

# CEO's report

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## Introduction

The Peregrine group has produced an excellent set of results for the year under review with attributable earnings increasing by 135% to R251,8 million. This resulted in the return on average equity, calculated with respect to attributable earnings, exceeding 40% for the year.

Features for the year include:

- strong organic growth within the group's core hedge fund and related prime broking operations, enhancing Peregrine's dominant position in the South African hedge fund industry;
- highly satisfactory investment performances, both within Peregrine's suite of hedge fund offerings and within the group's private wealth management arm, Citadel, resulting in substantial performance fees being earned for the year;
- remarkably strong cash generation by the group resulting in an increase of 150% in the annual dividend to 30 cents per share.

## Results

Total revenue, comprising operating revenue and investment income, increased by 70% to R628,5 million from R369,8 million, as a result of good investment performances on an appreciably larger asset base for the year. Investment income amounted to 14% of total revenue, compared to 13% in the previous year.

Stripping out the effects of direct staff profit participation in the increased profitability of each of the underlying businesses, as well as the first time consolidation effects of Deloitte Private Clients (DPC) into Citadel, core operating expenses of the group increased by 18%. The major contributor to this was Peregrine Securities, with an increase in costs of 74% (excluding bonuses). This increase must, however, be seen in the context of a burgeoning business which, though incurring substantial additional marginal cost, produced an overall profit increase of 232%.

The substantial growth in the group's hedge fund related prime-broking operations and continued strong cash generation within the group resulted in net interest earned for the year of R68,4 million from R13,9 million previously.

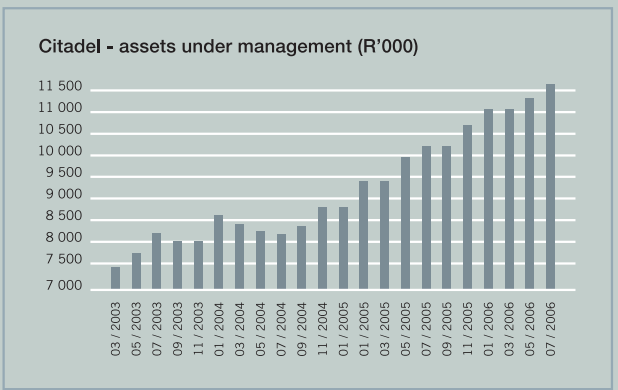
A capital profit of R36,0 million was earned principally from the receipt, during the year, of proceeds arising from the disposal of a non-core group subsidiary during the group's refocusing exercise in 2003. This helped increase profit before taxation to R356,0 million for the year, an increase of 106%.

With a reduced rate of taxation as a result of the utilisation of previously assessed losses, and a lower number of shares in issue, basic earnings per share increased by 137% to 130,4 cents per share and headline earnings per share increased by 106% to 111,7 cents per share.

## Operating highlights

Private-client **wealth manager**, Citadel, produced a 75% increase in profit from ordinary activities to R73,4 million, contributing 23% to group profitability. Effective from 1 June 2005, Citadel acquired 64% of DPC, making it a wholly owned subsidiary. DPC was thus consolidated for 10 months of the year and a seamless integration of the DPC business into the Citadel group was completed during the year. Following disappointing inflows from inception, Citadel's fledgling joint venture with Sanlam Life was terminated during the second half of the year.

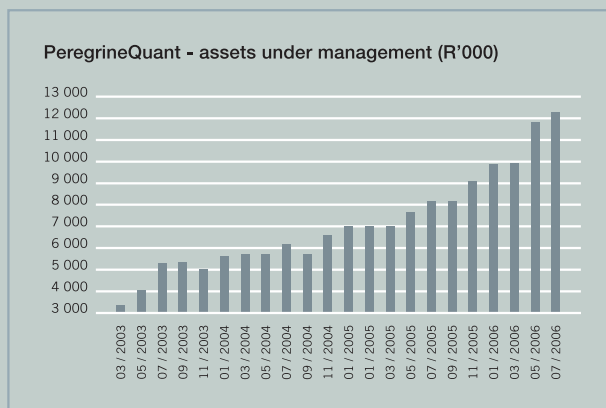
Gross inflows continued at a rate of R100 million per month with the average inflow from new clients increasing to approximately R8 million per client. These flows, together with positive investment performance for the year, saw Citadel's assets under management rise comfortably above R10 billion, with the business starting to accrue performance fees in the last nine months of the year under review. Citadel, whose annuity earnings base now exceeds R50 million per annum before performance fees, currently has more than half of its client base in performance fee territory, with a substantial portion on the threshold of paying performance fees. A year ago, the number of clients paying performance fees was negligible.



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Following the spectacular rise in local equity markets over the three year period to March 2006 and prior to the recent bout of market volatility, Citadel, on behalf of its client base, implemented a structure which gives comprehensive protection against a sharp fall in the local equity market whilst still preserving the long-term upside linkage to the market within the local component of its portfolios. In addition, the business still retains a strong positive correlation to any depreciation in the local currency over time.

The businesses within the **asset management** division collectively increased their contribution to group profitability by 60% to R109,4 million, or 34% of group profitability. The group's hedge fund management operations, comprising both Peregrine Capital and Peregrine Investment Managers (PIM) contributed R101,3 million (93%) of this amount and PeregrineQuant (PQ), whose assets under management now exceed R12 billion, contributed R8,1 million (7%) for the year.



Peregrine is currently South Africa's largest single strategy hedge fund manager, managing in excess of R3 billion of single strategy hedge funds. The group's hedge fund flagship, Peregrine Capital, which has an outstanding (and the country's longest hedge fund) track record, currently manages R2,3 billion. The business is currently expanding its staff complement with a view to increasing its capacity in due course.

The group's newer range of hedge funds, housed within PIM, currently manage an additional R1 billion. During the period, PIM's assets under management were augmented by the acquisition, from Decillion,

of 50% of Big Rock, the fund with the second longest track record in the country.

Returns were consistently good across the group's suite of hedge funds with substantial performance fees being earned. It is worth noting that the group's hedge fund assets under management have almost doubled in the past year alone and tripled over the past two years. With this level of growth, a lower level of return is required in the current year to generate the same level of performance fees achieved in the year under review.

Whilst it is difficult to predict returns in any single year, we envisage that the growth in the hedge fund industry (and concomitantly our funds) will continue at a significant pace and that Peregrine's returns will continue to be attractive on a risk-adjusted basis over the medium to long-term.

Overleaf is a table summarising the performance and risk statistics of several of the single strategy hedge funds managed by Peregrine Capital.

In November last year, Peregrine entered the local fund-of-hedge-fund market with the announcement of the formation of Caveo Fund Solutions, a joint venture with Investment Solutions, the country's largest multimanager. The formation of this business is an integral part of the group's focus on attaining a strong vertically integrated position within the local hedge fund industry. The deal only became unconditional following FSB approval in April 2006 and as a result, Caveo, which will be associate accounted, was not included in the results under review. It is anticipated that inflows into the business will be substantial over time. Assets under management, which were approximately R340 million at inception of the business have grown to R750 million in a short space of time.

The **structuring, broking and distribution** activities housed within Peregrine Securities produced a 232% increase in profitability to R82,3 million, contributing 26% to group profit from ordinary activities. A substantial portion of the profits in the division emanated from interest earned from activities within the prime-broking division. Building a prime-broking capacity within Peregrine Equities has been a further initiative in establishing a vertically integrated platform within the hedge fund industry. The benefits of this strategy became patently evident over the past twelve months with the group applying substantial additional resources and capital to the business during the year. The business now has a "book" of hedge fund and similar clients of approximately R4 billion which is expected to grow as the hedge fund industry expands, which growth will be carefully managed.

Hedge fund performance and risk analysis to 31 March 2006						
	ALSI	Pure Hedge Fund	Performance Fund	High Growth Fund	Global (\$ Fund)	Description
<b>General info</b>						
Inception date		01-Jul-98	01-Jul-98	01-Feb-00	01-Oct-03	
Asset Class		Equity	Equity	Equity	Equity	
Reporting currency		Rand	Rand	Rand	US \$	
<b>Returns</b>						
Compound annual return	19.1%	35.7%	51.6%	41.1%	29.0%	<i>Return since inception, ALSI since 1 July 1998, annualised</i>
Average quarterly return	5.0%	7.9%	11.1%	9.0%	6.2%	<i>Since inception, calendar quarters (e.g. Jan-March), non-annualised</i>
Average monthly return	1.7%	2.6%	3.6%	2.9%	2.0%	<i>Since inception, non-annualised</i>
Rolling 12 month return	57.3%	20.3%	34.4%	56.7%	27.0%	<i>12 months to 31 March 2006</i>
<b>Variability of returns</b>						
% of positive months	57.0%	92.5%	84.9%	79.9%	82.1%	
% of negative months	43.0%	7.5%	15.1%	20.1%	17.9%	
Average positive monthly return	6.0%	2.8%	4.6%	4.1%	2.6%	<i>Since inception, non-annualised</i>
Average negative monthly return	-4.1%	-1.0%	-2.4%	-2.0%	-1.1%	<i>Since inception, non-annualised</i>
Maximum monthly drawdown	-29.7%	-1.8%	-10.7%	-7.3%	-1.6%	<i>Greatest loss, 1 calendar month</i>
Maximum cumulative drawdown	-29.7%	-3.4%	-13.3%	-7.3%	-3.1%	<i>Greatest loss across any unbroken series of losing months</i>
Standard deviation	22.9%	9.2%	18.0%	13.2%	5.9%	<i>Since inception, annualised</i>
Semi-variance	21.0%	2.7%	6.5%	9.2%	9.9%	<i>Last 12 months, annualised</i>
<b>Risk-adjusted returns</b>						
Sharpe ratio (RFR 7%)	0.5	3.1	2.5	2.6	3.7	<i>(Ann return since inception - NCD return) / (ann std dev since inception)</i>
Rolling 12 month Sharpe	2.7	4.3	4.5	6.0	2.9	<i>(Rolling 12m return - NCD return) / (12m standard deviation)</i>
Sortino ratio	2.3	4.4	4.0	5.2	1.9	<i>As with rolling Sharpe, but using semi-variance (downside only)</i>
Information ratio	0.8	3.9	2.9	3.1	4.9	<i>As with Sharpe, but without deducting NCD return</i>
<b>Relationship to other investments</b>						
Correlation to ALSI40 - since inception	1.0	0.12	0.44	0.36	0.42	<i>Monthly returns, since inception</i>
Correlation to ALSI40 - last 12 months	1.0	0.45	0.66	0.54	0.62	<i>Monthly returns, last 12 months</i>
All funds are managed by Peregrine Capital. All returns are after deducting fees.						

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Buoyant market conditions substantially boosted the profitability of the other broking businesses within the division. Similar levels of divisional profitability going forward are possible if the size of the prime broking "book" can be preserved and if market volatility remains high.

Return on **group investments** (net of group costs) increased by 54% to R54,8 million from R35,5 million, contributing 17% to group profitability. Investments were made into several new hedge funds during the year and no withdrawals of group capital were made from any of the group's existing hedge fund investments. Sound returns were achieved across this increased hedge fund base. Similar good returns were achieved within the group's private equity portfolio, which comprises 10% of the group's proprietary investments.

The disposal of all non-core operations in the two years previous to this one, the autonomous nature of the underlying subsidiaries in the group and the ongoing improvement in efficiencies within the group, have allowed the staff complement at a Holdings level to be reduced over the past two years. The head office staff complement is now smaller than at any time in the past five years.

Notwithstanding an increase in Holdings' staff bonuses commensurate with the increase in the group's profitability, head office costs were only 4,5% higher than the previous year (after stripping out the accounting effect of the reversal of the deferred lease obligation on the group's head office in 2005).

## Prospects

We have just completed a year in which the group's return on equity exceeded 40% and the basic earnings per share of 130,4 cents exceeded the low of the Peregrine share price just three years previous.

Whilst being cognisant that short term forecasts would be imprudent for our business, we are quietly confident of what can be achieved over the medium to longer term by continuing to build on the group's well established positions in the local private wealth management and hedge fund arenas.

## BEE transaction

Shareholders are referred to the announcement published on SENS on 7 August 2006, which sets out the revised terms of the proposed BEE transaction.

Completion of the BEE transaction, including receipt by shareholders of amounts arising out of the BEE transaction, should, subject to fulfilment of all conditions precedent, be implemented by October 2006.

## Dividend

In light of the superb results for the year and in keeping with the stated dividend policy of paying out a minimum of 25% of each year's earnings, the directors resolved to declare a dividend of 30 cents per share for the year, an increase of 150% on the previous year. Details of the salient dates for the dividend can be found on page 30.

## Appreciation

The refocusing of the Peregrine group is now complete and the platform for growth well established. With the knowledge that the group is well poised for its next phase of growth, I will hand over the role of CEO to Keith Betty in November this year in order to assume the Executive Chairmanship of this organisation.

Keith and I have had a close working relationship over the past five years and I have every confidence that the group will continue to thrive with him at the helm.

I would like to take this opportunity to personally thank Louis Fourie, our departing Chairman, for his unique contribution to the group over the years, for his wisdom, for his assistance and for the pivotal role that he played in helping to establish the Peregrine group as one of South Africa's leading wealth and asset management operations.

To our talented staff, my small executive team and our board of directors, I offer you my thanks and congratulations at the end of an outstanding year. To our clients, who are our partners in building our brand and reputation, thank you for your support and loyalty. We have an exciting journey ahead.



**Sean Melnick**  
Chief Executive Officer  
14 August 2006