux architecture is a very secure proprietary platform that is relatively strict in its requirements and limits bank and retailer innovation. The range of devices is extensive with each best suited for a particular use or operating environment.

Figure 6 AR – Linux device models

Source: Company data, ASB Research

Source: Company data, ASB Research

- Move series – designed for indoor and outdoor use, these are mobile units. Some have printers to issue a receipt.
- Desk series – these are high volume usage devices that are resilient in build. They can be linked to external devices at the merchant and are not mobile. Additional features can be added to these machines.
- Lane series – these are Pin Entry Devices for retailers that can also include signature or biometric verification and are most frequently seen at large supermarkets in SA.
- Link series – these are mobile lightweight pocket-sized terminals that can be used with 3G, Wi-Fi, and Bluetooth. This is an ideal solution for mobile merchants as its various connectivity options ensures network availability.

Android Terminals

Ingenico hardware that uses an Android platform, like that on a smartphone. Devices can appear as tablets or as Linux styled POS devices. The most notable difference is the absence of keys and buttons with the screen acting as a virtual keyboard (like a traditional smartphone). The Android platform is a more open platform that allows for application development in a manner very similar to a smartphone. The user interface is also more flexible and allows for greater customer engagement. It offers the merchant flexibility for the development of additional features and applications such as loyalty cards, delivery options or location-based services.

Figure 7 AR Android device models

AR also offers merchants self-service terminals which are popular in vending machines, parking payment machines, petrol stations, supermarkets, fast food outlets etc. This is currently a very small component of the business but will gain traction as evidenced by trends in Europe.

Dashpay

Dashpay started out as an aggregator in 2013 but has evolved into a multifaceted payments business that provides payment devices, operates as an ISO and as an Aggregator. As a result, Dashpay has relationships with various banks that help facilitate its transactions and transactions on behalf of its merchant clients, relationships with traditional retailer merchants and increasingly with smaller SMME retailers. Dashpay has a robust software development capability and is well positioned to tailor software to its clients' needs and earn a revenue-based fee.

Dashpay devices are manufactured by Newland Payment Technologies, a Chinese manufacturer that has specialised in Android platform device types. Dashpay has the distribution rights for Newland devices in South Africa and the greater SADEC region. Newland competes with Ingenico and is the second largest manufacturer of payment devices globally.

Figure 8 Newland product range – within each category there are numerous models

Source: Company data, ASB Research

Dashpay approaches the market with dual purposes. Non-traditional enterprise clients that have networks that can benefit from a payment ecosystem, e.g., the Attacq property group that was looking for a unified solution for its retailer tenants. Its typical target market, however, is SMME retailers that require quicker and simplified access to POS solutions. The entire application process is electronic. Its hardware offering is as broad as AR's, covering desk-based systems, mobile systems, Pin pad devices, cash registers and Android devices. Customers have access to a Dashpay online portal that gives them visibility of all the transactions processed on the terminals.

Dashpay is evolving with the electronics payment industry, expanding into SoftPOS, enhancing value-add services to clients, breaking into new industries (for example its joint venture with Attacq) and delivering cost effective solutions.

The launch of Dashpay Glass is an important evolution of Dashpay's payment services offering. Utilisng Halo Dot's technology, it's a SoftPOS App that can be white labelled by customers who want to rapidly deploy their own SoftPOS application. The SMME merchant market is the primary target. The service is in the soft-launch phase and will be formally released later this year.

Summary of Payment division's operations

CAPPREC is at the leading edge of electronic payment technology with the benefit of creating internal IP such as Halo Dot. This ensures it can swiftly adapt to market changes and trends ensuring its clients remain relevant.

It's enterprise model with the major banks is unrivalled in the SA market given its extensive offering ensuring that banks have minimal involvement in the process whilst delivering a superior service to their clients.

CAPPREC is in a unique position given it has two leading payment businesses in the SA industry. These businesses are free to compete and each targets a different market ensuring broad based coverage of clients' payment needs. We see the benefits of this structure as follows:

- Should AR's bank clients look for an alternative solution provider (for example a switch away from Ingenico devices), Dashpay is a very likely candidate given its relationship with Newland and its shared high standard of support and value add services.
- Dashpay provides the group with a platform to approach retailers directly. AR is focused on servicing the banks and would be cautious not to compete with them.
- Should the traditional desktop POS model come under pressure, the extensive offering of alternative devices between AR and Dashpay should satisfy such a transition. Halo Dot will also play a key role.

- Should Ingenico or Newland decide to partner, on an exclusive basis, with a competitor, it still leaves CAPPREC with a competitive offering. We see the chances of this happening as slim.

Finally, having a software innovator like Synthesis in the group enables it to ensure its devices are all market relevant and keeping up with technology innovation.

Outlook for the payments industry

Competition in SA

To affect a payment requires access to clearing. Clearing encompasses the activities from the time of transacting until the transaction is settled. It essentially turns the promise of payment via an electronic request into the actual movement of money from one account to another. In SA this is accomplished through the National Payment System of which the major banks are participants. Visa and Mastercard play an important role in ensuring global standards are adopted and that cards issued by international banks operate as efficiently as those issued by domestic banks.

The bulk of POS devices in SA are distributed to merchants directly by banks (as with AR) and this would require meeting their strict procurement criteria, which we assume would include:

- A healthy balance sheet. AR needs to import the devices, manage the FX, and carry the necessary working capital to complete the transaction.
- The ability to develop payment software to allow each device type to interface with an individual bank's system (each bank has a different backend with individual system requirements).
- The ability to secure the devices including the injection of key codes
- Maintain and service the devices. This would require a strong relationship with the suppliers.
- Have a national reach to ensure devices are timeously available to merchants.
- Ensuring adequate redundancy. AR has arrangements with MTN and Vodacom to ensure all devices have multiple communication redundancies.

We believe the above criteria impose a considerable barrier to entry to this core component of CAPPREC's payment activities.

Operating as an aggregator or ISO, as is the case with Dashpay, would also require the buy in from a major bank to act as the acquiring bank. Lastly for a Halo Dot SoftPOS model, the software is only effective if certified by Mastercard, Visa and Amex as they impose the security standards that govern card acceptance. However, competition in this space is likely to be higher and barriers to entry lower, particularly SoftPOS.

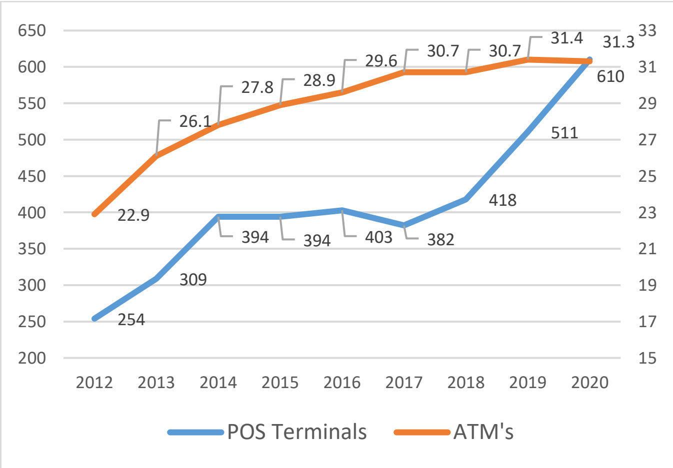
In SA there are numerous operators providing POS solutions to clients, including:

- Card Connect (part of the Connect Group recently acquired by Net1). They don't supply Ingenico or Newland devices but do offer Verifone which would be the third largest POS terminal company globally. They are well accredited partners to the major banks and have nearly 44 000 SMME clients in Southern Africa.
- Net1. They also distribute Ingenico devices.
- NuPay, a division of Altron. They are primarily hardware suppliers.
- Yoco. Targeting smaller retailers with simplified and lower cost structures. It has seen explosive growth over the past two years with 80% of its customers never having accepted digital payment before. It is therefore not competing for existing business but future growth.

- Wizzit. A global operator in mobile payments. It has recently partnered Absa to provide it a SoftPOS solution.

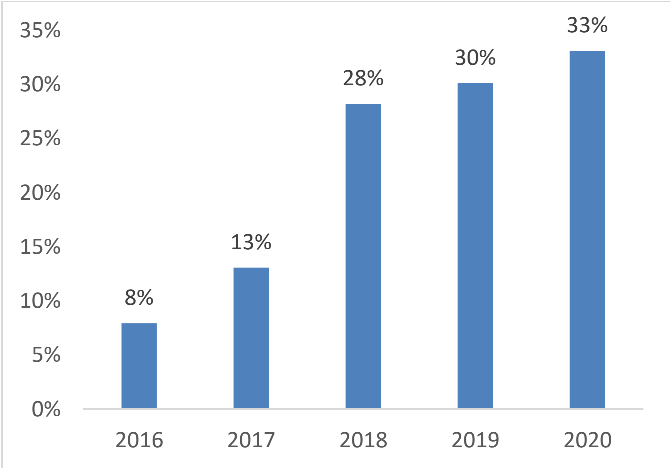
There is healthy competition in the market but key to CAPPREC's success is its partnerships with all the major banks and its stronghold in the enterprise POS market. Its success is evident by its ongoing increase in market share. There were an estimated 610 000 POS terminals in SA in 2020, up considerably from 254 000 in 2012. At 30 Sep 2020 CAPPREC disclosed an estate of 259 000 terminals, an estimated 33% market share, up considerably from 8% in 2016.

Figure 9 SA POS terminals (LHS) and ATMs – '000



Source: BIS, ASB Research

Figure 10 CAPPREC estimated market share of POS terminals



Source: Company data, ASB Research

Despite being around for a considerable period and the less reliance placed on cash, ATM numbers in SA still rose around 3% CAGR over the period 2016 to 2020 (approx. 32 000 in circulation). POS terminals grew by a 11% CAGR over the same period.

Shift away from dedicated POS devices

A threat to the traditional POS device is the use of SoftPOS. Essentially this is turning your phone/tablet into a POS terminal by downloading software (i.e., no hardware required). SoftPOS will find traction among small SMMEs, but its settlement speed and security is unlikely in our view to see it replace POS terminals in mainstream retail, the core to CAPPREC's payment revenues. Growth in SoftPOS is more an opportunity (through Dashpay Glass) than a threat for CAPPREC.

POS devices remain versatile. They can accommodate biometrics, e-commerce, crypto currency payments and more importantly offer value-add services which are beneficial to the merchant's business apart from payment acceptance. Their integration into the merchants reporting (incl via the cloud) makes them relevant for many years to come.

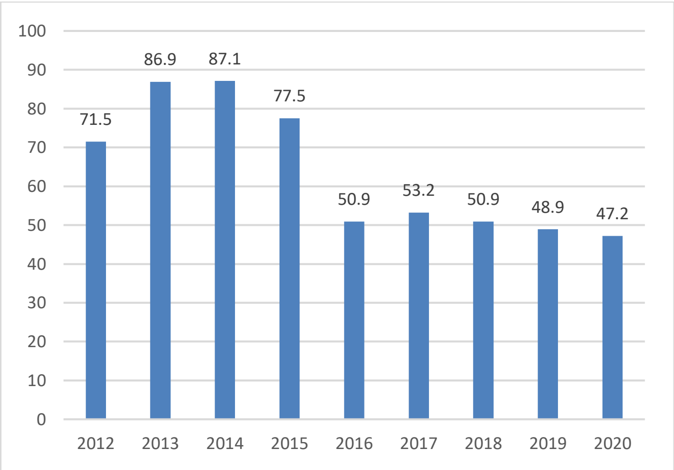
Outlook for terminal growth

We believe the future existence of payment devices is secure and growth prospects are promising given the ongoing move away from cash transacting. Devices have evolved with their customers' needs and the value-add services are creating more interest in the solution. Cards are being replaced by mobile phone wallets, but the POS device is still the key payment enabler that interacts with wallets, wearables and other payment forms as easily as they do with physical cards

We see the following key drivers behind growth in the industry:

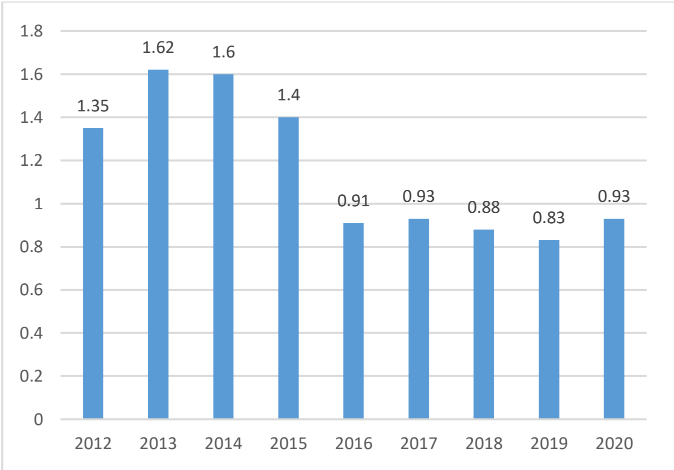
1. % Unbanked – scope for steady gains

Figure 11 Number of payment cards in SA - mn



Source: BIS, ASB Research

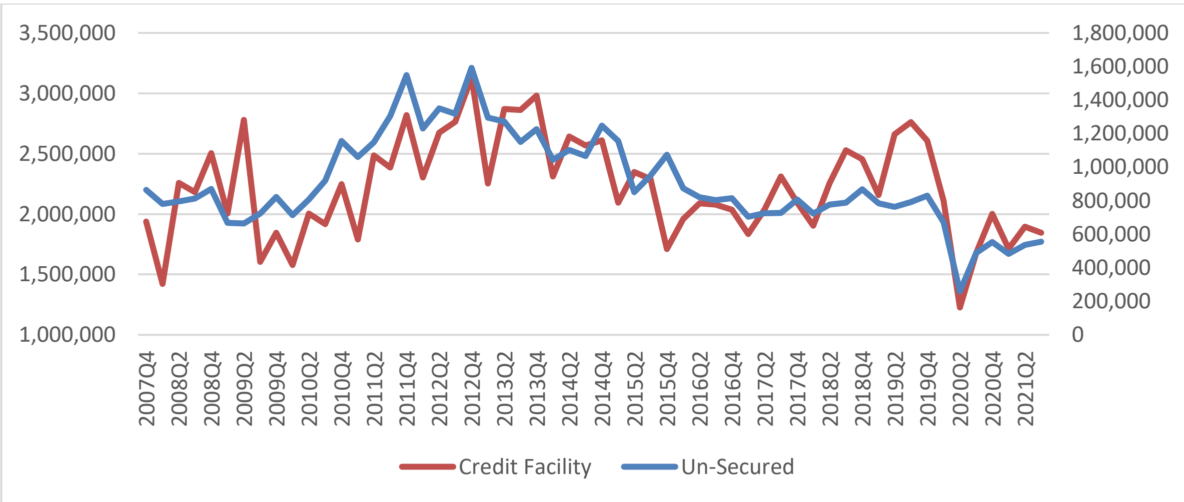
Figure 12 Cards per SA inhabitant



Source: BIS, ASB Research

The total number of payment cards in SA is estimated at 47.2m in 2020. This represents a penetration of 0.93x per consumer. Card issuance has declined from its peak of 87.1m (1.6x penetration) in 2014 reaching a more stabilised level over the past five years. We believe this decline is largely due to a decline in unsecured lending and credit facilities (including store cards and credit cards) which in number and value terms peaked in Q42012, as is evident in the chart below.

Figure 13 Unsecured lending & credit facilities (LHS) volumes

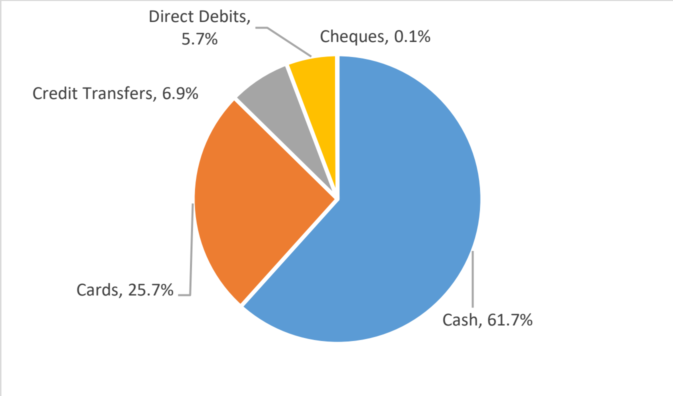


Source: NCR, ASB Research

After the consolidation in SA card numbers, we anticipate the numbers and penetration per inhabitant to rise steadily from this base. With penetration rates of 1.8x in Brazil and 2.5x in the UK for example, there is considerable upside. The traction seen in digital banks like Tyme Bank, Discovery Bank and further inroads made by Capitec Bank and African Bank, bode well for increased card penetration. SASSA grant recipients are also moving into more card-based transacting as many receive Visa-branded cards to enable them to transact.

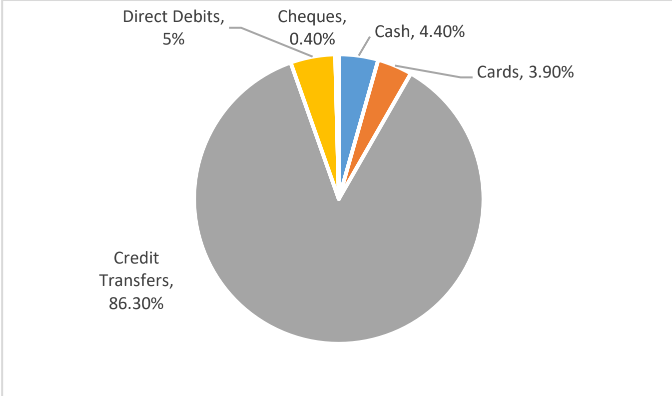
2. Cash utilisation to decline sharply

Figure 14 Breakdown of SA transaction volumes - 2020



Source: BIS, ASB Research

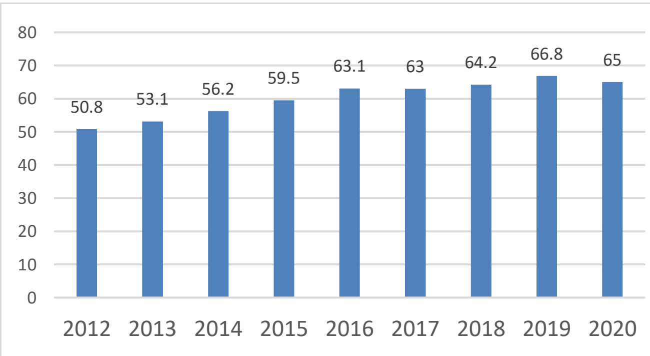
Figure 15 Breakdown of SA transaction values - 2020



Source: BIS, ASB Research

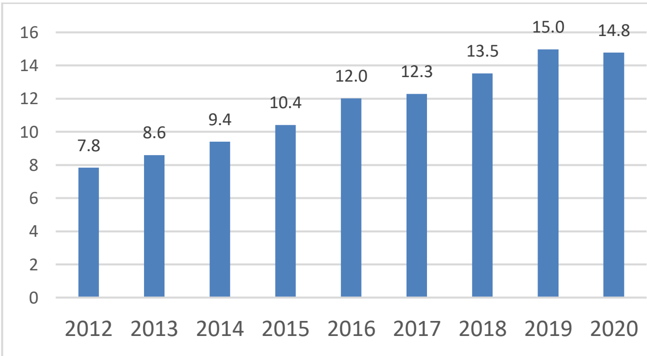
SA remains a cash dominated payment society. BIS research suggests 61.7% of payments in SA are cash based, 25.7% cards, 6.9% credit transfers (e-commerce) and 5.7% debit orders. Cheques are no longer accepted. Measured by value this changes considerably with cash declining to 4.4%, still ahead of cards.

Figure 16 % of cashless payments in card



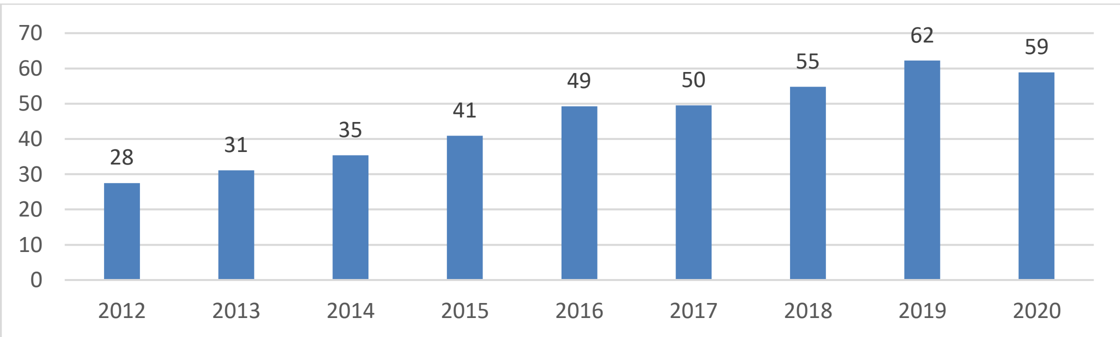
Source: BIS, ASB Research

Figure 17 Daily ave cashless payments per day (mn)



Source: BIS, ASB Research

Figure 18 SA annual card payments per inhabitant

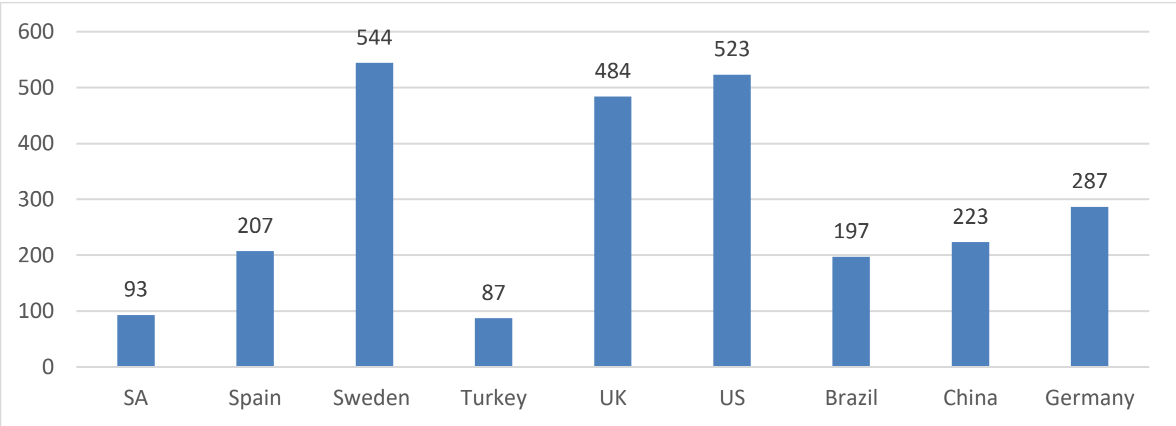


Source: BIS, ASB Research

Over the past eight years cash transacting has consistently declined in SA. In Figure 17 above, we can see that the average daily cashless payments in SA have risen from 7.8m in 2012 to 14.8m in 2020. Cards have been a beneficiary of this trend as highlighted in Figure 16, with card becoming a greater proportion of non-cash transacting – increasing from 51% in 2012 to 65% in 2020. Figure 18 further highlights the increased utilisation of card. However, there has been a slowdown in cashless payments by card from 2016 due to the decline in cards in issue. Growth was further negatively impacted with COVID-19 when consumers were cash flush following lockdowns and the receipt of additional social benefit payments.

COVID-19 has been a catalyst to accelerate the move away from cash given hygiene risks and higher tap and go limits making cards ever more convenient. Mastercard data indicated that contactless transactions grew by 13% in March 2020 compared to March 2019. Capitec recently disclosed that it had 34 million tap to pay transactions in the 6 months to August 21 (up more than 100%). Mobile wallet usage is also rising with strong growth still anticipated as SA lags many emerging markets in this regard.

Figure 19 Ave number of cashless transactions per inhabitant - 2019



Source: BIS, ASB Research

Relative to EM peers, SA does not fare too badly on its shift away from cash, but lags Brazil and China. Achieving the levels of cashless payments per inhabitants of developed markets like the UK, USA and Sweden (see Fig 19) boasts significant upside for card transaction volumes. With a relatively low unbanked population, narrowing this gap is achievable. Germany has traditionally favoured cash, but this is changing at a rapid rate.

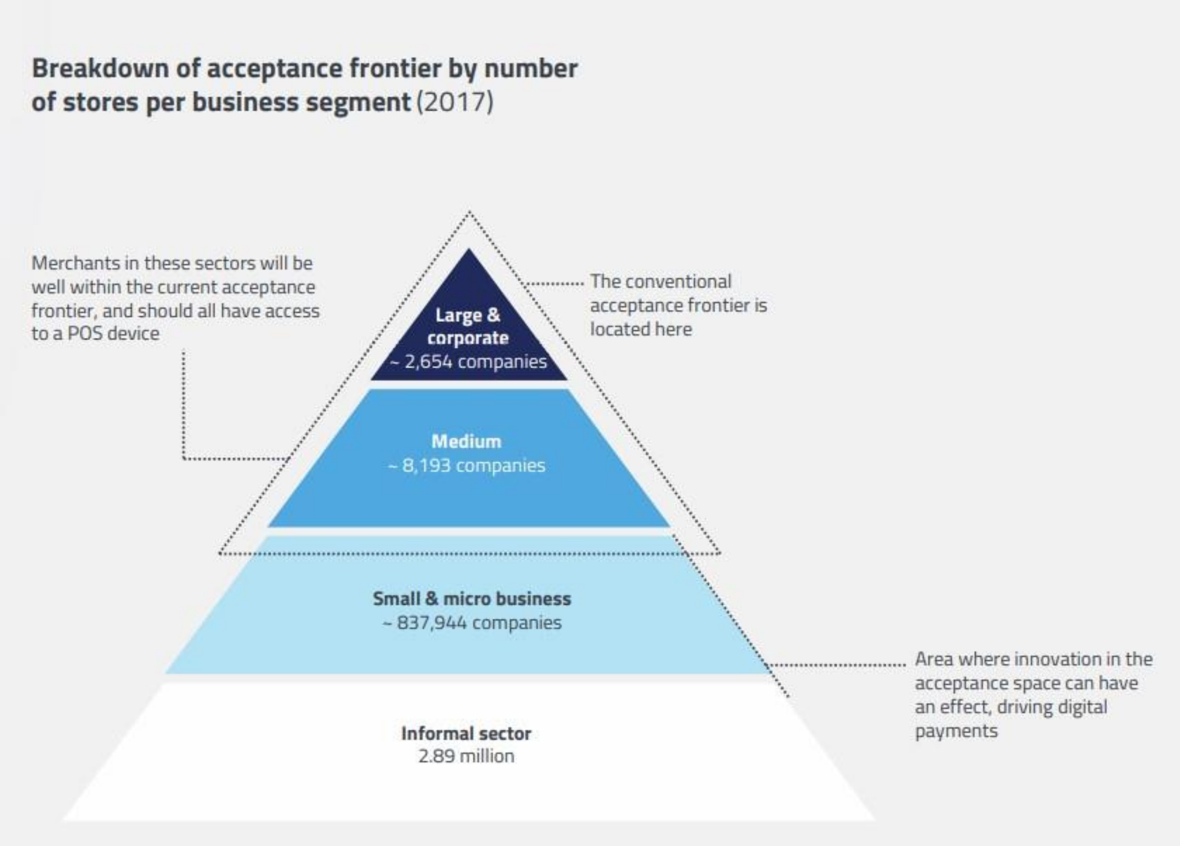
We see the move away from cash in SA as a key driver to increased terminal numbers by retailers and increased usage positively impacting transaction-based revenue.

3. Increased retailer penetration

Traditionally banks favoured their large retail customers for the provision of POS devices. Aggregators and ISO's have widened the distribution of devices but there remains a considerable number of retailers without electronic payment functionality in SA. The challenge is to provide cheaper, mobile and easy to use devices or SoftPOS solutions to this market.

In the chart below the potential in small & micro business as well as the informal sector is highlighted. The number of stores in these segments is a multiple of what is currently being serviced with POS terminals. SMME's hold significant potential for the growth in POS devices. The generation of transaction-based revenue would be the key revenue driver at this end of the market.

Figure 20 SA merchants' profile



Source: SA payments statistics, BIS, 2019

4. Value-add services facilitated by POS devices

In a world that is fast digitalising, data is becoming a key corporate asset. POS devices process huge amounts of data which if stored appropriately can be analysed and utilised for efficiencies and marketing purposes. We see the following value add services offered by POS devices:

- E-commerce facilitation
- Loyalty programmes
- Vouchers
- Inventory management
- AI assistance
- Data analysis
- Apply for finance through the terminals
- Lay-by purchasing
- Incorporated camera or biometrics for alternative security procedures when customers don't have a physical card or mobile wallet.

Retailers are therefore incentivised to offer card/wallet payments to enjoy these benefits and ensuring they remain relevant to their customers changing needs.

5. Economic growth

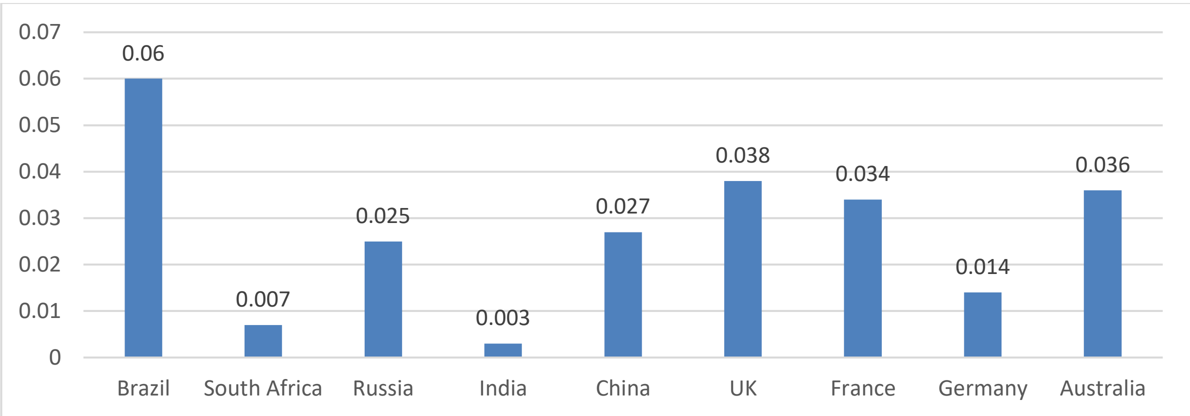
It goes without saying that economic growth supports spending and therefore it will impact spending volumes and values through POS devices. The outlook for a gradual economic improvement in SA's economy should provide some underpin to transaction volumes.

Risks to growth

- E-commerce. - Capitec indicated 1m of its customers are shopping online, >100% increase YoY. E-commerce grew by CAGR 22% from 2016 to 2020 according to GlobalData as penetration of smartphones and internet access rose. A CAGR of 13.9% is expected to 2024. Of the spend approximately one third is via card payments, the rest is bank transfer. POS devices can be enabled to facilitate e-commerce.
- In-house distribution of POS devices by the major banks. We see this as low risk given that the banks once managed their owned POS and ATM networks only to outsource them. Management of both comes with considerable investment.
- Use of crypto for payment. POS devices can facilitate this.
- SoftPOS - eliminates the need for hardware sales. Dashpay and Halo Dot are well positioned in this market.

Summarised outlook for terminal growth

Figure 21 POS device penetration per individual - 2020



Source: BIS, ASB Research

Apart from India, SA lags others BRICS nations in POS device penetration per inhabitant. Relative to developed markets it is considerably behind as per the chart above, suggesting significant upside for the roll out of POS devices. Research done by Juniper Research sees greater penetration from mobile POS devices and forecast a 56% rise in the number of these terminals sold to 32m per annum (from 20m) in SA over the next five years. GlobalData forecast the SA market to have more than 870k payments devices by 2024 (CAGR of 9.3%), up from the current 610k in 2020. Management believes that the POS market in SA will exceed 800 00 devices by 2025.

The Far East and China are the most dominant global contributors to POS transaction values, followed by North America and Western Europe. India and Africa offer considerable upside, with both being of equal nonmaterial size in a global context.

We therefore have estimates of 7.5% growth in volume of transactions and 9.3% in POS terminal numbers over the next four years from 2020.

Synthesis

Founded in 1997, it has its roots in RegTech, regulatory reporting for banks and treasuries. In 2006 it introduced a digital channel offering and its first internet banking platform. This opened it up to a growing client base in the financial services sector. It began its journey to the cloud in 2014, long before most were aware of the technology. It initially implemented it internally to fully understand the offering before taking it to market. In 2016 it began its partnership with AWS (Amazon Web Services) and started cloud consulting. By 2019 it had achieved 28% CAGR EBIT growth over a 5-year period. In 2020 it made inroads into the payments space with the launch of Halo Dot and in 2021 introduced pin entry for SoftPOS.

Figure 22 Synthesis's prominent customers

Source: Company data, ASB Research

Effective 1 March 2022, The Responsive Group, comprising three SA financial technology companies was acquired for R48.68m, settled with treasury stock and cash. A further R8.5m (20% stake) was invested in Regal Digital (as part of the Responsive transaction), a technology company in the Netherlands. These businesses provide technology solutions, services and related technical support services to financial institutions and others in the financial services and Fintech sectors. The Dutch operation has a particular focus on next generation technologies, including Blockchain, NFTs (non-fungible tokens) and Web 3.0 advances.

Figure 23 Active Responsive Clients

Source: Company data, ASB Research

Synthesis has global aspiration that will ensure it remains ahead of global trends and secures a diversified currency revenue stream. In 2021 it opened an office in the Netherlands to expand its offering globally and to facilitate skills retention and migration. It's a small office but will work closely with the Halo Dot team to promote the adoption of Halo Dot globally.

Synthesis has over 245 employees, 80% are technical in nature. Historically customers are banks (all 6 major banks) and other financial services companies including major life insurers and certain asset managers. Its strong cloud and digital skills are opening new sectors such as retail (including their financial services offerings), healthcare (e.g., Vitality) and Telco's, however, financial services remains approximately 80% of its client base. It has expanded its focus into Africa by following its customer base, for example banks that require regulatory reporting in different jurisdictions. It has also expanded into Southeast Asia through a strategic relationship with a Singaporean based consulting firm

Services Offering

Figure 24 Synthesis's areas of expertise

Source: Company data, ASB Research

Synthesis's primary offerings include:

- Cloud consulting – this comprises approximately 35% of revenue and a key focus for the business going forward. Being a Platinum Amazon Web Services (AWS) partner places it well to attract new business. The business recently achieved the impressive milestone of 200 certifications, and it received the AWS Consulting Partner of the Year 2021 award for sub-Saharan Africa. This business continues to grow aggressively given the vast opportunities in the market.
- Digital & emerging tech – approximately 30% of revenue. It entails building digital channels such as internet banking and mobile banking, with security playing a key role in its offering. Services are project based and internet banking is an integral component. Services outside of financial services are also offered; it currently has a logistics client in Singapore which requires interaction with ports, couriers etc. Digital goes hand in hand with cloud which manages the ERP system. The GovChat venture is driven from this division. Clients include Capitec, Standard Bank, Afgri, Nedbank, TransUnion
- RegTech – around 20% of revenue. It entails automated reporting with speed, accuracy and data insight. It enters monthly, long dated subscription agreements with clients for regulatory reporting purposes, such as those for the SARB (e.g., Balance of Payments) and SARS (e.g., IT3b issuance). Its primary clients are banks and insurance companies. It covers regulators in SA, Namibia, Lesotho, Malawi and Eswatini.
- Intelligent data and Managed Services Provision (MSP) – combined circa 15% of revenue. Intelligent data entails large data projects aimed at analysing data for its clients and machine learning. Clients include Vitality, Woolworths Financial Services and four of the five major banks. Traditional MSP would entail managing data centres, servers and desktop hardware. MSP as pursued by Synthesis focuses primarily on the cloud and the management of its application at the client. MSP revenue is annuity based.
- Academy – a small component of revenue and not a core focus of Synthesis. It entails the delivery of customised technology training for clients' projects, predominantly cloud based.

- Payments and cryptography – two key products are Keystone and Halo Dot. Keystone is a PIN management solution used by major banks across Africa that enables view/change PIN functionality through any digital channel.

We've touched on Halo Dot in the Payments section of the report. There has been significant development spend in getting Halo Dot to market and a positive contribution to earnings is only anticipated by management in FY24. Halo Dot is not a consumer facing brand and is intended to be white labelled by those acquiring the App. Three different models exist to generate revenue, namely: a licence fee for the software, a user fee and a usage fee based on the level of volumes transacted. The product is undergoing extensive marketing, including globally through the Netherlands office. Its distinction from the other 18 SoftPOS providers that are Mastercard and Visa accredited (it has also been AmEx accredited) is that it's a cloud-based product, and therefore more versatile, and its functionality is modular and can be consumed piecemeal.

Responsive expands and compliments the groups offering to its core financial services clients. Responsive is a digital solutions group that designs and develops digital applications for clients. It recently launched numerous client apps in global money transfer and for an international credit bureau.

Regal Digital has two operating companies, Firelava and Flamelink. Firelava offers consulting service focused on Web 3.0, NFT's and Blockchain solutions, promising future trends in technology. Firelava offers a software-as-a-service (SaaS) solution to Google's Firebase for a Content Management System. Regal Digital will work closely with Synthesis Labs BV to target EU-based customers and seek out collaboration opportunities.

Management has a vision to migrate Synthesis from a pure services focused company to that of services and product. Its ability to develop software solutions for clients enables it to utilise those solutions for a broader global market application. An example is the white labelling of Halo Dot's software. This could be considerably profitable given the bulk of the research and development costs are already sunk.

Competition

Despite EOH having a strong presence in the financial services industry where Synthesis is primarily focused, it does not compete much with Synthesis given Synthesis' focus on AWS. Dimension Data favours an internally developed cloud option. Primary competitors are Accenture and Deloittes. Synthesis currently has no public sector clients and does not intend to compete in that space.

Remaining competitive requires the necessary skills. Attracting skills in SA is currently not a major problem, it's retaining them that's problematic. There are sufficient SA graduates being produced and Synthesis is an attractive employer given its niche offering and its ability to incentive staff with share options. Its Netherlands office will assist with skills retention and migration.

European markets are clearly more competitive than SA and therefore competing on cloud services or digitalisation is challenging. Instead of services, a product driven approach is more likely such as the marketing of Halo Dot. COVID-19 has, however, made competing in other jurisdictions easier as it's no longer necessary to have people on the ground. Its link with Alumni, an IT advisory firm in Singapore, has opened that market to Synthesis and it should result in additional mandates.

Outlook for Synthesis

Growth will continue to come from RegTech given its market leading position and strong relationship with financial services providers. It recently confirmed a multi-year contract to assist a major SA life insurer with enterprise tax reporting. Its ability to expand geographically with its clients opens new markets for it, primarily in Africa.

The adoption of the cloud continues at an accelerated pace globally, spurred on by COVID-19 but driven more by the benefits it offers corporates. Its primary benefits are increasing business agility, accelerating the time to market and allowing faster deployment of new offerings. It further benefits staff productivity by eliminating certain tasks and reducing others, thereby freeing up time to focus on higher value outcome activities. This is in addition to its benefits around security of information, lower operational risk and cost savings due to lower hardware expenditure.

The migration towards digital and intelligent data is an area of considerable growth given the strong market moves in this direction. The Digital unit's expertise is in high demand, including global opportunities – it recently secured the logistics contract in Singapore and has a strong pipeline heading into FY23E. Intelligent Data has experienced very high demand due to its highly sought-after skills in AI and the Machine Learning environments and has attracted several new customers in financial services, telecoms, retail, healthcare services and contact centres. The division also grew its banking footprint with the development of a new business bank application.

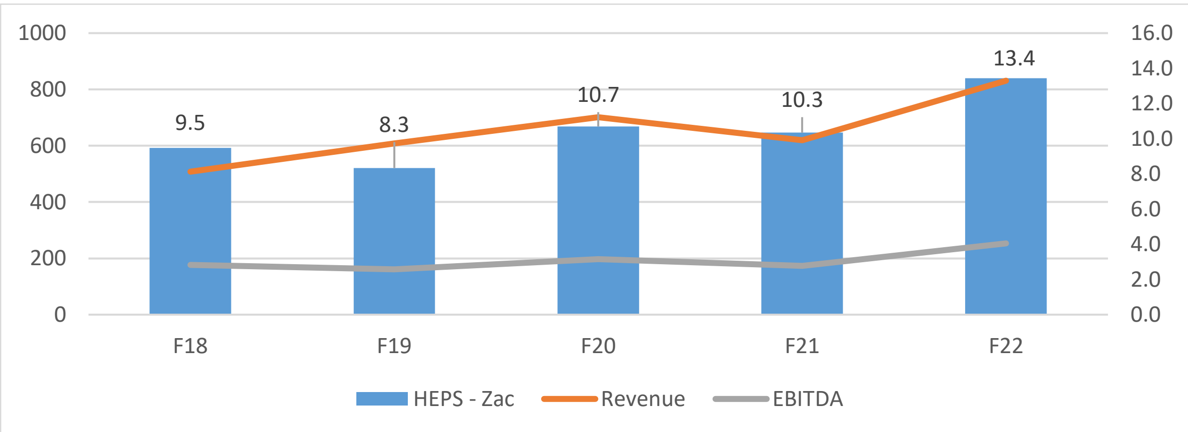
The outlook for the Payment Technology and Cryptography unit is exciting as Halo Dot gains traction – at 31 March it had secured five new customers including Nedbank and Telkom. Further discussion is being held and services are expected to be launched in 2H23.

The acquisition of Responsive ensures that Synthesis is well structured to capitalise on the leading technology themes and it remains relevant to its clients, providing value added services and products.

Financial Outlook

Results overview

Figure 25 HEPS (RHS in ZAc), EBITDA and Revenue - R'm



Source: Company data, ASB Research

EBITDA and HEPS has been erratic over the past four years and do not reflect the steady growth achieved in the terminal estate and Synthesis (revenue has consistently grown YoY). This can largely be attributed to the following:

- Despite a rise in revenue in FY19, heavy investment into the payment platforms, cloud operations and the group operating structure resulted in a decline in EBITDA and HEPS.
- FY20 saw a sharp rebound (+29%) in HEPS, in part the reward from the prior year's investments but also inflated by a forward FX contract gain of R14.6m. Revenue continued its growth trajectory.
- COVID-19 had a considerable impact on FY21 results with revenue declining due to delayed corporate spend on IT, delayed sales of POS devices and lower levels of transacting activity. There was no repeat of an FX gain in FY21 and declining interest rates impacted cash returns. HEPS benefited from a lower tax rate due to the recognition of a deferred tax asset on acquired assessed losses. This resulted in a 19.7% tax rate compared to 27.2% in FY20, offsetting some of the negative impact.

FY22 saw a 30% rise in HEPS as the impact of COVID-19 reversed, and delayed FY21 orders materialised – revenue was up 34% (35% in Payments and 32% in Software). The terminal estate grew by 28% to 277k, driving terminals sales revenue up a significant 51%. Maintenance and support service revenue grew 8% and transaction related income up 69%, benefiting from specialised payment offerings. Synthesis's revenue growth history continues to impress with 34% CAGR growth over 4-years. Its largest revenue component (74% of total revenue), services and consultancy fees were up 34%.

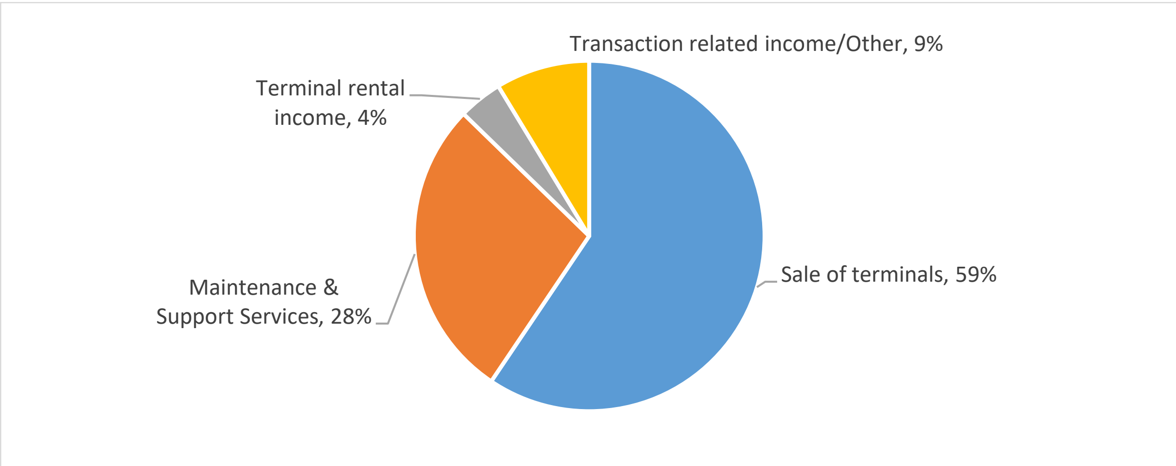
Operating expenses increased at 25%, reflecting 24% growth in staff numbers, the opening of the Netherlands office and marketing and development costs, in particular Halo Dot. This excludes share based payments expenses that were up 71% to R12m.

The positive jaws saw EBITDA margins rise by 2,4% to 30.3%. A higher tax charge (FY21 benefited from a R11.3m recognition of a deferred tax asset) saw PBT growth of 49% decline to 30% PAT growth.

We focus on Payments, Synthesis and other initiatives separately

Payments

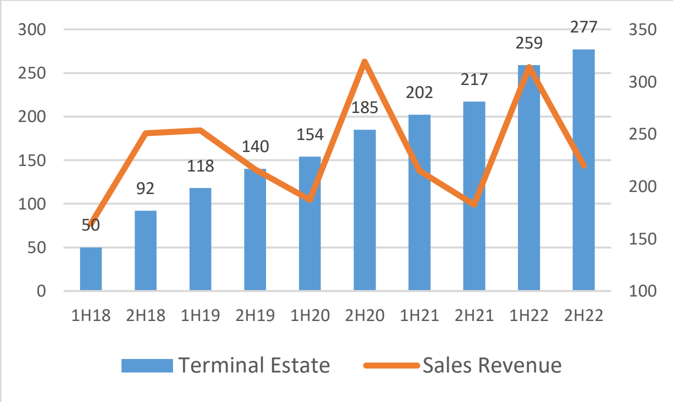
Figure 26 Payments revenue sources – FY22



Source: Company data, ASB Research

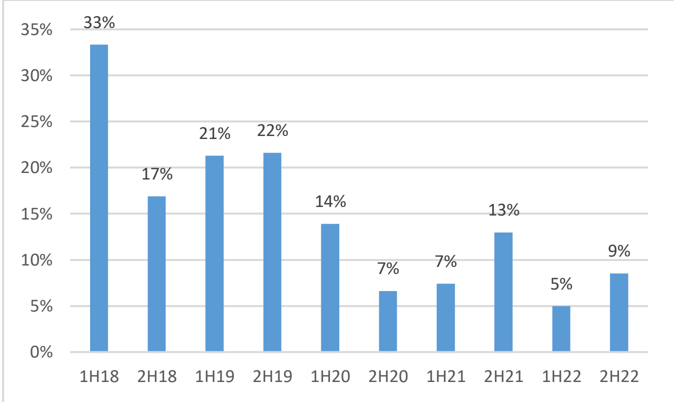
The sale of POS devices remains the single biggest revenue driver in Payments at 59%, or 38% of total group revenue. Gross margins for the sources are not disclosed.

Figure 27 Terminal estate (LHS) vs sales revenue R'm



Source: BIS, ASB Research

Figure 28 % of terminal estate as rentals

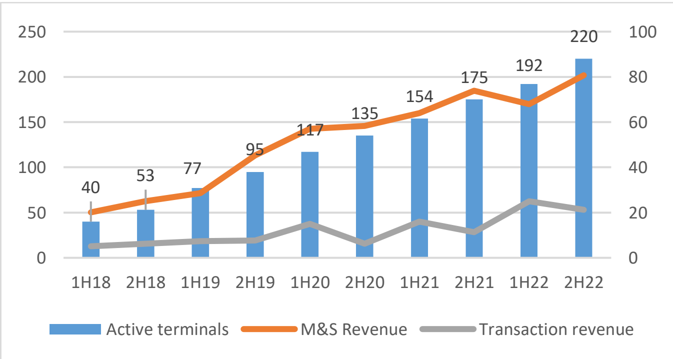


Source: BIS, ASB Research

At the time of acquisition, the group was far more active in the rental of devices. There has been an intentional shift away from rentals towards sales in the enterprise business within AR. This is evident by rental income as a % of total sales and rental income declining from 33% in 1H18 to 5% in 1H22. There is, however, a business case for rentals, particularly in Dashpay for smaller retailers and SMME's that prefer to avoid the upfront costs of a POS device. We believe this trend is already underway as reflected in rental income rising to 9% in 2H22 as Dashpay gains momentum.

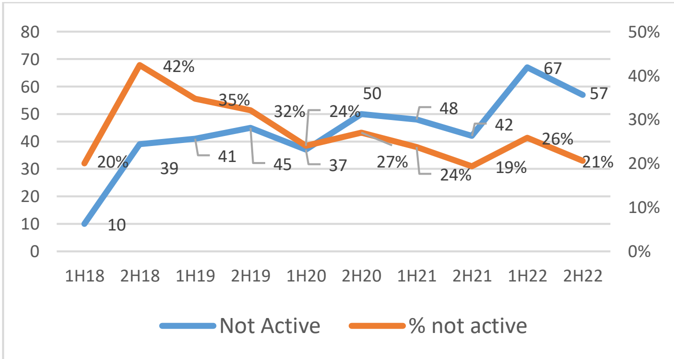
The terminal estate (terminals in client's hands, including rentals) has shown significant growth from 50 000 in 1H18 to 277 000 in FY22, 454% growth over the period. This has facilitated a steady rise in sales revenue, although it is volatile year on year (see below)

Figure 29 Active terminals vs maintenance & support revenue and transactional revenue R'm



Source: BIS, ASB Research

Figure 30 Non-active terminals – number and %



Source: BIS, ASB Research

Active terminals, defined as those that are in use by clients (including rentals) and therefore under management (earning annuity revenue for the group), have grown from 40 00 to 220 000 over the period, up 450%. This has provided a consistent rise in annuity income earned with maintenance and support revenue rising by a CAGR of 35% over the 4-yr period. Transaction related revenue is also correlated to the number of active terminals and has shown steady growth over the past 4-yrs.

Lastly terminals that are not active (total terminals less active terminals) amounts to 57 000 in FY22. This equates to approximately 21% of terminals - an average of 27% over the past four years. These terminals are likely to be deployed soon which is positive for maintenance and support revenue growth.

Sales revenue

Sales revenue trends are volatile and therefore there is high forecast risk. It's a function of the following:

- Cost prices of the devices based in USD or EUR. There would be little if any inflation in these prices (up until recently). They would be sold to clients in ZAR and therefore the exchange rate plays a key role. No currency risk is taken, as forward contracts are entered, and sale prices approximate the forward rates.
- The mix of terminals. As the non-enterprise sales increase (i.e., from Dashpay), the unit prices will drop given the cheaper Android based devices as well as mobile devices.
- The rental mix. This is a combination of legacy contracts that are coming to an end and the increasing rentals from new Dashpay merchants. Should rentals with banks switch to a purchase it doesn't change the number of terminals in issue but would increase the sales numbers. The terminal estate numbers include sales and rentals and therefore the difference from one year to the next does not necessarily imply the sales volumes. For example, the company disclosed sales number of 49 000 and 58 000 in FY19 and FY20 (disclosed in no other years). The move in the estate numbers was 48000 and 45 000 in each year, a considerable distortion in FY20. In these two years sales revenue per unit was R5936 in FY19 and R5717 in FY20, indicating a price decline as the mix changes.
- The rate of renewal. Devices generally have a 5-year life span after which they are replaced. As device types evolve and functionality improves it is likely that the lifespan of devices will shrink and start to tend towards 4 years. Renewals are going to have a material impact on sales volumes going forward. On the basis of a 5-year renewal, the F16/19 sales would have started to renew in FY22, however, terminal numbers were not meaningful in those years (32k in FY17). FY18 on the other hand had 92k and FY19 140k. With these terminals maturing and being replaced it increases terminal sales significantly.
- Timing. Sales can be delayed to the next financial half, for example a considerable portion of FY21 sales efforts were only finalised in 1H22, resulting in an abnormally high rise in 1H22 sales, dropping back again in 2H22.

Figure 31 Estimate of terminal sales

Terminal Sales Outlook	Assumptions	F17	F18	F19	F20	F21	F22	F23E	F24E	F25E
Industry terminals				**418**	**511**	**610**	**667**	**729**	**797**	**871**
New business growth	9.3%						57	62	68	74
CTA Terminal estate pre maturities		32	92	140	185	217	277	305	335	369
CTA new business growth A	10.0%							28	30	34
Implied market share				33.5%	36.2%	35.6%	41.5%	41.8%	42.1%	42.3%
5yr maturing terminals **C**								78	116	163
Maturing terminal % converted to sales **B**	50%							39	58	81
Terminals expired	50%							-39	-58	-81
Total sales **A+B**				49	58	32	60	67	88	115
Terminal estate = opening balance+ sales - maturities		32	92	140	185	217	277	266	238	190
Ave price R/ price increase	-2%			5937	5717	6547	5288	5183	5079	4977
Sales R'm			276	291	332	210	317	346	449	571
% Growth				5%	14%	-37%	51%	9%	30%	27%

Source: Company data, ASB Research estimates

From the table above we forecast growth in terminals as guided by management (>800k terminals by 2025) and forecast by independent research (GlobalData). GlobalData envisages 9.3% CAGR terminal growth from 2020 (FY21 for CAPPREC) to 2024, circa 871K terminals in 2024. We believe CAPPREC will have a higher growth rate as it continues to gain market share given its broader offering - we assume a

10% CAGR for CAPPREC. As evident in the table above, this ensures a gradual increase in market share to 42.3% in FY25E. Forecast risk is clearly very high.

The difference between the terminal numbers from one year to the prior represents industry growth. In addition to this volume growth, there are renewals of matured devices. In the table above we assume a very conservative 50% replacement rate of the devices maturing. The average of FY17 & FY18 terminals are assumed to be replaced in FY23 and so on. We calculate 39k matured devices to be replaced in FY23. This together with the 28k volume growth equates to 67K sales of devices.

It's difficult to know the value of a device given the varying price points. In FY20 management disclosed sales of 58 000 units which equated to ave sales price of R5717. The ave USD exchange rate in that financial year was 15.45. We would be closer to 15 in FY22 implying some modest downside. We would anticipate further downside as cheaper terminals are rolled out across the payments business. We assume a R5000 value per unit (broadly in line with sales revenue divided by calculated device sales in FY22), declining by 2% per annum, primarily a FX increase (a structural annual decline in ZAR) offset by cheaper devices in the mix. Once again forecast risk is very high but recent history has shown a steady decline in average sales prices of devices.

On the above analysis we estimate 9% sales growth in FY23E (off a high FY22 base) and 30% growth in FY24E, robust growth numbers driven by a rising renewals base. FY22 had a significant rise in sales of 51%, largely driven by the elevated rise in 1H22 sales due to a large portion of FY21 sales carried over.

Maintenance Revenue

Figure 32 Maintenance revenue outlook

Maintenance Revenue Outlook	Assumptions	F17	F18	F19	F20	F21	F22	F23E	F24E	F25E
Active terminals		40	53	95	135	175	220			
% of total terminals	Ave 72%		58%	68%	73%	81%	79%			
Apply 72% ave to total terminal estate outlook from Fig 31	72%							219	241	265
Ave active terminals per year			46.5	74	115	155	198	220	230	253
Maintenance & support revenue R'm			45.1	73.9	115.3	137.9	148.7			
Per ave active terminals - R			970	999	1003	890	753			
% Growth rate	3%							775	799	823
Revenue R'm								170	184	208
% Growth								15%	8%	13%

Source: Company data, ASB Research estimates

This is calculated on the number of active terminals. We calculate the average active terminals per total number of terminals at 72% over the five-year period commencing FY18. We apply this to our estimate of terminals in Fig 31 and calculate the number of active terminals per annum followed by an average per year. Next, we calculate the average revenue per terminal – this was R753 per terminal in FY22. We apply a 3% annual growth rate to this to determine total revenue per average active terminal. Growth averages 12% p.a going forward.

Transactional related and total revenue

Figure 33 Transaction related and total revenue outlook

Transaction Related Revenue Outlook	Assumptions	F17	F18	F19	F20	F21	F22	F23E	F24E	F25E
Ave active terminals			46.5	74	115	155	198	220	230	253
Transaction related revenue R'm			11.3	15.1	21.2	27.4	46.3			
Per ave active terminal R'000			243	204	184	177	234			
% Growth rate	5%							246	258	271
Revenue								54	60	69
% Growth								17%	10%	16%
Rental Income			82	79	33	22.6	21	21	21	21
Total Revenue			414	459	501	397	533	591	714	869
				11%	9%	-21%	34%	11%	21%	22%

Source: Company data, ASB Research estimates

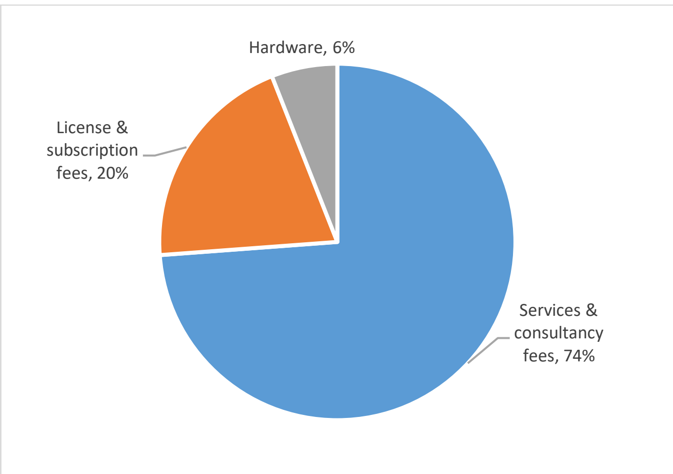
We calculate this on the average active terminals as calculated in Fig 32 above. On the FY22 value, average revenue per terminal was R234. We anticipate this to grow at around 5% going forward. The result is growth of approximately 14% p.a. going forward.

We don't do separate detailed forecasts for rental income given its current immaterial contribution to revenue at 3.5% and its gradual decline. It remains an offering but given its contribution and the forecast risk above, its immaterial. We include it at the same level it recorded in FY22, R21m.

Our total revenue estimate is for 11% growth in FY23E, 21% in FY24E and 22% in FY25E. We anticipate a decline in EBITDA margins in FY23E to 39% given a very strong FY22 performance (42.2% vs 36.9% in FY21), with rising margins in FY24E (39.5%). This equates to EBITDA of R231m (+3%) in FY23E and R282m (+22%) in FY24E.

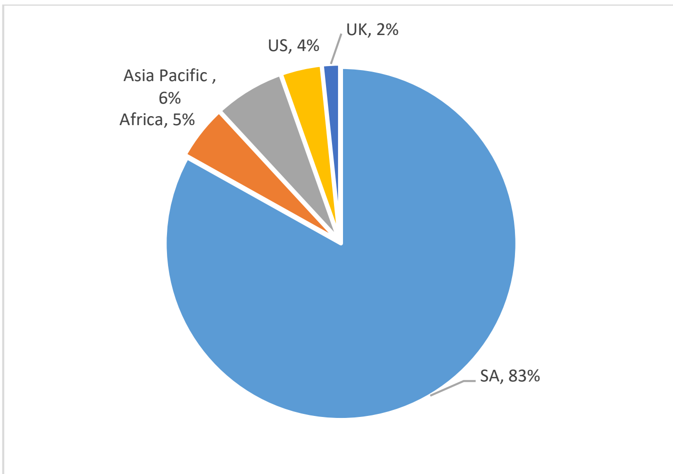
Synthesis

Figure 34 Revenue split - FY22



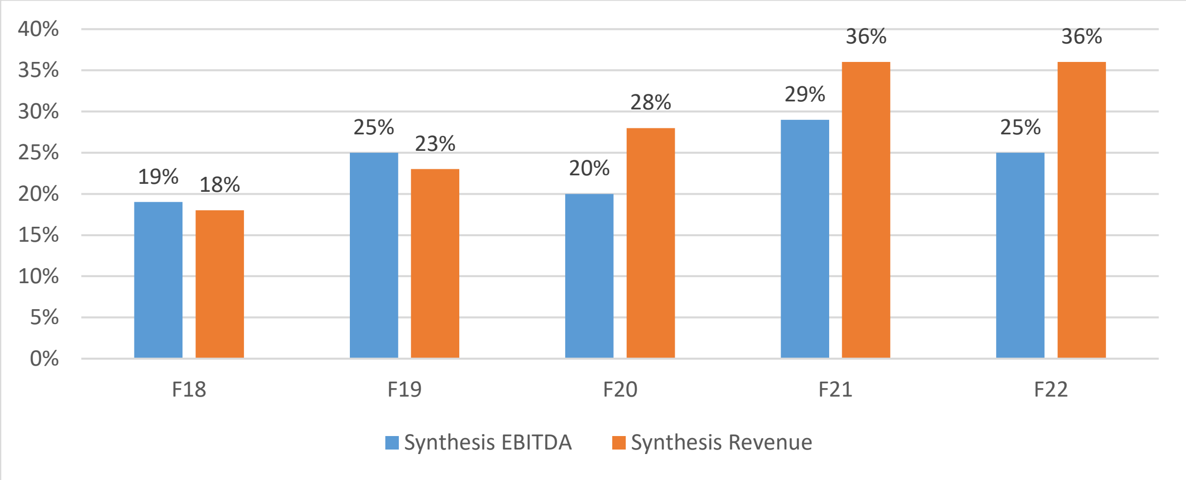
Source: Company data, ASB Research

Figure 35 Geographical revenue split – FY22



Source: Company data, ASB Research

Figure 36 Synthesis contribution to the group – revenue & EBITDA



Source: Company data, ASB Research

Synthesis revenue has grown at 34% p.a from FY18 to FY22, doubling its group contribution from 18% to 36%. At an EBITDA level the group contribution has increased more modestly from 19% to 25%. This is due to the considerable spend on Halo Dot, development costs and the opening of its office in the Netherlands.

Gross revenue was up 32% in FY22, with a considerably better second half with a strong pipeline of work and new clients. Services and consultancy fees grew by 34% due to the increased demand for cloud and digital projects, and licence and subscription fees increased by 12%. Synthesis provides state-of-the-art cryptography, backed by Hardware Security Modules (HSM) to protect Payment Card PINs, contactless payments and enterprise encryption. HSM sales increased threefold during the year on the back of a significant project for a major bank by the Payment Technology and Cryptography unit.

EBITDA increased by 23% to R75m. EBITDA margins, however, declined due to increased sales of third-party software products, which attract a lower gross margin, as well as further investments in staff growth, the continued development costs in Halo Dot, regional expansion to the Netherlands, and other growth initiatives, all of which were expensed.

We anticipate revenue growth of 34% in FY23E to R399m, driven primarily by services and consultancy fees on the back of cloud and digital based revenue which is experiencing robust growth. We have license and subscription revenue (largely RegTech) growing at 20% and Hardware at 10% given the high FY22 base. We forecast revenue of R473m in FY24E, up 19%. Growth is dependent on the underlying economy and the rate at which corporates embrace digital data and the cloud. We have more confidence in the latter as the merits of digital and cloud are clear to see for corporates and the services are becoming integral to corporate progression.

Synthesis continues to invest for growth, so we are likely to see margins contract further in FY23E before rising as the benefit of the spend comes through. Synthesis has achieved an average 27.2% EBITDA over the past three financial years, dropping to 25.3% in FY22 given the above-mentioned investment expenditure. We envisage the EBITDA margin will track towards managements target of 30% over the next five years. We have EBITDA margins declining to 24.8% in FY23E, rising to 25.3% for FY24E and 26% in FY25E.

We therefore forecast EBITDA of R99m in FY23E (+32%) followed by R120m in FY24E (+21%). The acquisition of Rethink and Responsive was effective 1 March 2022 and therefore the full impact will come through in FY23E – this was disclosed as revenue and EBITDA of R40.8m and R7.1m had they been included in the full year. The extent of Halo Dot's success is difficult to determine at this stage. There is traction for the product both in SA and globally. It could result in our estimates being too modest from FY24E.

Other initiatives

CAPPREC has associate interests in LayUp and GovChat.

It has invested R6.4m and provided loan funding of R5m to LayUp which is operational and achieved good traction in FY22. It achieved 10 times more monthly new payment plans in FY22, 3 times more merchant sign-ups, 9 times more monthly new users and 5 times more monthly transaction values. There is ongoing developmental spend which would only see a potential profit contribution in FY24E (loss of R4.3m in FY22).

Management is exploring ways of monetising GovChat. It currently processes a significant number of transactions but is not revenue producing. Government involvement is key to monetising this investment but as can be appreciated this is challenging. It may therefore not transpire into a profitable venture on its current basis, but it has fulfilled a social development role. The model and software can, however, be exported and monetised. The loans in GovChat are secured by the technology it owns. Management does not foresee any credit losses.

Group financial

Figure 37 Segmental revenue and EBITDA

	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	623	831	990	1187	1435
Payments	397	534	591	714	869
Synthesis	225	297	399	473	566
EBITDA	173	253	279	346	435
Payments	147	225	231	282	348
Synthesis	61	75	99	120	147
Corporate/costs	-35	-44	-52	-58	-64
International	0	-4	2	3	4

Source: Company data, ASB Research

The sum of our divisional revenues from Payments and Synthesis is R990m and R1 187m in FY23E and FY24E respectively. Similarly, the EBITDA is R330m and R402m. Post corporate and other costs (transformation costs and share based payments), our group EBITDA estimates are R279m and R346m in FY23E and FY24E.

Operating costs are prudently managed but are anticipated to rise well ahead of inflation as the business continues to invest and grow. The dominant cost is payroll (it's not possible to determine the % as some of these costs are allocated to cost of sales), with Synthesis being the biggest contributor (staff complement of circa 245). The groups headcount grew 24% in FY22 to 427 staff members. Learnership programmes account for approximately 10% of the staff complement. Costs for premises are the second largest costs. Management indicated that their leases are expiring during FY23 and that they have secured new premises, better suited to their expansion, at a saving. Cost growth is managed relative to revenue growth. As a % of revenue costs have averaged 20.8% over the past four financial periods. We forecast operating costs at 22.1% of revenue in FY23E (+40%) and 21.1% in FY23E (+15%). Our costs are inflated in FY23E due to ongoing high expenditure in the development and bringing to market of Halo Dot and Dashpay Glass.

Management discloses transformation costs separately. These are the costs incurred in building the appropriate corporate structure around the evolving business. This would include accounting, governance, internal audit, secretarial, premises and B-BBEE credentials. These amount to R9m in FY22 and R7m in FY21. We forecast R9m in FY23E.

The depreciation and amortisation charge of R41m in FY22 includes approximately R13m of amortisation of intangible assets relating to the acquisition of a business. This is depreciated on a straight-line basis and will begin to taper off in FY23E and fully amortised by FY24E, resulting in a lower charge.

We calculate the average interest yield on cash at 4.3% in FY22. We anticipate this to rise to 5.6% given the increase in interest rates.

There is no firm dividend policy, instead it is determined based on the liquidity of the group. There was a 56% pay-out ratio in FY22. We see this rising to 58% in FY23E. In the absence of any material acquisitions there is scope for it to rise to 70% or beyond in the medium term. Management is open to buying back shares at the right price – we see no opportunity at the current share price given the premium to NAV.

As a consequence of the above we arrive at HEPS of 15.8c (+17%) and 20.5c (+30%) in FY23E and FY24E. Strong terminal sales driven by renewals, robust Synthesis revenue growth and rising EBITDA margins in FY24E are key drivers.

Management has 80.9m treasury share at its disposal at an average cost of approximately 77c per share. This is valuable currency for such an acquisitive business as highlighted by its recent usage of such shares for its Responsive Group acquisition.

The strategy is for ongoing acquisitions in the financial services sector. These could be local or global and can be significant in size given the value of the treasury shares (circa R150m), cash at circa R530m and an ungeared balance sheet. There could also be an issuance of shares which would help diversify its shareholder base (GEPF owns 25.45% and company insiders 25.9%). We don't forecast for any acquisitions given the uncertainty around size, timing and the nature of the funding.

Valuation

Figure 38 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	10.5%
Beta	0.8
Market risk premium	6.5%
Marginal tax rate	27.0%
Pre-tax cost of debt	7.5%
Cost of equity	15.7%
Target debt/value ratio	0.0%
Target equity/value ratio	100.0%
WACC	15.7%
Growth Rate assumption	
Sustainable long term growth rate	4.0%

Source: ASB Research estimates

Figure 39 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
Terminal Growth	3.0%	246	236	228	220	212
	3.5%	250	240	231	222	215
	4%	254	244	234	226	218
	4.5%	259	248	238	229	220
	5%	264	252	242	232	224

Source: ASB Research estimates

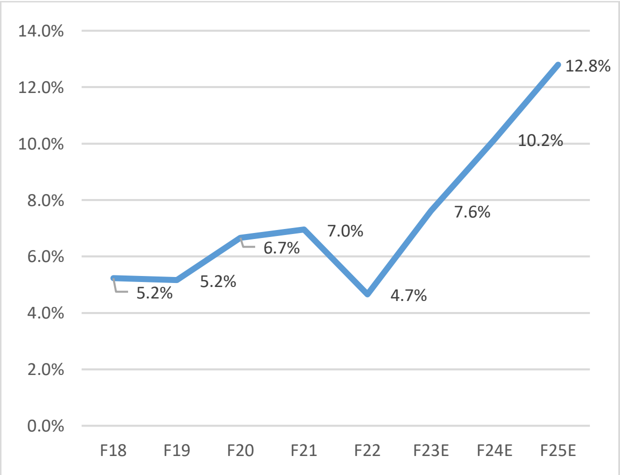
We value the group on a DFCF basis, applying a WACC of 15.7%, a risk premium of 6.5%, a beta of 0.8 (as per Bloomberg) and a sustainable long-term growth rate of 4%, as highlighted in the table above. The lack of gearing negatively impacts its WACC. Applying some sensitivities to WACC and terminal growth rates leads to a valuation range of R2.22-2.48/share. R0.41/share is in cash at 31 March 2022. Applying the midpoint of the valuation range (R2.34), values the stock on a 21-month forward P/E of 11.4x.

Based on our HEPS forecasts, the stock trades on a 9M forward P/E of 10.2x, a 18% discount to its 5-year historical average of 12.5x as highlighted in the chart below. With circa 24% HEPS growth p.a over the next three years, rising free cash flow yields and ROE's rising to new highs, the discount to its historic average appears unjustified (historic 3-year average HEPS growth of 16.6% p.a). Applying a 12.5x P/E to our FY23E and FY24E HEPS equates to R1.98/share and R2.56/share valuation.

The stock trades on an attractive 5.5x and 4.5x FY23E and FY24E EV/EBITDA.

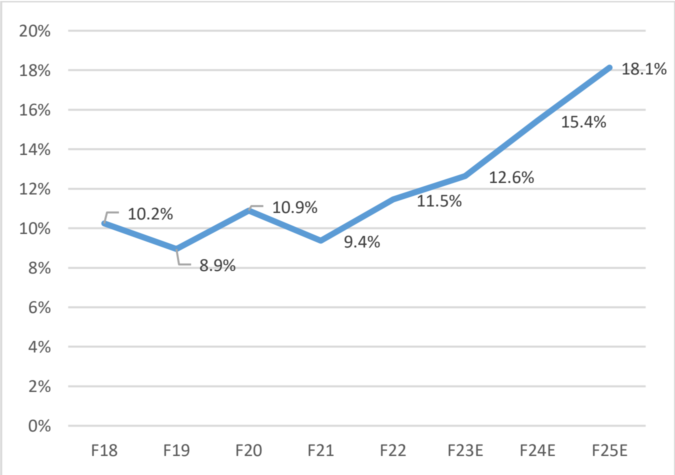
With an anticipated progressive dividend payout ratio, the dividend yield is also attractive with a 5.7% and 8.3% yield in FY23E and FY24E.

Figure 40 Free Cash Flow Yield



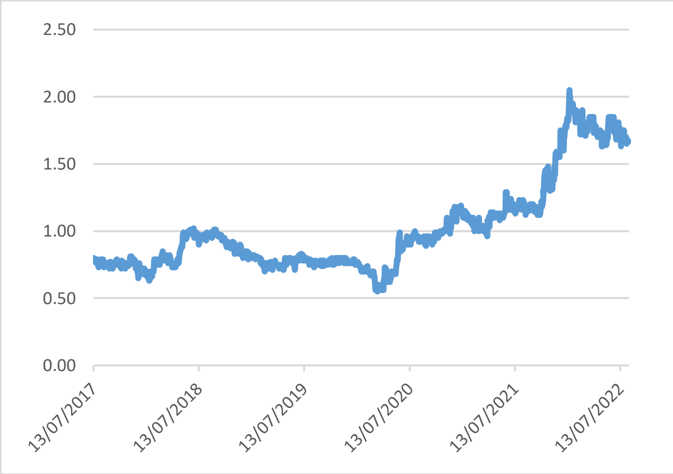
Source: FactSet, ASB Research

Figure 41 ROE



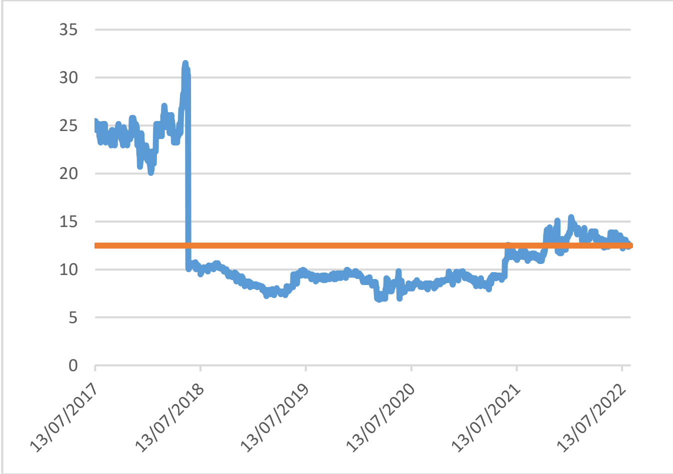
Source: FactSet, ASB Research

Figure 42 5-year price history



Source: FactSet, ASB Research

Figure 43 P/E - ave 12.5x



Source: FactSet, ASB Research

Risks

- Economic slowdown – this will negatively impact volumes through the terminals, it would reduce corporate IT spend and may slow the roll-out and replacement of maturing terminals. Cloud and digital have remained resilient judging by the order book.
- Supply constraints of terminals – these are largely imported items.
- Increased competition in POS device management in SA. As indicated on Page 13, the barriers to entry are very high.
- The continued aggressive roll out of cheaper mobile devices and the use of SoftPOS. CAPPREC is well positioned in both markets to ensure it remains competitive. Both are small contributors at present so growth in this space is an opportunity.
- Impairment of the GovChat loan of R48.8m. The loans in GovChat are secured by the technology it owns. Management does not foresee any credit losses.

Appendix 1 – Management Team

Michael Pimstein - *Bcomm Acc (Wits)*

JOINT CHIEF EXECUTIVE

Michael has more than 30 years' experience as a senior executive in the steel, engineering and manufacturing sector having served most recently as CEO of Macsteel Service Centres SA, a position he held from 1999 through 2013. Michael has been and is a member of various government, labour and business committees that address industrial policy, growth and development plans, infrastructure requirements and investment, labour mediation and wage negotiations. Michael has served as President of the Steel and Engineering Industries Federation of Southern Africa, President of the Southern African Stainless Steel Development Association and President of the Association of Steel Service Centres. He served on the advisory committee of The Adopt-A-School Foundation.

Bradley Sacks - *BEconSc (Wits), MBA/JD Hons (Duke University School of Business and School of Law)*

JOINT CHIEF EXECUTIVE

Bradley has more than 30 years' experience in the financial services and investment business. Bradley is the Managing Partner of Centric Capital Ventures LLC, a private investment firm based in New York. Previously Bradley was a Managing Director, Global Head of Technology, Media and Telecommunications Mergers & Acquisitions for Bank of America. Bradley was also an investment banker with Citigroup, having started his investment banking career at Salomon Brothers. Bradley started his professional career as an associate in the corporate department of Fried, Frank, Harris, Shriver & Jacobson, a law firm based in New York.

Over the course of his career Bradley has been involved in evaluating, advising and investing in strategic and financing transactions with an aggregate value exceeding US$100 billion.

Alan Salomon - *BSc Hons (University of London), CA (SA)*

CHIEF FINANCIAL OFFICER

Alan has more than 35 years' experience as a senior executive in an array of financial services and industrial sectors. Most recently Alan served as the CEO of Bidvest Bank, a subsidiary of The Bidvest Group Limited, a position he held for 8 years. In addition to Banking and Financial Services, Alan has also held executive management positions in Waste Management and Waste Recycling, Stationery, Packaging, Catering Equipment, Services, Property, Import and Export and Distribution businesses. He also has extensive experience in various manufacturing businesses. Other directorships held by Alan include Executive Director of The Bidvest Group Limited (from 1990 to 2012), CEO of AFCOM Group Limited, Non-Executive Director of Transpaco Limited, Non-Executive Director of Voltex Limited and Non-Executive Director of Enviroserv Holdings Limited.

Michael Shapiro - *BSc Hons in Electrical Engineering*

EXECUTIVE DIRECTOR

Michael is the Managing Director at Synthesis. He has been with Synthesis since 2003. Prior to joining Synthesis, Michael held various senior positions at Internet Solutions and Dimension Data. He has strong interest in the FinTech sector and a deep understanding of how technology and information security is shaping financial services. As an Executive Director of Capital Appreciation, he will play a significant role in the future technical development of the Group and will continue his executive position at Synthesis

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