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Credit Opinion: Real People Investment Holdings (Pty) Ltd

Global Credit Research - 04 Aug 2015

Johannesburg, South Africa

Ratings

Category	**Moody's Rating**
Outlook	Negative
NSR Issuer Rating	Ba3.za
NSR ST Issuer Rating	NP.za

Contacts

Analyst	**Phone**
Christos Theofilou, CFA/Limassol	357.25.586.586
Nondas Nicolaides/Limassol	
Sean Marion/London	44.20.7772.5454

Key Indicators

Real People Investment Holdings (Pty) Ltd

	[1]**2015**	[1]**2014**	[1]**2013**	[1]**2012**	[1]**2011**
Total Managed Assets (Rand Million) [2]	**3,755.0**	**4,559.5**	**4,305.8**	**4,278.7**	**3,611.8**
Pretax Preprovision profits / Average Managed Assets	**8.16%**	**17.12%**	**23.53%**	**16.92%**	**11.87%**
Net Income/ Average Managed Assets [3]	**-8.01%**	**-6.85%**	**2.53%**	**3.07%**	**3.96%**
ROE (NPATBUI / Avg. Equity) [4]	**-51.56%**	**-29.16%**	**12.85%**	**9.41%**	**10.51%**
Short Term Debt / Total Debt % [5]	**--**	**--**	**--**	**23.72%**	**16.81%**
Tangible Common Equity / Tangible Managed Assets % [6]	**13.55%**	**15.05%**	**23.11%**	**23.86%**	**27.12%**
Problem Loans/Gross Loans [7]	**53.44%**	**38.03%**	**30.78%**	**27.82%**	**25.75%**
Problem Loans/(Shareholder Equity+ Loan Loss Reserve)	**86.00%**	**75.78%**	**56.70%**	**44.10%**	**30.29%**
Net Charge-offs / Gross Loans [7]	**35.40%**	**26.88%**	**14.73%**	**5.32%**	**24.25%**

[1] For the fiscal year ending March 31 [2] The total assets include the disposal group and may differ from figures below where it is excluded [3] Net income includes income/ loss from the disposal group and may differ from figures below [4] NPATBUI refers to net profit (loss) after-tax before unusual items [5] Short term debt refers to the current liabilities reported by the company [6] Tangible managed assets are total assets less intangibles [7] Gross loans exclude the fair value of acquired debt, housing and education loans

Opinion

Rating Rationale

The Ba3.za/NP.za national scale issuer ratings (negative outlook) of Real People Investment Holdings Limited (Real People) reflect the company's still weak profitability and the challenging domestic operating environment, that poses risks for asset quality and funding. The aforementioned constraints are partially offset by Real People's strengthened capital and loan loss provisioning coverage, and by the company's niche expertise in the unsecured lending and credit management business in South Africa, with a particular strength in risk pricing and loan collections.

No external support has been imputed in Real People's ratings.

Rating Drivers

- The challenging operating environment continues to pose asset quality risks, despite signs of a recovery

- Real People's capital levels have been supported by the recent capital increase

- Profitability continues to provide a weak buffer to absorb credit losses

- Wholesale funding concentrations remain high, although the company's capital increase will support its funding

- Despite a small and narrow franchise, the company maintains a successful niche

Rating Outlook

The outlook on the Ba3.za long-term issuer rating is negative.

What Could Change the Rating - Up

Given the negative outlook and the challenging operating conditions in South Africa's unsecured lending market, there is currently limited upside pressure on Real People's ratings. The outlook may be changed to stable if Real People further strengthens its provisioning and capital levels or Real People's profitability is strengthened.

What Could Change the Rating - Down

Real People's ratings could be downgraded if the challenging operating environment leads to further material provisioning needs and/or the company faces increased risk of a loss of market funding access.

DETAILED RATING CONSIDERATIONS

THE CHALLENGING OPERATING ENVIRONMENT CONTINUES TO POSE ASSET QUALITY RISKS, DESPITE SIGNS OF A RECOVERY

While we acknowledge Real People's experience and expertise in credit management (specifically in risk pricing and loan collections), strengthened provisioning and signs of a recovery in asset quality (supported by management's actions), we expect the challenging operating conditions in South Africa's unsecured lending market to continue to pose asset quality risks. South Africa's weak economic growth (we expect GDP growth to remain weak around 2.0% in 2015), high unemployment and still elevated inflation - will likely continue to weigh on consumers' loan affordability and lead to elevated loan loss provisioning expenses.

Any potential lower loan loss recoveries stemming from any further weakening in the operating environment, present a material downside risk for Real People given its high balance sheet exposure to problematic loans and written off exposures. As of March 2015, Real People's net non-performing loans (NPLs less loan loss reserves) to gross loans stood at 37% of total qualifying capital, while the written-off loan book accounted for an additional 53% of total qualifying capital.

Positively, Real People has taken higher provisions during the fiscal year ending March 2015, to strengthen the general provisioning of the performing loan book and increase the coverage of the NPLs. As of March 2015, loan loss reserves stood at 78% of NPLs, up from 68% as of March 2014. In addition, we note that the company's more recent loan vintages have shown improving asset quality performance following measures taken by management to address the weaker asset quality.

REAL PEOPLE'S CAPITAL LEVELS HAVE BEEN SUPPORTED BY THE RECENT CAPITAL INCREASE

Real People's recent capital increase of ZAR278 million has been used to strengthen provisioning levels and has also allowed the company to maintain capital levels above the stipulated minimum. Although, Real People is not a registered bank nor does it take deposits, and is therefore not regulated by the central bank (the South African Reserve Bank [SARB]), it is contracted to maintain a minimum capital adequacy ratio of 30%. As of March 2015, its total capital adequacy ratio stood above the contracted level at 34.4% (March 2014: 31.7%), although slightly below the company's internal target of 36%. We expect the company to gradually reach its internal target supported by a reduction in risk-weighted asset as its legacy general lending loan book gradually runs-off the balance sheet.

As of March 2015, the tangible common equity (TCE)-to-tangible assets ratio stood at 13.6% (March 2014: 15.1%)

and its Tier 1 capital ratio stood at 18.7% (March 2014: 22.4%). These capital ratios are lower as they exclude the company's subordinated debt and preference shares.

PROFITABILITY CONTINUES TO PROVIDE A WEAK BUFFER TO ABSORB CREDIT LOSSES

Real People reported a loss for the fiscal year ending March 2015, primarily due to the higher provisions required against its loan book. At the same time, Real People's pre-provision profitability has weakened amid lower business volumes. For the fiscal year ending March 2015, pre-provision profitability stood at 8.5% of average assets, compared to 17.1% last year.

While we expect lower provisioning (last year's provisions included one-off adjustments to improve the coverage) and a pick-up in the company's acquired debt business to support profitability, Real People's pre-provision profitability is likely to remain weak amid still subdued volumes in its home finance lending business and a higher cost of funding. As such, Real People's ability to withstand any worse-than-anticipated asset quality deterioration will likely remain constrained in the next 12 months.

Positively, we expect a limited impact on Real People's profitability from potentially lower interest rate caps in unsecured lending, since Real People's lending falls under developmental credit (where the rates have not been lowered). However, pressure may stem from any potential change in the South African regulatory environment that reduces the allowable insurance fees that the company can charge.

WHOLESALE FUNDING CONCENTRATIONS REMAIN HIGH, ALTHOUGH THE COMPANY'S CAPITAL INCREASE WILL SUPPORT ITS FUNDING

High wholesale funding concentrations remain a rating constraint for Real People. The company's top five funders accounted for a relatively high percentage of total funding (at over 50%), despite a gradual diversification over the past few years. As of March 2015, domestic listed and unlisted bonds accounted for 27% of total funding, bilateral loans for 22%, securitisation for 20%, Nordic bonds for 17%, subordinated debt for 10% and preference shares accounted for the remaining 5%.

The company has gradually reduced the proportion of secured debt in its funding structure (March 2015: 17% of gross tangible assets; assets minus goodwill and adding back loan loss reserves); however, the company may increase the amount of securitisation in the next 12 months. Structural subordination could arise if the volume of secured funding exceeds one-third of total funding, thus weighing on the company's unsecured debt ratings.

Although Real People has been under severe liquidity pressure during the last fiscal year, following the capital increase the company's funding position has been improving and liquidity pressures have been easing. For the remainder of the fiscal year ending March 2016, Real People aims to finance its South African operations through ZAR200 million additional funding through a securitisation and its Kenyan operations with KES 2 billion through its inaugural Kenyan bond programme.

DESPITE A SMALL AND NARROW FRANCHISE, THE COMPANY MAINTAINS A SUCCESSFUL NICHE

Real People has a small and narrow franchise in South Africa, with relatively low operational diversification as the company's two main business lines are interconnected; both are dependent on trends in the unsecured lending market. The company's strategy focuses on areas of niche expertise, in particular (1) purpose-specific unsecured lending - primarily home improvement finance - through its cooperation with building material merchants, and education finance (accounting for 43% of net advances as of FYE2015); and (2) the acquisition and servicing of non-performing unsecured debt portfolios (accounting for 31% of net advances). An additional 26% of net advances are related to the company's discontinued operations and are being run-down.

Nevertheless, Real People maintains a successful niche franchise underpinned by its competitive advantage in credit management and distressed debt collections (with collections exceeding the market average). Its housing finance business model is also supported by its IT systems, with a branch origination platform incorporating customer risk scoring, product selections and pricing, and affordability calculations, all of which are linked directly with a centralised database. In terms of the acquisition of unsecured debt portfolios, we expect Real People to strengthen its market position following some recent portfolio acquisitions. While this market's growth potential is high, it remains relatively small and underdeveloped. Real People also provides outsourced collections services to other credit providers in the banking, retail and cellular phone industries.

SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, we have sourced data relating to system-wide trends and market shares from the central bank. Bank specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: "Financial Statement Adjustments in the Analysis of Financial Institutions" (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_182293) published on 15 June 2015.

RATING METHODOLOGY

The principal methodologies used in this rating were "Finance Company Global Rating Methodology", published in March 2012, and "Mapping Moody's National Scale Ratings to Global Scale Ratings", published in June 2014. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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