# Real People Investment Holdings

REAL PEOPLE™

## Financial results for the 3 months ended 30 June 2016

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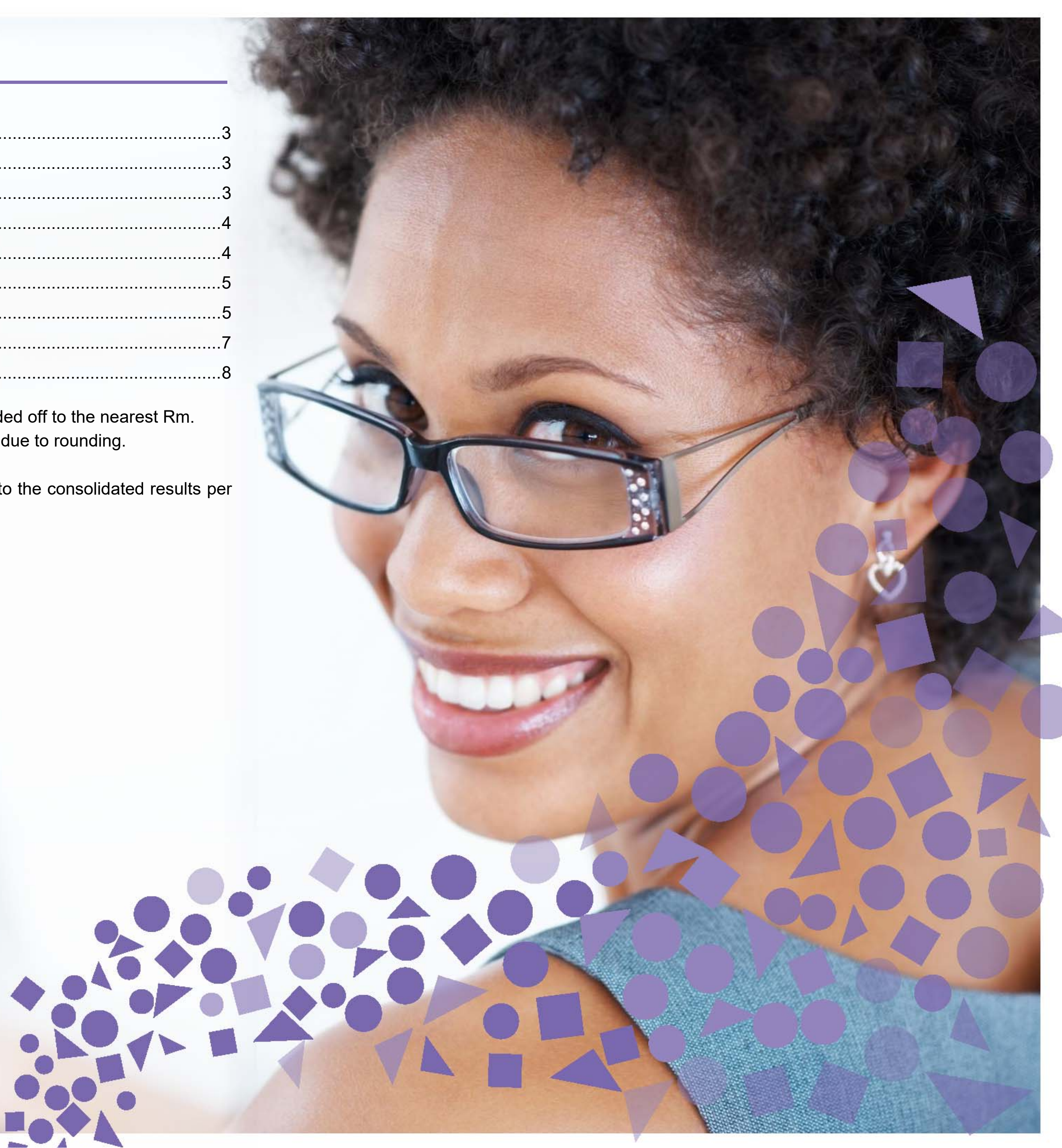
* Unless otherwise stated, all financial figures have been rounded off to the nearest Rm. In certain instances, published calculations may not be exact due to rounding.

The sum of the divisional results per line item may not agree to the consolidated results per line item due to consolidation elimination entries.



## 1. Introduction

The start to the financial year was disappointing for the Group as a result of a challenging operating environment in South Africa and a poor operating performance in the East African business. Despite this, Management's strategic focus remains unchanged with continued focus on growth in the main existing businesses being the Responsible Finance offering in South - and East Africa and the acquisition and collection of non-performing debt in South Africa.

## 2. Overview: Operating environment

The SARB left rates unchanged at its most recent meeting owing to a marginal improvement in its inflation forecast. Inflation is now expected to average 6.6% over the 2016 forecast period. Growth rates were also revised down to 0.0% from an already stagnant 0.6% offering no respite to an unemployment rate officially confirmed at 26.7% in May.

In Kenya, the CBK's decision to retain the policy rate at 10.5% reflects its apparent satisfaction with the macroeconomic landscape characterised by: muted demand-led inflationary pressures; a stable foreign exchange market underpinned by a narrowing of the current account; diminishing credit and liquidity risks; and robust economic growth. Inflation is expected to track the upper boundary of the target band of 7% although the CBK remains weary of financial vulnerabilities which may arise out of political rumblings in the EU.

## 3. Regulatory developments

**National Credit Amendment Act**

The published amendments to regulations associated with new interest and fees that may be charged took effect on 6 May 2016 successfully and are considered to be positive in light of the Group's stated intent to reduce the cost of credit to consumers within the Responsible Finance division.

The proposed regulations with regard to maximum credit life premiums were published for public comment during November 2015. There have been no further developments published since then. A worst case scenario, that the credit life rates remain as proposed for Developmental Credit Agreements, being R2.00 per R1 000 of the deferred amount (excluding the cost of credit), will have a significant impact on the Home Finance division's risk appetite and accordingly on its origination volumes and long term sustainable profitability.

Management has engaged the Department of Trade and Industry (DTI) as part of the public comment process, wherein a submission was made arguing, inter alia, that the rates for Developmental Credit Agreements should be the same as for Unsecured Credit Agreements. The current rate proposed for Unsecured Credit Agreements is R4.50 per R1 000 of the deferred amount (excluding the cost of credit).

**Legal action regarding the legislation governing Emoluments Attachment Orders (EAOs) - Stellenbosch case**

This matter is currently awaiting judgment from the Constitutional Court. The potential impact on the Group, should the order be upheld with prospective effect, is not expected to be material as previously communicated. In the event of the order being implemented retrospectively, the impact would be materially negative for the Group.

**Authenticated collections**

The Payments Association of South Africa (PASA), under the auspices of the South African Reserve Bank, is in the process of replacing the current debit order collection mechanism utilised by most mass market financial product providers, NAEDO, with a mechanism that requires greater levels of customer authentication of the payment mechanism (AC). It is critical for the uninterrupted operations of the Group that the AC mechanism incorporates a customer friendly user interface, in the absence of which the Group's ability to obtain payment arrangements will be impaired severely. PASA is being engaged in this regard via various stakeholder forums. Implementation has been delayed to February 2018.

**Real People Assurance Company Ltd (RPAC) - Solvency Assessment and Management (SAM)**

RPAC is currently in a Comprehensive Parallel Run (CPR) phase and has submitted the required returns during the period. The Financial Services Board (FSB) confirmed that full SAM implementation will be effective on 1 January 2017, and the CPR phase will continue until that date.

Board Notice 158 has been applicable since 1 April 2015 and it prescribes several additional governance and risk management requirements. A number of transitional exemptions have been applied for and approval has been received from the FSB. The FSB has confirmed classification of RPIH as an Insurance Group in terms of the Insurance Laws Amendment Bill (2016). Management is currently assessing the associated regulatory requirements with which the group needs to comply.

***East Africa***

In Kenya, there has been significant focus by regulators on enhancing transparency with regard to the total cost of credit within the financial sector. Despite this development, no significant change in credit pricing has been observed.

In Uganda, a new bill is under discussion that is intended to govern operators licensed under the Money Lenders Act under which the Group's business there operates. The main issues under discussion include placing a cap on maximum rate and maximum loan amounts that money lenders can offer, protection for borrowers who pay off loans early, bringing more of the money lenders into the tax paying bracket and restrictions on payroll loans. These developments are being monitored closely and Management will continue to evaluate any potential impact to business in Uganda.

## 4. Corporate actions

The Group received an offer for the Aspire Group which has been accepted and approved by the Board. Agreements are in the process of being finalised with the effective date of sale remaining 1 January 2016. In terms of the transaction agreed, the Group will retain contingent exposure on potential closure costs related to the post schools' business for a period of 6 months after the signature date of the transaction.

## 5. Matters of emphasis

As mentioned in the previous quarter's report, there has been concern surrounding the recoverability of approximately **R25m** cash deposited with Rafiki Bank, a subsidiary of Chase Bank. Chase Bank has been placed under recovery and resolution by the Kenya Central Bank. Management has negotiated a payment plan with Rafiki over the next six months which has been honoured to date. Based on actions by Rafiki, management expects full recovery, however, there is still concern surrounding the recoverability of the amount. This is being monitored closely by Management.

## 6. Capital

The Group remains adequately capitalised at **33%**. The Capital Adequacy Ratio remains above the covenant level of **30%** but below Managements' target level of **36%**.

| Capital Adequacy Ratio<br>RPIH Group | Dec 15<br>R'000s | Mar 16<br>R'000s | Jun 16<br>R'000s |
|---|---|---|---|
| **Tier 1 Capital** | **384 653** | **386 362** | **359 290** |
| Capital and reserves* | 484 307 | 500 343 | 472 483 |
| Investment in financial institutions | (13 070) | (8 093) | (9 016) |
| Investments in securitisation vehicles | (85 087) | (105 888) | (104 177) |
| Intangible assets | (1 497) | - | - |
| **Tier 2 Capital** | **336 119** | **330 058** | **319 746** |
| Subordinated debt | 267 481 | 271 564 | 263 866 |
| Less: Non qualifying subordinated debt | (25 328) | (21 392) | (27 624) |
| Qualifying preference shares | 165 590 | 170 846 | 173 138 |
| General allowance for credit impairment | 26 533 | 23 021 | 23 559 |
| Investment in financial institutions | (13 070) | (8 093) | (9 016) |
| Investments in securitisation vehicles | (85 087) | (105 888) | (104 177) |
| **Qualifying capital** | **720 772** | **716 420** | **679 036** |
| Credit risk | 2 122 569 | 1 892 391 | 1 884 709 |
| Operational risk | 65 297 | 65 297 | 54 981 |
| Market risk | 97 666 | 118 729 | 119 317 |
| **Total risk weighted exposure** | **2 285 532** | **2 076 417** | **2 059 008** |
| **Capital Adequacy Ratio** | **31.54%** | **34.50%** | **32.98%** |
| **Tier 1 Capital** | 16.83% | 18.61% | 17.45% |
| **Tier 2 Capital** | 14.71% | 15.89% | 15.53% |

**Reserves exclude FCTR and cashflow hedge reserve*

## 7. Funding and liquidity

The Group continues to raise new funding at divisional level for ongoing asset origination in line with its stated intention to migrate funding from Group to divisional level. **R50m** was raised at a divisional level for the period under review.

Given deteriorating investor sentiment regarding the outlook for the SA economy and consumer, as well as the poor operating performance from the East African business, the Group's continued access to funding to fund growth is cause for specific concern.

The Group's liquidity policy is summarised as follows:

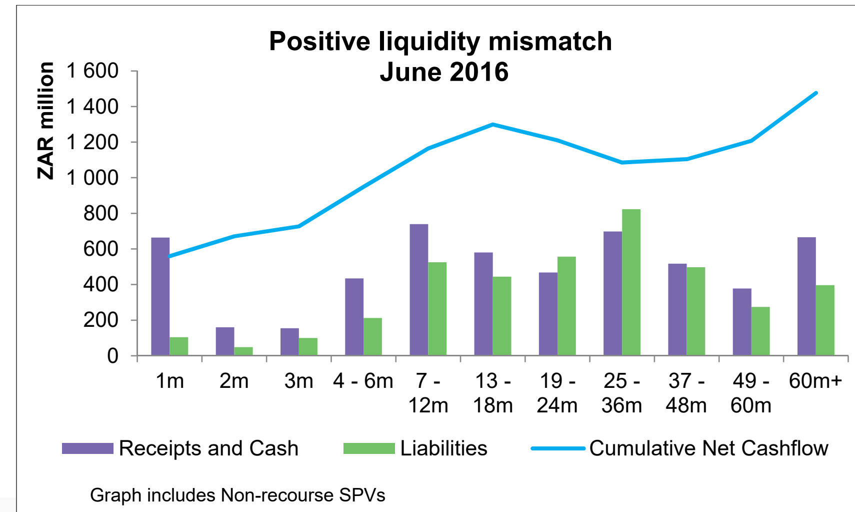
- In the **short-term**, the liquidity policy is designed to ensure that the Group is able to meet all of its operating expenses and debt obligations over the forthcoming 12 months by ensuring that for any 12 month period, available cash and unutilised credit facilities are sufficient to meet the net cash outflow of the Group.

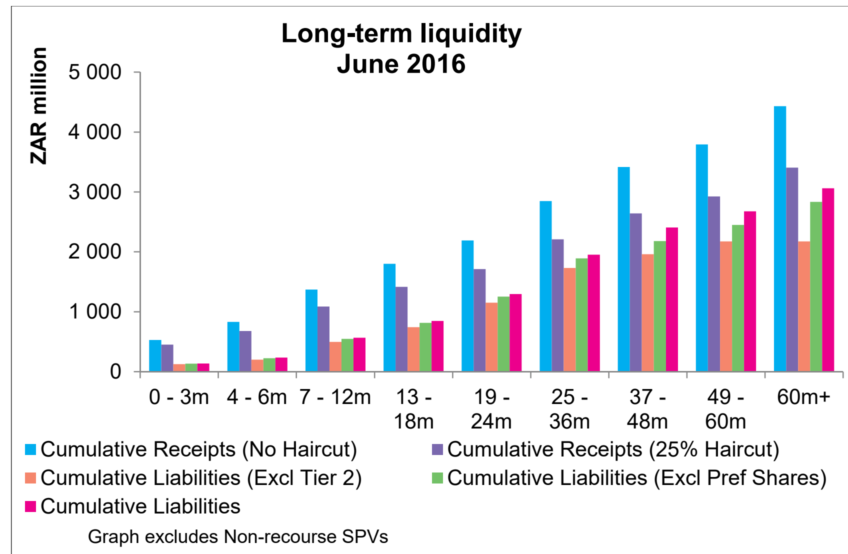
- In the **long-term**, the Group safeguards its debt obligations by ensuring that at any point on its funding profile the following limits are not breached:
  - *Cumulative mismatch limit:* 75% of expected cumulative receipting must at any point of the funding profile exceed the cumulative cash outflows relating to debt repayments (capital and interest). This is measured on a monthly basis and excludes cash flows relating to non-recourse funding special purpose entities.

  - *Single bucket mismatch limit:* The cash outflows relating to debt repayments (capital and interest) less 90% of expected receipting for each six month bucket between month 13 and month 60 may not exceed 15% of the Group's total assets excluding non-recourse funding special purpose entities. This requirement is measured each time the Group enters into any new funding agreements.

The Group remained within its stated short and long term liquidity policies for the period under review.

| | 31 Dec 15 Rm | 31 Mar 16 Rm | 30 Jun 16 Rm |
|---|---|---|---|
| Receipting (10% haircut) | 1 254 | 1 014 | 1 031 |
| Committed expenses | (538) | (618) | (618) |
| Liability repayment | (668) | (585) | (568) |
| **Total net cash inflow/(outflow)** | **48** | **(190)** | **(155)** |
| Available cash | 99 | 245 | 146 |
| Available facilities | 22 | 66 | 68 |
| **Surplus** | **169** | **121** | **59** |



## 8. Group results

***Consolidated Group statement of financial performance***

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| Gross yield from assets | 255.0 | 221.0 | 15% |
| Impairment provision | (49.2) | (47.2) | -4% |
| Net assurance income - credit life | 14.5 | 21.8 | -34% |
| **Net yield** | **220.3** | **195.6** | **13%** |
| Finance costs | (93.4) | (77.2) | -21% |
| **Net margin** | **126.9** | **118.4** | **7%** |
| Net assurance income - funeral benefits | 8.8 | 11.5 | -23% |
| Outsourced collection income | 9.1 | 10.9 | -16% |
| Sundry income | 0.7 | 0.5 | 41% |
| **Net operating income** | **145.6** | **141.3** | **3%** |
| Operating expenditure | (160.4) | (131.4) | -22% |
| **Contribution before cost of tier II capital** | **(14.8)** | **9.9** | **> -100%** |
| Attributable to providers of qualifying tier II capital | (16.7) | (16.7) | 0% |
| Foreign exchange gain/(loss) | (0.9) | (0.2) | > -100% |
| **Attributable to ordinary shareholders** | **(32.4)** | **(7.1)** | **> -100%** |
| Profit before tax - disposal group | (0.0) | (0.4) | 100% |
| **(Loss)/profit before tax** | **(32.4)** | **(7.4)** | **> -100%** |
| Taxation | 10.6 | (9.4) | > 100% |
| **(Loss)/profit after tax** | **(21.8)** | **(16.9)** | **-29%** |
| Dividends and non-controlling interest expense | (3.3) | (3.0) | -12% |
| **(Loss)/profit for the period** | **(25.2)** | **(19.8)** | **-27%** |

***Group segment statement of financial performance***

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| **Contribution** | | | |
| Home Finance | 8.5 | 13.1 | -35% |
| Business Finance | (26.9) | (1.8) | > -100% |
| Assurance | 3.3 | 6.0 | -44% |
| DMC | (2.2) | (7.2) | 70% |
| | | | |
| Group Central Services | (8.2) | (14.2) | 42% |
| Hedging gains/losses | (0.6) | 2.2 | > -100% |
| Treasury unallocated net margin | (6.4) | (5.2) | -24% |
| **Profit/(loss) before tax - continuing operations** | **(32.4)** | **(7.1)** | **> -100%** |
| | | | |
| Loss before tax - disposal group | (0.0) | (0.4) | 100% |
| **Attributable to ordinary shareholders** | **(32.4)** | **(7.4)** | **> -100%** |

***Group overview***

Overall, Group losses widened year on year and is more fully explained in the individual units' results below.

The Group's effective tax rate is stablising following tax planning initiatives deployed in the 2016 financial year to end off the quarter at 32.7% versus the previous year's -127.0%, whilst recognition of additional deferred tax assets within the Real People (Pty) Ltd operating company remains suspended.

*Group statement of financial position*

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| **Assets** | | | |
| Loans and advances | 1 792.4 | 1 893.4 | -5% |
| Acquired assets | 975.9 | 945.1 | 3% |
| Property and equipment and intangibles | 60.2 | 79.9 | -25% |
| Investments | 33.1 | 32.3 | 3% |
| Assurance assets | 65.9 | 74.8 | -12% |
| Other assets | 48.8 | 38.9 | 25% |
| Deferred tax assets | 197.3 | 185.6 | 6% |
| Cash and cash equivalents | 526.0 | 493.8 | 7% |
| **Assets of continuing operations** | **3 699.5** | **3 743.8** | **-1%** |
| Assets of disposal group | 0.0 | 17.7 | > -100% |
| **Total assets** | **3 699.5** | **3 761.5** | **-2%** |
| | | | |
| **Equity and liabilities** | | | |
| **Equity** | **519.7** | **440.8** | **18%** |
| | | | |
| **Liabilities** | | | |
| Long term interest bearing borrowings - senior | 2 546.3 | 2 710.8 | -6% |
| Long term interest bearing borrowings - subordinated | 260.1 | 204.1 | 27% |
| Long term interest bearing borrowings - preference shares | 170.9 | 194.7 | -12% |
| Assurance liability | 56.5 | 64.9 | -13% |
| Deferred and current tax liabilities | 10.7 | 14.0 | -24% |
| Other liabilities | 135.3 | 125.9 | 7% |
| **Liabilties of continuing operations** | **3 179.8** | **3 314.4** | **-4%** |
| Liabilities of disposal group | - | 6.3 | > -100% |
| **Total equity and liabilities** | **3 699.5** | **3 761.5** | **-2%** |

# 9. Cluster results

## 9.1. Home Finance

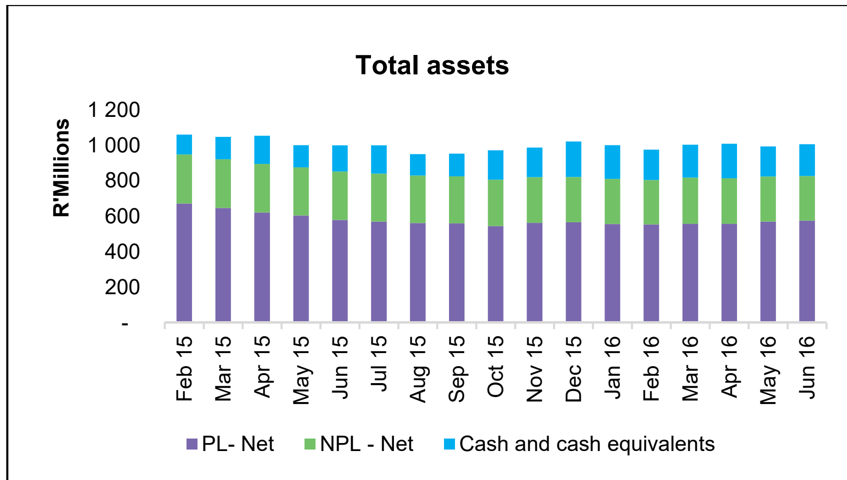
*Statement of financial performance*

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| Gross yield from assets | 94.0 | 98.9 | -5% |
| Impairment provision | (19.9) | (23.2) | 14% |
| **Net yield** | **74.1** | **75.7** | **-2%** |
| Finance costs | (26.4) | (27.1) | 3% |
| **Net margin** | **47.8** | **48.6** | **-2%** |
| Operating expenditure | (36.0) | (31.6) | -14% |
| **Normalised contribution** | **11.8** | **17.0** | **-30%** |
| Attributable to providers of qualifying tier II capital | (3.3) | (3.8) | 14% |
| **Attributable to ordinary shareholders** | **8.5** | **13.1** | **-35%** |
| | | | |
| **Net advances** | **827.2** | **855.4** | **-3%** |

*Financial results*

Earnings attributable to ordinary shareholders has declined year on year by 35%, stemming in part form a marginal drop in the net margin in combination with increased expenditure due to inflationary pressure as well as spend directed at increasing disbursement volumes.

Yield and finance costs need to be seen in light of the Home Finance asset base. From the graph below, it is evident that the trend of declining net advances continued into the 2017 financial year following the impact of capital and liquidity constraints faced by the business in the second half of FY 2015. On average net advances were 6% down on that of the prior period, being the main reason for the drop in gross yield. This trend has now reversed with the performing loan book increasing and becoming a larger percentage of the book overall.




The period under review reflects a recovery in origination volumes, which have increased by 47% from Q1 FY2016 to R135m Q1 FY2017.

Requirements for cash balances in securitisation funding structures have on average increased, and so too the associated negative carry. Despite this, the overall net yield has remained constant at approximately 30% for the current quarter (note the overall yield referred to here differs from the vintage view shown in the yield graph later on, in that it includes the yield on all vintages, cash balances and a number of small legacy books).

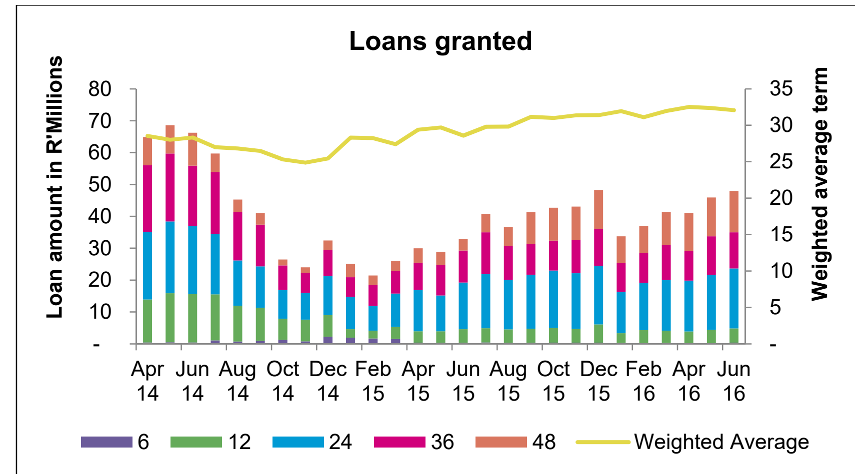
The credit metrics for the business have continued to improve over the past year, with a greater percentage of loans disbursed being directed at lower to medium risk business. This change has had a positive effect on asset and earnings quality.

Finance costs have shown a marginal decline year on year, despite an increasing interest rate environment, this being attributable to a larger percentage of the book being funded through capital than in the prior period.

Operating expenditure has increased by 14% on a year on year basis mainly due to increased staff related and other costs associated with growing disbursement volumes.

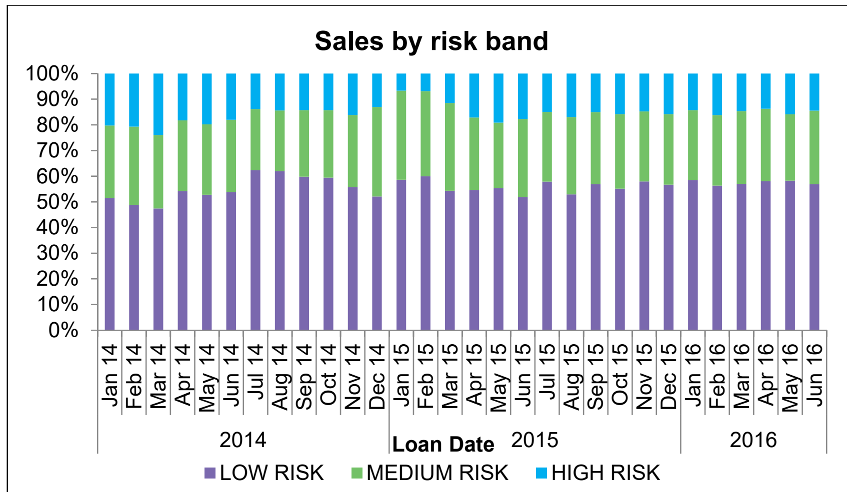
***Loans granted***

The period under review reflects strong growth in volumes with June sales approaching R50m. The average term originated has also been increasing as lower risk customers are originated from stores such as those in the Massbuild group.



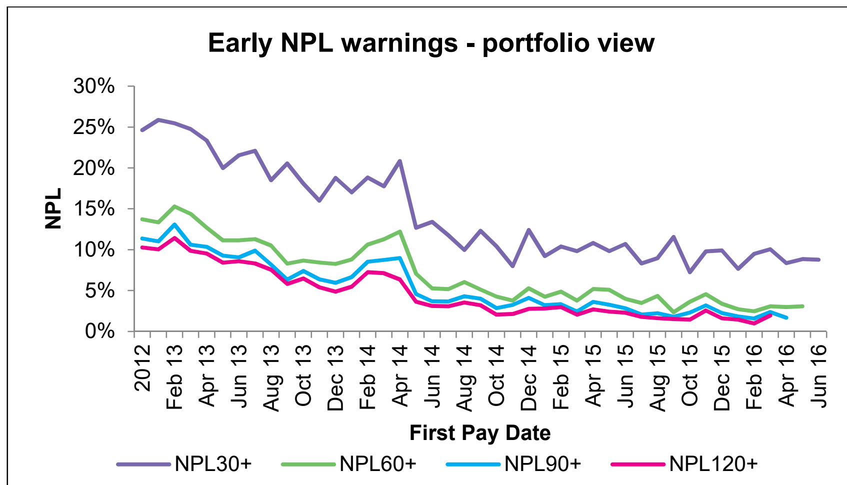

***Risk distribution***

The risk mix remained stable for the period under review with the low risk products making up close to 60% of loans disbursed. The low and medium risk business forms a higher percentage of the total than it did in the comparative period.



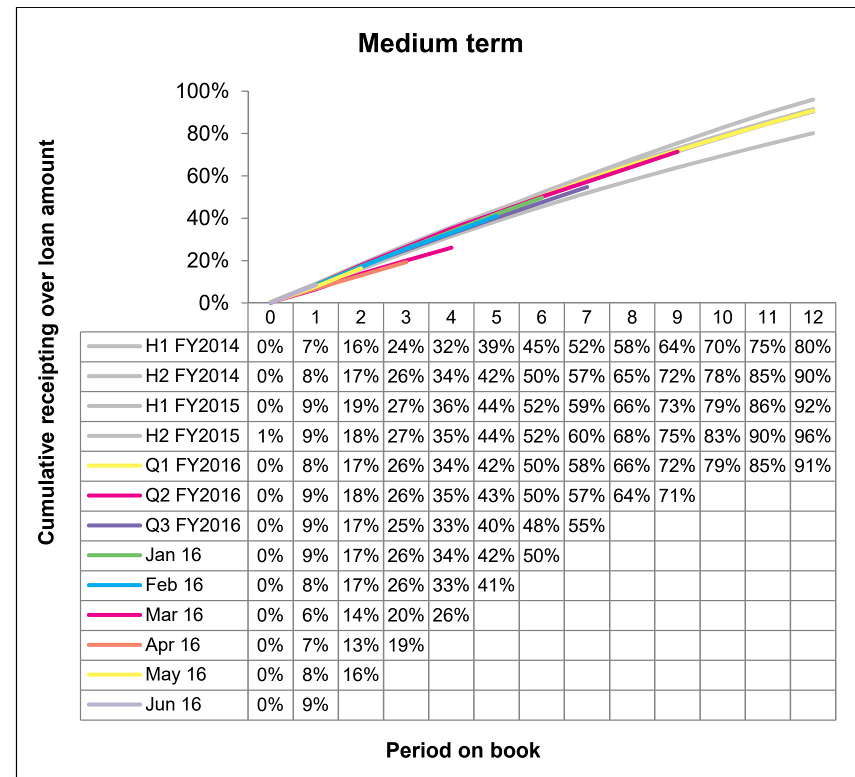

***NPLs Early Warning Indicators***

Early stage NPLs (arrears in the first four months of contract origination) remained within expected levels. The March vintage saw an increase in missed payments from the first month on book. This has however normalised in May and June. Missed four payments in a row remains significantly lower than they have been in prior years.



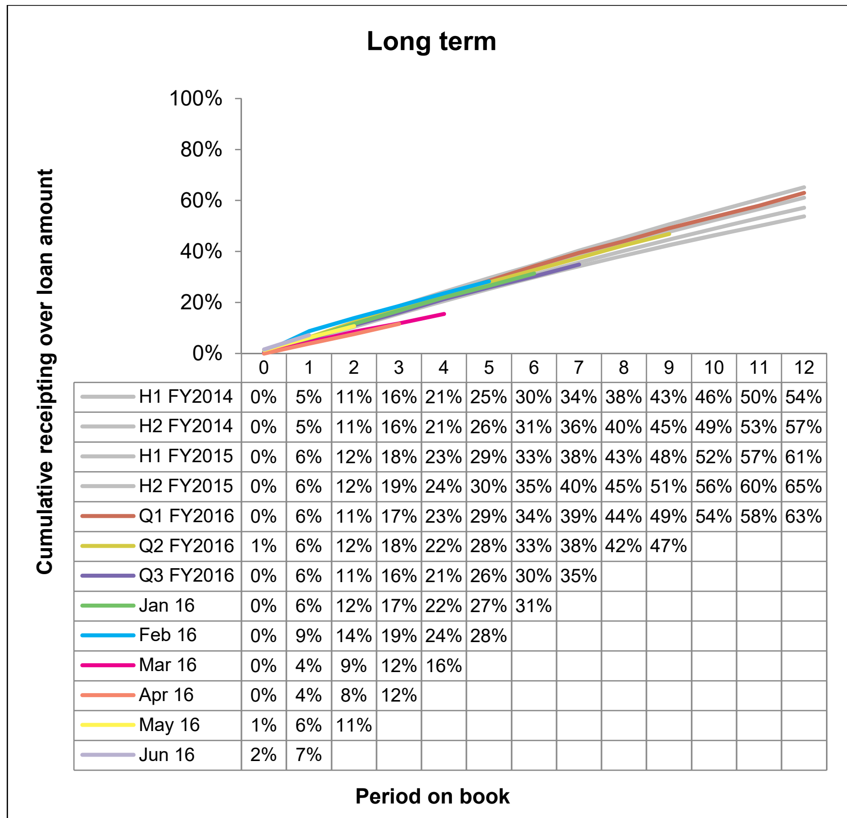

***Cumulative receipting***

The cumulative receipting percentage represents cumulative receipting as a percentage of original loan amount. The graphs below show this percentage on a vintage basis allowing for comparisons to be made.

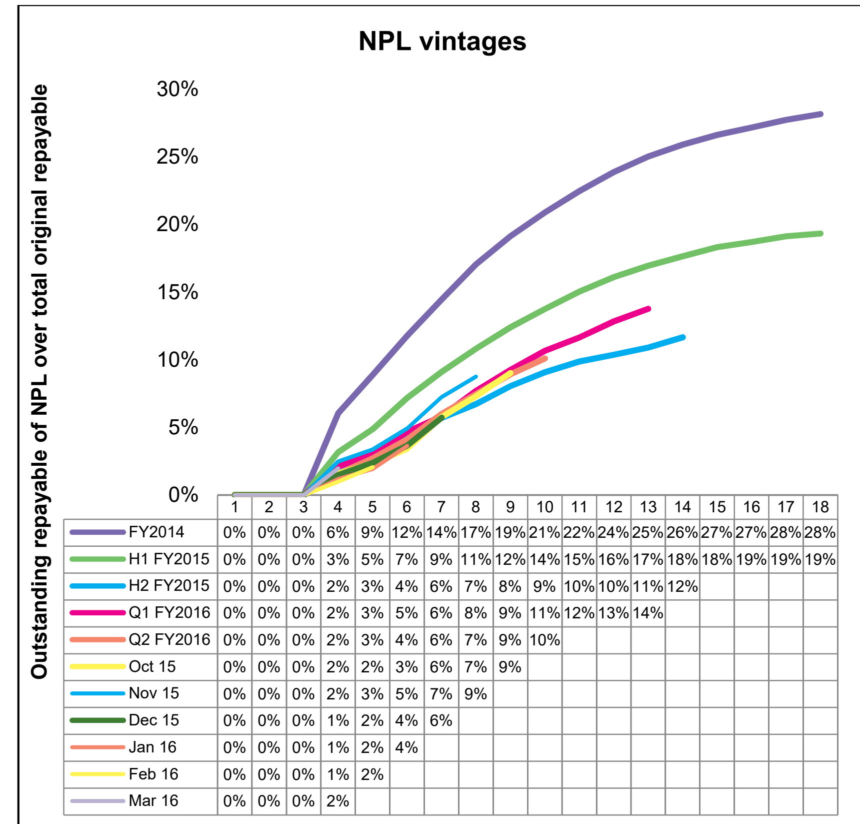



| | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| H1 FY2014 | 0% | 7% | 16% | 24% | 32% | 39% | 45% | 52% | 58% | 64% | 70% | 75% | 80% |
| H2 FY2014 | 0% | 8% | 17% | 26% | 34% | 42% | 50% | 57% | 65% | 72% | 78% | 85% | 90% |
| H1 FY2015 | 0% | 9% | 19% | 27% | 36% | 44% | 52% | 59% | 66% | 73% | 79% | 86% | 92% |
| H2 FY2015 | 1% | 9% | 18% | 27% | 35% | 44% | 52% | 60% | 68% | 75% | 83% | 90% | 96% |
| Q1 FY2016 | 0% | 8% | 17% | 26% | 34% | 42% | 50% | 58% | 66% | 72% | 79% | 85% | 91% |
| Q2 FY2016 | 0% | 9% | 18% | 26% | 35% | 43% | 50% | 57% | 64% | 71% | | | |
| Q3 FY2016 | 0% | 9% | 17% | 25% | 33% | 40% | 48% | 55% | | | | | |
| Jan 16 | 0% | 9% | 17% | 26% | 34% | 42% | 50% | | | | | | |
| Feb 16 | 0% | 8% | 17% | 26% | 33% | 41% | | | | | | | |
| Mar 16 | 0% | 6% | 14% | 20% | 26% | | | | | | | | |
| Apr 16 | 0% | 7% | 13% | 19% | | | | | | | | | |
| May 16 | 0% | 8% | 16% | | | | | | | | | | |
| Jun 16 | 0% | 9% | | | | | | | | | | | |

Receipting is generally stable except for the March and April vintages. This is due to lower settlements on the PL book, which is positive, but worse than expected PL receipting. This trend has however stabilised to normal levels for the May and June vintages.




| | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| H1 FY2014 | 0% | 5% | 11% | 16% | 21% | 25% | 30% | 34% | 38% | 43% | 46% | 50% | 54% |
| H2 FY2014 | 0% | 5% | 11% | 16% | 21% | 26% | 31% | 36% | 40% | 45% | 49% | 53% | 57% |
| H1 FY2015 | 0% | 6% | 12% | 18% | 23% | 29% | 33% | 38% | 43% | 48% | 52% | 57% | 61% |
| H2 FY2015 | 0% | 6% | 12% | 19% | 24% | 30% | 35% | 40% | 45% | 51% | 56% | 60% | 65% |
| Q1 FY2016 | 0% | 6% | 11% | 17% | 23% | 29% | 34% | 39% | 44% | 49% | 54% | 58% | 63% |
| Q2 FY2016 | 1% | 6% | 12% | 18% | 22% | 28% | 33% | 38% | 42% | 47% | | | |
| Q3 FY2016 | 0% | 6% | 11% | 16% | 21% | 26% | 30% | 35% | | | | | |
| Jan 16 | 0% | 6% | 12% | 17% | 22% | 27% | 31% | | | | | | |
| Feb 16 | 0% | 9% | 14% | 19% | 24% | 28% | | | | | | | |
| Mar 16 | 0% | 4% | 9% | 12% | 16% | | | | | | | | |
| Apr 16 | 0% | 4% | 8% | 12% | | | | | | | | | |
| May 16 | 1% | 6% | 11% | | | | | | | | | | |
| Jun 16 | 2% | 7% | | | | | | | | | | | |



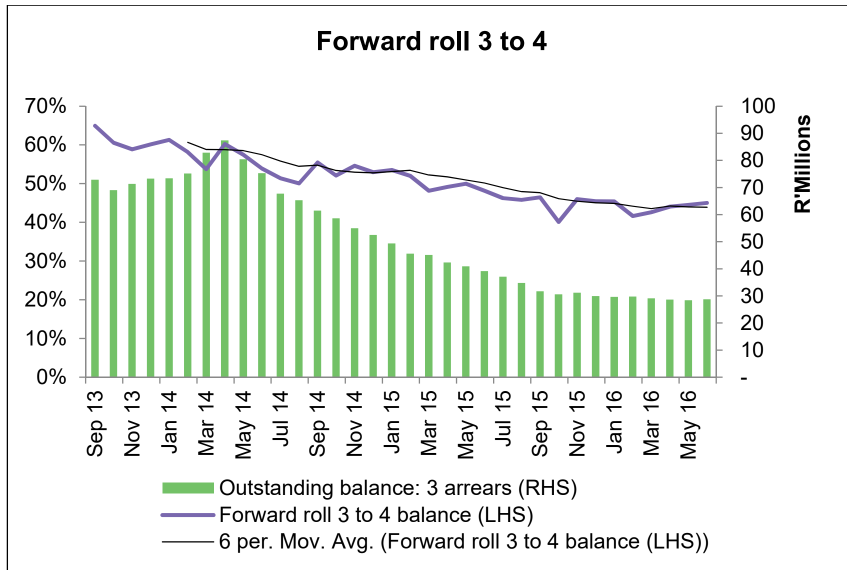

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FY2014 | 0% | 0% | 0% | 6% | 9% | 12% | 14% | 17% | 19% | 21% | 22% | 24% | 25% | 26% | 27% | 27% | 28% | 28% |
| H1 FY2015 | 0% | 0% | 0% | 3% | 5% | 7% | 9% | 11% | 12% | 14% | 15% | 16% | 17% | 18% | 18% | 19% | 19% | 19% |
| H2 FY2015 | 0% | 0% | 0% | 2% | 3% | 4% | 6% | 7% | 8% | 9% | 10% | 10% | 11% | 12% | | | | |
| Q1 FY2016 | 0% | 0% | 0% | 2% | 3% | 5% | 6% | 8% | 9% | 11% | 12% | 13% | 14% | | | | | |
| Q2 FY2016 | 0% | 0% | 0% | 2% | 3% | 4% | 6% | 7% | 9% | 10% | | | | | | | | |
| Oct 15 | 0% | 0% | 0% | 2% | 2% | 3% | 6% | 7% | 9% | | | | | | | | | |
| Nov 15 | 0% | 0% | 0% | 2% | 3% | 5% | 7% | 9% | | | | | | | | | | |
| Dec 15 | 0% | 0% | 0% | 1% | 2% | 4% | 6% | | | | | | | | | | | |
| Jan 16 | 0% | 0% | 0% | 1% | 2% | 4% | | | | | | | | | | | | |
| Feb 16 | 0% | 0% | 0% | 1% | 2% | | | | | | | | | | | | | |
| Mar 16 | 0% | 0% | 0% | 2% | | | | | | | | | | | | | | |

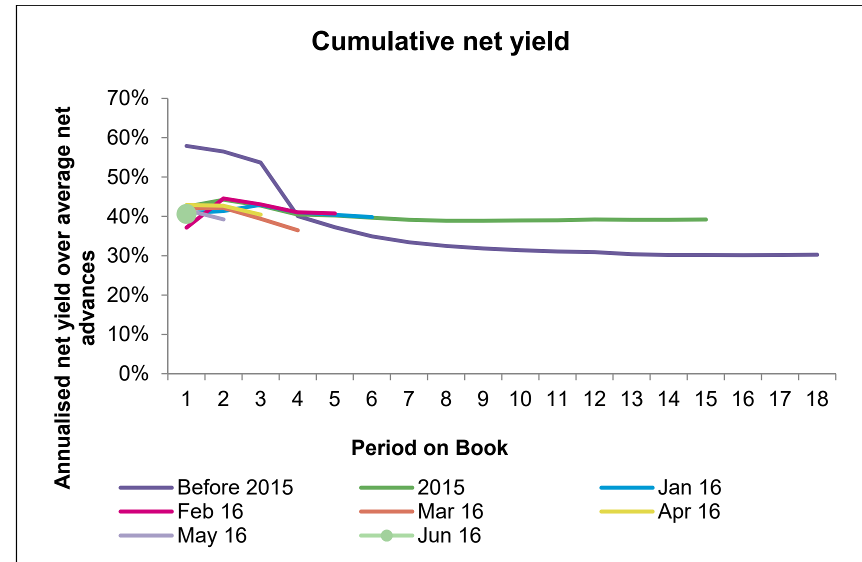
### *Non-performing loan (NPL) rates*

In measuring the quality of credit granted, reference is made to the outstanding balance of NPL loans as a percentage of the original balance, on a vintage basis.

The highest NPLs on the book were experienced in 2014. Product development and underwriting risk enhancements are having a beneficial effect on NPLs. The rate of non-performing loans has improved as the most recent vintages are on track to exceeding expectations.

There has also been continuous improvement in the forward roll on the book from 3 to 4 in arrears (loans 4 in arrears being classified as NPL). The continued decline in both the size of the 3 in arrears bucket as well as the roll rate to 4 in arrears confirms asset quality is improving with the expectation that impairments will continue to decline.




***Yield***

Changes in provisioning policy have impacted the carrying values of PL and NPL loans and have resulted in a change in the profile of the cumulative net yield percentage (post the 2015 FY). IBNR impairments were lifted with provisions for losses being recognised earlier on in the life of the loan. The current product mix and portfolio performance is resulting in an improved and more sustainable net yield of just under **40%**. This is the yield on the net advances book, exclusive of the impact of cash balances.

## 9.2. Business Finance

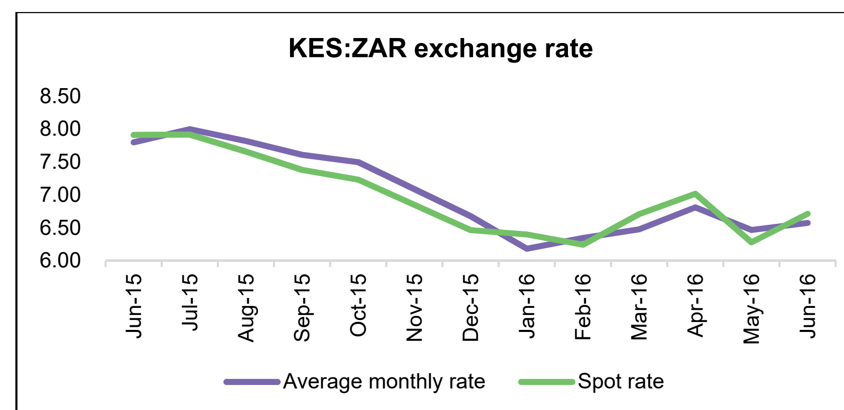
***Statement of financial performance***

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| Gross yield from assets | 48.8 | 33.6 | 45% |
| Impairment provision | (29.3) | (5.9) | > -100% |
| **Net yield** | **19.5** | **27.7** | **-29%** |
| Finance costs | (15.5) | (6.8) | > -100% |
| **Net margin** | **4.0** | **20.9** | **-81%** |
| Operating expenditure | (24.7) | (20.4) | -21% |
| **Normalised contribution** | **(20.7)** | **0.5** | **> -100%** |
| Restructure provision | (3.2) | - | - |
| **Contribution** | **(23.9)** | **0.5** | **> -100%** |
| Attributable to providers of qualifying tier II capital | (3.0) | (2.2) | -34% |
| **Attributable to ordinary shareholders** | **(26.9)** | **(1.8)** | **> -100%** |
| | | | |
| **Net advances** | **334.1** | **282.7** | **18%** |

***Operational overview***

The operating environment in East Africa has deteriorated and is placing pressure on the performance of the business. Corrective actions have been implemented in the underwriting and collection of loans and are expected to start bearing fruit from the second half of the financial year.

The majority of the East African operations are conducted in Kenyan Shillings. The graph below demonstrates movement in the KES:ZAR exchange rate. The KES moved **13.5%** against the ZAR year on year.




Due to the currency fluctuations mentioned above, the division's results in Kenyan Shillings are as follows:

| | Q1 FY2017 Jun KES'm | Q1 FY2016 Jun KES'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| Gross yield from assets | 322.7 | 261.4 | 23% |
| Impairment provision | (193.8) | (46.0) | > -100% |
| **Net yield** | **128.9** | **215.4** | **-40%** |
| Finance costs | (102.6) | (53.0) | -94% |
| **Net margin** | **26.3** | **162.4** | **-84%** |
| Operating expenditure | (167.4) | (158.6) | -6% |
| **Normalised contribution** | **(141.1)** | **3.8** | **> -100%** |
| Restructure provision | (21.0) | - | - |
| **Contribution** | **(162.1)** | **3.8** | **> -100%** |
| Attributable to providers of qualifying tier II capital | (19.7) | (17.3) | -14% |
| **Attributable to ordinary shareholders** | **(181.8)** | **(13.5)** | **> -100%** |
| | | | |
| **Net advances** | **2 242.2** | **2 236.7** | **0%** |

### *Gross yield*

Gross yield increased by 23% year on year as gross advances increased by 29% from KES 2.8 billion to KES 3.7billion. High asset origination after Q1 FY2016 positively affected transaction fees (account maintenance) in Q1 FY2017.

### *Impairments*

The overall impairment charge deteriorated to KES 193.8m from KES 46m. The deterioration is attributable to the high NPLs arising from assets originated after Q1 FY2016 in Kenya and is being driven by collection underperformance and elements of problematic underwriting. The external operating environment during this period contributed to difficulties in servicing these loans. The business has now adopted a steady state growth operational approach as both the underwriting and collections processes are strengthened.

### *Finance costs*

Finance costs increased year on year and is attributable to the bond issue in Kenya being priced at a higher rate than the internal group rate, growth in assets and currency volatility.

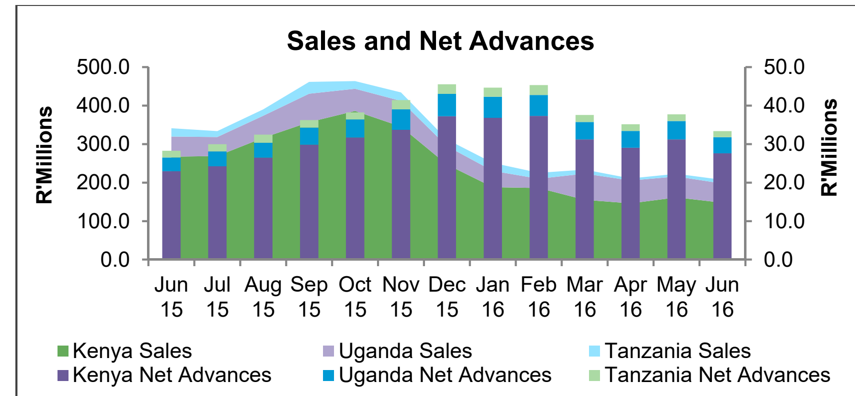
### *Operating costs*

Operating costs increased year on year by **6%** and is due to:

- Increased staff costs associated with medical cover and retirement benefits funding (at 5% from 4% to comply with the legal minimum) and a cost of living adjustment implemented in June 2016; and
- Property rental escalations.

### Origination

Management has placed restrictions on origination volumes in the last two quarters as it focusses on improving portfolio quality and refining the credit underwriting and collections processes in the business. These initiatives will continue into the very near term and will be lifted once they gain traction.




## 9.3. Assurance (excluding credit life)

### *Statement of financial performance*

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| Premiums received | 13.9 | 15.4 | -10% |
| Benefits paid | (2.5) | (3.0) | 16% |
| Assurance liability expense | (2.2) | (1.0) | > -100% |
| Net reinsurance | (0.3) | 0.1 | > -100% |
| **Net assurance income - funeral benefits** | **8.8** | **11.5** | **-23%** |
| Other income | 0.1 | 0.1 | -27% |
| **Net operating income** | **8.9** | **11.5** | **-23%** |
| Operating expenditure | (5.0) | (5.3) | 6% |
| **Contribution** | **3.9** | **6.2** | **-38%** |
| Attributable to providers of qualifying tier II capital | (0.5) | (0.3) | -78% |
| **Attributable to ordinary shareholders** | **3.3** | **6.0** | **-44%** |

**Policy book size**

The planned implementation of increasing outsourced call centre capacity to increase sales volumes was delayed and had a negative effect on growth for the period under review. Management is currently fast-tracking its strategy to implement internal call centre seat capacity in the second quarter of the 2017 financial year.

***Financial performance***

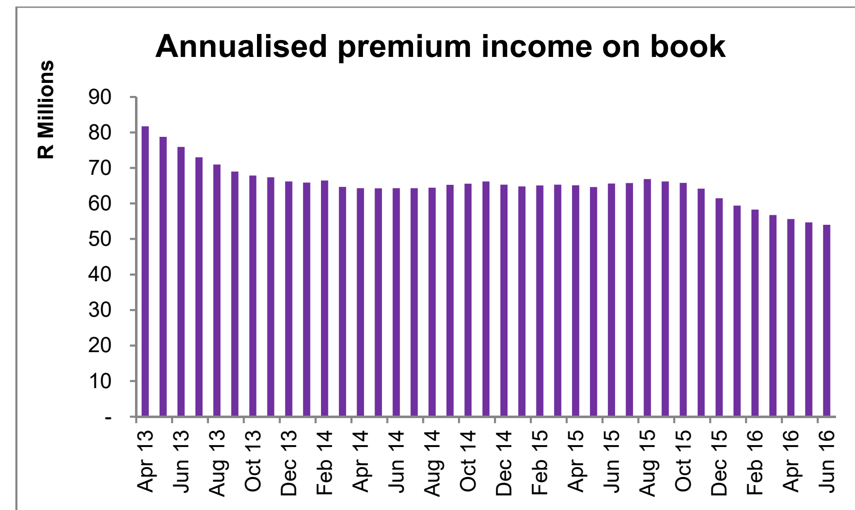
***Net assurance income***

Lower premium policies continue to replace older higher premium policies. This, coupled with lower in force policy numbers, has resulted in lower premium income overall. The product offering has been updated to include multiple lives at the point of sale, and as an upsell later on. This was implemented late in the first quarter and is expected to have a positive impact on receipting. Benefits paid, although remaining difficult to predict, reduced with the diminished in force policy book. The actuarial liability expense increase is due to the increased value of linked policies, which are due to mature in the second quarter of the 2018 financial year. This effect is offset by an increase in the value of the linked assets, which is included in “Premiums received” and is therefore neutral to the income statement. The impact of reinsurance remains low.

***Expenses***

Expenses continue to be managed prudently in line with lower than expected sales despite an increase in expenditure related to compliance with regulatory requirements, which includes a Group Mock ORSA.

***Book size***



## 9.4. DMC

***Statement of financial performance***

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| **Net yield** | 124.3 | 86.0 | 45% |
| Finance costs | (47.4) | (37.0) | -28% |
| **Net margin** | **76.8** | **49.0** | **57%** |
| Outsourced collection income | 9.1 | 10.9 | -16% |
| Internal servicing income | 9.4 | 10.3 | -9% |
| **Net operating income** | **95.4** | **70.3** | **36%** |
| Operating expenditure | (88.2) | (69.2) | -27% |
| **Normalised contribution** | **7.2** | **1.0** | **> 100%** |
| Attributable to providers of qualifying tier II capital | (9.4) | (8.2) | -14% |
| **Attributable to ordinary shareholders** | **(2.2)** | **(7.2)** | **70%** |
| | | | |
| **Net advances** | **1 532.0** | **1 789.5** | **-14%** |

### Financial performance

### Productive assets

| | Net advances - Rm | | Net advances - % | | Net yield - Rm | | Net yield % pa | |
|---|---|---|---|---|---|---|---|---|
| | Q1 FY2017 | Q1 FY2016 | Q1 FY2017 | Q1 FY2016 | Q1 FY2017 | Q1 FY2016 | Q1 FY2017 | Q1 FY2016 |
| Externally acquired | 978 | 940 | 64% | 53% | 91 | 54 | 33% | 31% |
| Internally acquired - General purpose lending | 391 | 566 | 26% | 32% | 21 | 21 | 24% | 16% |
| Internally acquired - Education | 107 | 133 | 7% | 7% | 8 | 9 | 26% | 26% |
| Internally aquired - Cellular | 51 | 132 | 3% | 7% | 4 | 2 | 42% | 42% |
| | **1 527** | **1 770** | | | **124** | **86** | | |

The net yield of the business has grown as a result of three main drivers:

- A change in relative asset mix towards higher yielding externally acquired assets;
- An increase in the acquired assets via a R200m acquisition concluded in June 2015; and
- An increase in the yield of internally acquired assets as a result of impairments raised in Q4 FY2016 in order to increase the forward yield profile of the assets.

Although receipting has been largely in line with asset valuation requirements, performance has fallen short of internal targets, which has impacted the net yield and financial performance negatively.

Finance costs have increased primarily through:

- Changes in mix and methodology of allocating group debt to divisional balance sheets;
- The addition of certain non-productive assets, such as the deferred tax asset, to the DMC business unit as part of the group re-organisation process. These assets attract finance costs; and
- A R200m acquisition concluded in June 2015, with R140m of new debt funding.

The group funding instruments have been hardened from 1 April 2016 and stability is expected in the forward run rate.

As at June 2016, 30% of DMC debt liabilities had been funded from non–group funding lines.

Increases in costs relate to the R200m acquisition which resulted in an increase in call centre capacity and increased costs incurred on collections via external debt collectors.

### Asset quality

Actual receipting for Q1 FY2017 was 99.1% of the receipting requirement supporting asset valuations. Elevated paying customer fall off rates are posing risk to asset valuations.

### Operating environment

Consumer credit statistics for the quarter ended March 2016 show the continuation of a slow improving trend in the number and proportion of impaired records. In the face of a struggling economy, DMC is of the opinion that the

improvement is driven by reduced credit risk appetite and supply (and resultant deleveraging) rather than an improving consumer health and confidence.

Generally, debt collectors and credit providers have experienced a difficult quarter in collections performance.

Collections performance in the Home Finance business has remained stable, largely attributable to good underwriting.

**New business**

There has been a strong flow of debt sales for Q1 FY2017. DMC has been selective in its acquisitions and pricing in light of the uncertain macro-economic outlook. Q1 FY2017 acquisitions were R47m vs R24m for Q1 FY2016. (Note Q1 FY2016 acquisitions have been normalised by the removal of a large once off acquisition).

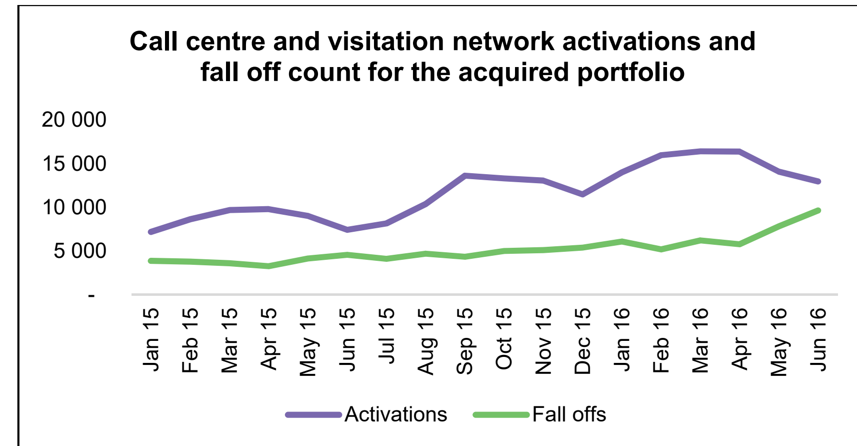
A conservative acquisition volume and pricing appetite will continue with a focus on extracting additional cash from the existing stock pool.

Outsourced (agency) handover volumes are subdued and the levels of competition between panel members is high. The focus in this area of business is not on growth, but on consolidation of performance on existing panels and improving the operating margins.

**Operations**

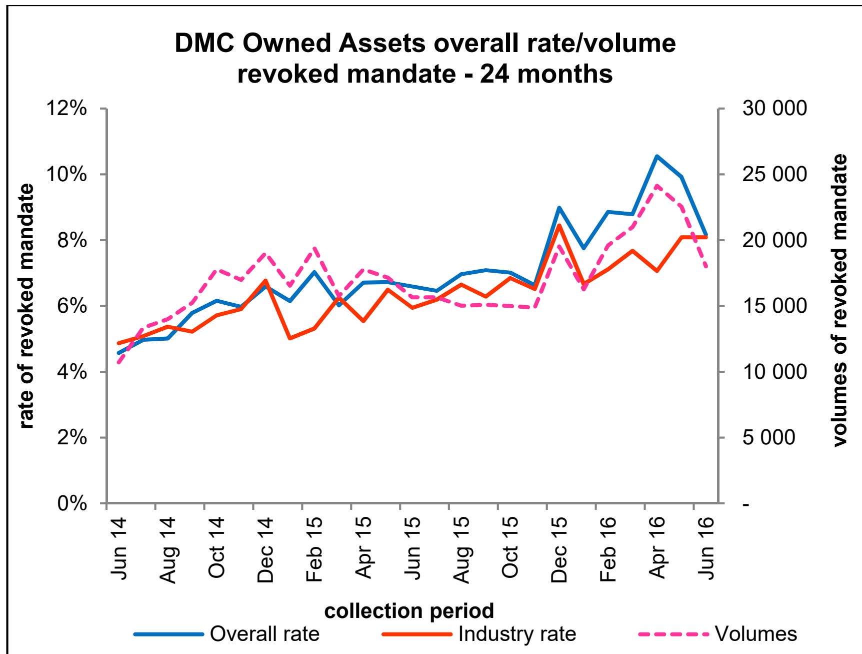
The two primary drivers of receipting levels are activations (accounts paying for the first time in 3 months) and fall offs (accounts that were paying and have not paid for 3 months).

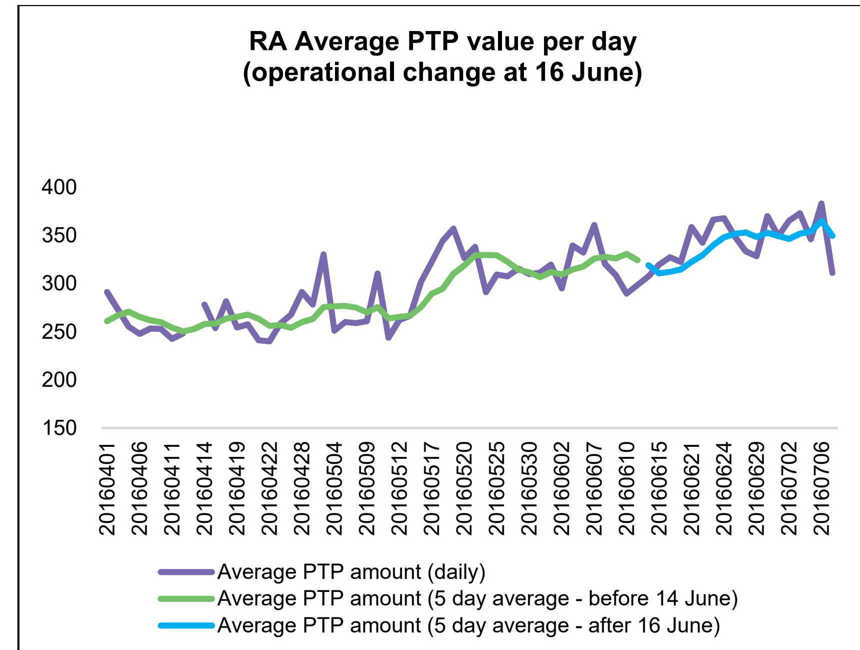
The two primary channels for activations are the collections call centre and a network of visitation agents.




Activation levels have been relatively stable, with some pressure emerging in June, which appears to have reversed in July.

Fall off levels have increased significantly. The primary driver of this has been increased levels of customers stopping payments on their debit orders. This has been an industry wide trend.

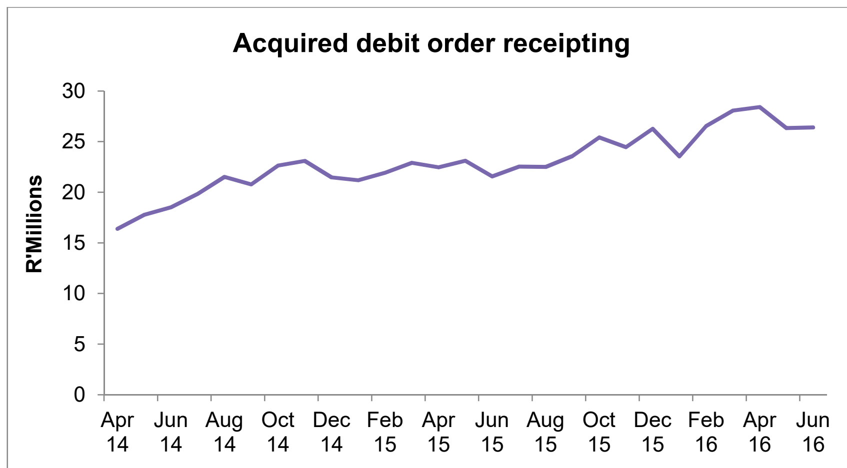



DMC's tactics to improve the fall off rate centre on improved debit order tactics, increasing the average activation instalments and improved process and rigour in following up on fall off defaulters.

Improvements in the process of negotiating instalments implemented in May and June have delivered a significant increase in the average activation instalment derived by the call centre.

Despite the challenges, steady increases in the levels of debit order receipting have been achieved over the past two years. Receipting derived from debit orders is of higher quality than other sources of debt collection receipting. The high fall off rates experienced in Q1 FY2017 have resulted in flat debit order receipting levels.




**Regulatory**

Prescription

DMC has adopted an internal policy of not collecting on debt where internal data proves the debt to be prescribed. Systems have been implemented to manage the prescription status of each debt. Approximately R10bn of this older debt identified as prescribed has been written off.

Authenticated Collections

A project is being managed by the Payments Association of South Africa (PASA) in order to replace the current Naedo industry direct debit mechanism with a new mechanism named Authenticated Collections. Essentially the new mechanism requires a specific customer initiated mandate before a deduction can be made in the early deduction window.

Initial project implementation timeframes were for a full implementation by October 2016. These timeframes were not able to be met due to the complexity and scale of the project and the systemic risk probability of a hasty implementation. Thankfully, the PASA steering committee has now acknowledged the risks and current state of readiness, and revised project timeframes have been proposed to the SARB. Under the new timeframes (still subject to SARB approval) users will convert to the new system from February 2018, with the existing Naedo system still available as a backstop during this process.

## 9.5. Group Central Services and unallocated interest

| | Q1 FY2017 Jun R'm | Q1 FY2016 Jun R'm | Q1 FY2017 v FY2016 % |
|---|---|---|---|
| Net margin | (5.8) | (3.1) | -89% |
| Hedging gain/loss | (0.6) | 2.2 | > -100% |
| Operating expenditure | (8.2) | (12.4) | 34% |
| Attributable to providers of qualifying tier II capital | (0.6) | (2.1) | 72% |
| | **(15.3)** | **(15.4)** | **1%** |
| Closed divisions | 0.0 | (1.8) | > 100% |
| | **(15.3)** | **(17.2)** | **11%** |

The decrease in operating expenditure on a year on year basis is largely attributable to the following:

- Decentalisation of the Human Capital and Payroll functions to the operating divisions (R1.1m); and
- R900k was released to the income statement in June 2016, based on an overprovision of the short term incentive for the 2016 financial year. No provision has been raised to date for FY2017, whereas R1.6m had been raised for Q1 FY2016. This has resulted in a year on year variance of R2.5m.