

Transaction Capital Limited

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Transaction Capital Limited	Long term Issuer	National	A-(ZA)	Stable Outlook
	Short term Issuer	National	A2(ZA)	--
	Long term Issuer	International	B+	Stable Outlook

Rating rationale

The national scale ratings on Transaction Capital Limited ('the group') primarily reflect the strengths and weakness of its two major subsidiaries, SA Taxi Holdings ('SA Taxi') and Transaction Capital Risk Services ('TCRS').

Transaction Capital Limited is an unregulated non-operating holding company ('NOHC'), actively investing in credit-oriented alternative assets. The NOHC has its two major subsidiaries both operating broadly within the financial services space. We consider both entities to be essential parts of the group, based on their earnings contribution.

SA Taxi is a vertically integrated asset backed lending company, providing developmental finance, insurance and other services to the minibus taxi industry in South Africa ('SA'). TCRS is a technology led data-driven provider of customer management solutions through a scalable and bespoke fintech platform, with a geographical presence in SA, Australia, and it has recently penetrated the European market. The final rating on the group takes a blend of the strengths and weaknesses of SA Taxi and TCRS, in addition considering the diversification benefits from such different business lines. The fact that the holding company is net ungeared and is not exposed to any regulatory structural subordination also supports the rating of the NOHC.

We consider the competitive positioning of SA Taxi and TCRS to be a relative weakness to the rating, balancing their small and niche positions versus the large, diverse and prudentially regulated financial services providers operating in SA. Having said that, we believe the two entities defend their market position well, with competitive advantages obtained from vertically integrated businesses that supports a strong supply value chain, good distribution network, pricing advantages, coupled with rich proprietary data on their industry. Furthermore, track record of revenue stability has been good for both entities.

The risk score of 12 on SA Taxi is supported by the entity's niche position primarily as a provider of vehicle finance to the minibus taxi industry in South Africa. The risk score also balances the sound capital position at half year 2019, with GCR leverage and total capital ratio of 18% and 21% respectively. We expect GCR capital ratios to be maintained within strong ranges, supported by earnings growth and moderate loan growth. Risk position is broadly weak relative to sector average, reflected by credit losses of 3.4% which inadequately compares to top tier and some mid-tier banks whose credit losses through the cycle have averaged below 1%. Positively, due to the vertically integrated businesses, recoveries are well controlled and we think credit losses will be managed sustainably at the current level. Funding flexibility is credit positive for SA Taxi, supported by diversified funders including DFIs and securitisation vehicles. Furthermore, liquidity is considered to be fairly strong, supported by a significant amount of committed unutilized funds and strong expected future cash outflows. As a result, sources outweigh uses of liquidity by over 2.5x over the next 12months.

The risk score of 12.5 on TCRS is supported by the entity's niche position as SA's premier acquirer of non-performing consumer loans as principal and debt recoveries agent on contingency or fee-for-service basis, alongside increasing but relatively small penetration into the Australian and European markets. The risk score also balances the modest levels of leverage at year end 2018, with net debt to EBITDA of approximately 2x and funds from operations accounting for over 40% of net debt, but with free operating cash flow remaining negative due to the fairly rapid expansion of TCRS' purchased book debts. We also factor in fairly strong earnings, with the EBIT margin over 30%, and adequate levels of liquidity.

Outlook statement

The Stable outlook is supported by fair geographical diversification of the group, stable business position, good funding and liquidity profile, and our expectation that capital against risk will remain adequate.

Rating triggers

A ratings improvement could arise from increased revenue generation by TCRS in low risk markets, improved business line diversification, and stronger internal capital generation. A downgrade in the group credit profile could stem from weakening SA operating environment, and reduction in capital adequacy.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
 Criteria for Rating Financial Institutions, May 2019
 Criteria for Rating Financial Services Companies, May 2019
 GCR Ratings Scale, Symbols & Definitions, May 2019
 GCR Country Risk Scores, June 2019
 GCR Financial Institutions Sector Risk Score, July 2019

Ratings history

Transaction Capital Limited					
Rating class	Review	Rating scale	Rating class	Outlook	Date
Issuer Long Term	Initial	National	A ⁻ (ZA)	Stable	November 2016
	Last	National	A ⁻ (ZA)	Stable	June 2018
Issuer Short Term	Initial	National	A1 ⁻ (ZA)	Stable	November 2016
	Last	National	A1 ⁻ (ZA)	Stable	June 2018
Issuer Long Term	Initial	International	BB ⁻	Stable	November 2016
	Last	International	BB ⁻	Stable	June 2018

ANALYTICAL ENTITY: TRANSACTION CAPITAL LIMITED

Transaction Capital Limited is a JSE listed NOHC formed in 2007 by a merger of several South Africa-based specialist financial services businesses operating under its two main subsidiaries SA Taxi and TCRS.

OPERATING ENVIRONMENT

Country risk

The group's country risk score of '8.5' takes a weighted average view of the riskiness of markets where revenues are generated. Approximately 73% of TCRS revenues are generated in SA that has a risk score of 7.5, while the balance comes from Australia with risk score of 15. On the other hand, SA Taxi revenues are all generated in SA. Overall, we consider both entities essential to the group and therefore equal weight their respective country risk scores. Details on the discrete country risk scores are outlined in GCR's Country Risk Score report, published June 2019.

Sector risk

The sector risk score of '5' is based on the South African banking sector score. Details on the discrete sector risk scores are outlined in GCR Financial Institutions Sector Risk Scores report, published July 2019.

BUSINESS PROFILE

Competitive position

The competitive positioning of SA Taxi and TCRS is a relative weakness to the rating given their small and niche business focus in comparison to the large and diverse prudentially regulated banks. However, both entities have strong and defensible niche positions, we think, underpinned by the relevance of their value proposition in relation to the socio-economic dynamics in the markets they serve.

SA Taxi has over time achieved strong growth and modest diversification, supported by its vertically integrated businesses. While the majority of revenues are still being generated from vehicle finance, its insurance business is growing and currently contributing c. 20% to the entity's revenues. The fact that the key contributor to SA Taxi revenues is less sensitive to macro environment due to the non-discretionary nature of transport adds stability to the earnings.

TCRS has fairly diversified revenue streams, with majority of revenues generated from collecting debt as either agent or principal. Other revenue streams include value added transactional services as well as SME financing. As a collector of debt as principal, TCRS is the largest buyer of non-performing loans portfolios in SA leveraging on its pricing advantages whereas the Australia business is still small but growing. We think TCRS' robust technology platform and its pricing capabilities makes its niche market position defensible and provides stability to revenue generation. Pricing capabilities are also supportive of the entity's fairly strong margins after amortisation.

Management and governance

Management and governance are neutral to the ratings. We consider board structure and management teams of both entities to be adequate.

FINANCIAL PROFILE

Capital & Leverage

The group's capital and leverage position is moderate, balancing the strong capital position of SA Taxi and TCRS' modest levels of leverage.

SA Taxi's capital position is strong after it sold 25% of its equity stake to South African National Taxi Council and the cash was used to repay some of the borrowings, resulting in stronger capital ratios at 1H19. In addition, strong earnings have supported a healthy internal capital build. As of 31st March 2019, SA Taxi had a GCR leverage and total capital ratio of 18% and 21% respectively. We expect a slight deterioration in the GCR capital ratios however still maintained within strong ranges. We also consider the loan loss reserving, recoveries and earnings to be broadly supportive of the rating level.

On the other hand, we expect TCRS to maintain modest levels of leverage and negative free operating cash flow over the rating horizon, due to the fairly rapid expansion of its purchased debt book portfolio. Positively, the entity has ample liquidity to fund the gap and should book-buying slow there would, in our opinion, be a strong positive cash build for the entity. We also view positively, the fact that the majority of revenues are generated from debt collections as agent and other customer management solutions it provides, which would support cash generation if and when bad debt purchases slow.

Risk

The risk position is neutral to the ratings balancing SA Taxi's relatively weak asset quality in comparison to sector average and TCRS strong risk adjusted earnings.

SA Taxi's through the cycle credit losses do not compare favourably to most banks. This is because the company finances a relatively high-risk minibus taxi market, which most banks do not usually do. Positively, the company's vertically integrated businesses help recoveries through repossessions, refurbishments of the vehicle, re-financing and selling the vehicle for cash. This way recoveries are well controlled and have averaged over 75% over the past 3 years. Loan concentrations are very small due to the granularity of the book. Market risk is also minimal and well controlled through natural hedging and financial derivatives provided by top tier banks.

TCRS' earnings vs risk profile is strong. The company collects multiple debt asset classes within various sectors (as shown per the table below) and we view this diversification favourably for its earnings risk profile. Collections of debt as agent is also considered less risky.

Table 1: Diversification of revenues

By Sector (%)	FY17	FY18
Financial services	40.0	55.2
Lifestyle	3.1	2.9
Public sector	16.9	9.6
Retail	33.6	24.1
Telecom	5.9	7.3
Other	0.5	0.9

Funding structure and liquidity

The group's funding and liquidity is positive to the rating. Both SA Taxi and TCRS are wholesale funded as is typical for non-bank financial institutions. Funding is diversified for SA Taxi but somewhat concentrated for TCRS due to its relatively low funding needs.

Funding flexibility is credit positive for SA Taxi. The company is funded and refinances debt through its various securitisation vehicles and senior unsecured funders including DFIs. Liquidity is managed through cash flows and hence a uses vs sources of cash analysis accurately reflects its funding and liquidity risk. At review date, SA Taxi's sources vs uses ratio was over 2.5x supported by significant committed funds and moderate loan growth. Covenant risk is minimal reflected by good headroom above required levels. However, asset encumbrances are very high and we moderate the company's liquidity position for this.

TCRS' funding and liquidity is adequate balancing its significant positive cash flows from operations, fairly rapid expansion of purchased book debts, and significant committed liquidity lines. Overall, we view liquidity to be adequate, supported by minimal covenant risk, low asset encumbrance, and a uses vs source of cash ratio of 1.5x.

COMPARATIVE PROFILE

Group support

No group support given to either SA Taxi or TCRS as we consider both entities essential parts of the group based on their earnings contribution.

Peer analysis

We provide uplift to the group's rating based on diversification added by combining these two entities with different business lines which we think improves the group's credit profile in comparison to domestic non-bank peers.

Risk Score Summary

Risk score

Operating environment	13.5
Country risk score	8.5
Sector risk score	5.0
Business profile	-2.0
Competitive position	-2.0
Management and governance	0.0
Financial profile	1.0
Capital and Leverage	0.5
Risk	0.0
Funding structure and Liquidity	0.5
Comparative profile	1.0
Group support	0.0
Peer analysis	1.0
Total Score	13.5

Glossary

Benefits	Financial reimbursement and other services provided to insureds by insurers under the terms of an insurance contract.
Capital	The sum of money that is invested to generate proceeds.
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagor. Also called a Mortgage bond.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
National Scale Rating	National scale ratings measure creditworthiness relative to issuers and issues within one country.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Performing	An obligation that performs according to its contractual obligations.
Release	An agreement between the creditor and debtor, in terms of which the creditor release the debtor from its obligations.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term	Current; ordinarily less than one year.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings were influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to Transaction Capital Limited. The ratings above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Transaction Capital Limited participated in the rating process via face-to-face management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Transaction Capital Limited and other reliable third parties to accord the credit rating included:

- Audited financial results of Transaction Capital Limited as at 30 September 2018;
- Audited financial results of SA Taxi and TCRS as at 30 September 2018;
- Latest internal and/or external audit report to management;
- Industry comparative data.

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