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Credit Opinion: Real People Investment Holdings (Pty) Ltd

Global Credit Research - 01 Feb 2016

Johannesburg, South Africa

Ratings

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

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Key Indicators

Real People Investment Holdings (Pty) Ltd

	[1]2015	[1]2014	[1]2013	[1]2012	[1]2011
Total Managed Assets (Rand Million) [2]	3,815.4	4,606.9	4,355.0	4,278.7	3,611.8
Pretax Preprovision profits / Average Managed Assets	8.06%	16.93%	23.40%	16.92%	11.87%
Net Income/ Average Managed Assets [3]	-7.91%	-6.78%	2.52%	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]	13.33%	14.89%	22.85%	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 a challenging operating environment for its South African unsecured lending business, amid potential adverse regulatory changes and a fragile economic environment that continues to pose risks for asset quality and funding. These constraints are balanced against Real People's recent strengthening of its loan loss provisioning coverage and signs of improvement in its distressed debt collection and regional unsecured lending operations.

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

Rating Drivers

- Profitability will continue to provide a weak buffer to absorb credit losses

- A challenging operating environment continues to pose risks

- While solvency has improved, capital levels remain below target

- Wholesale funding concentrations remain high and secured lending is increasing

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 improves.

What Could Change the Rating - Down

Real People's ratings could be downgraded if, either (1) adverse changes in the regulatory environment materially impact the company's profitability and business proposition, (2) the challenging operating environment leads to further material provisioning needs that erode capital, or (3) the company's secured funding exceeds one-third of total funding (currently at 27%).

DETAILED RATING CONSIDERATIONS

PROFITABILITY WILL CONTINUE TO PROVIDE A WEAK BUFFER TO ABSORB CREDIT LOSSES

Real People has a small and narrow franchise in South Africa focusing on (1) purpose-specific unsecured consumer lending - primarily home improvement and education finance - through its cooperation with merchants (accounting for 28% of net loans as of September 2015); and (2) the acquisition and servicing of non-performing unsecured debt portfolios (32%), including outsourced collection services to other credit providers in the banking, retail and cellular phone industries. The company also provides unsecured business lending in East Africa (12%), while an additional 22% of loans relate to its South African discontinued operations (general-purpose lending and cellular receivables), which are being run-down.

Materially higher South African loan impairment provisions led to bottom line losses during the fiscal years ending March 2015 (FYE2015) and March 2014 (FYE2014), while pre-provision profitability weakened amid a cut-back in business volumes following funding constraints. For the first six months of the fiscal year ending March 2016 (1H FYE2016), Real People made a smaller loss of ZAR27.6 million (FYE2015: ZAR323.2 million, FYE2014: ZAR304.0 million) primarily due to an asset impairment of ZAR32 million in the company's discontinued cellular operations. While the company's ongoing operations were modestly profitable, business volumes remained depressed with pre-provision profitability at 8.0% of average managed assets during 1H FYE2016, similar to the 8.1% reported during FYE2015 yet below historical levels (FYE2014: 16.9%).

We expect Real People's profitability to remain weak over the next 12-18 months, providing a weak buffer to absorb credit losses, as business volumes are unlikely to show any material rebound, and the cost of funding will remain elevated (including a cumulative preference share dividend of ZAR21million per annum), at a time of material further risks to unsecured lending profitability amid regulatory developments (see below). This is despite lower provisioning compared to the past two fiscal years and a pick-up in the company's acquired debt business where Real People strengthened its market position following some recent portfolio acquisitions.

Within the context of already weak profitability, if implemented, the regulatory proposal to cap credit life insurance charges represents downside risks. The proposal sets the maximum prescribed cost of credit life insurance on unsecured developmental loans at ZAR2.0 per ZAR1,000 of the insured amount on a reducing balance. This is roughly half of what Real People currently charges and, if implemented, the new regulation would further depress the company's profitability, jeopardize the viability of its unsecured product offering and weigh on the company's ratings. We expect more clarity on any final regulation and its impact on its South African lending operations (accounting for 61% of normalized pre-tax profit from its ongoing operations during 1H FYE2016) within the first quarter of 2016.

A CHALLENGING OPERATING ENVIRONMENT CONTINUES TO POSE RISKS

Real People's asset quality has shown signs of stabilization, with recent non-performing loan vintages improving following corrective measures taken by management. However, the challenging economic conditions in South Africa continue to pose asset quality risks. South Africa's weak economic growth (we expect GDP growth to remain weak around 1.4% in 2016), high unemployment and still elevated inflation - will likely continue to weigh on consumers' loan affordability, lead to elevated loan loss provisioning expenses and weigh on collections. This is in spite of Real People's experience and expertise in credit management and distressed debt collections (specifically in risk pricing and loan collections). With Real People having a high balance sheet exposure to problematic loans and written off exposures, potentially lower loan loss recoveries will have a material impact. As of September 2015, Real People's net non-performing loans (NPLs less loan loss reserves) stood at 47% of total qualifying capital, while the written-off loan book accounted for an additional 52% 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. However, we do note that the eventual introduction of IFRS 9 will likely necessitate higher provisions over the next three years. As of September 2015, loan loss reserves stood at 77% of NPLs (March 2015: 78%, March 2014: 68%).

WHILE SOLVENCY HAS IMPROVED, CAPITAL LEVELS REMAIN BELOW TARGET

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 (the total capital adequacy level stood at 31.3% as of September 2015, March 2015: 34.4%, March 2014: 31.7%). 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 funders to maintain a minimum covenanted capital adequacy ratio of 30%.

However, the total capital adequacy level remains below the company's internal target of 36%, while the tangible common equity (TCE)-to-tangible assets ratio stood at 11.8% as of September 2015 (March 2015: 13.3%, March 2014: 14.9%) and its Tier 1 capital ratio stood at 16.5% (March 2015: 18.7%, March 2014: 22.4%). These capital ratios (which exclude subordinated debt and preference shares) are lower than our comfort levels. Capital levels dropped during 1H FYE2016 as Real People acquired a large distressed debt portfolio, a conscious move by management in order to support business volumes and recurring earnings going forward. While management expects to gradually reach its internal target through higher recurring earnings and lower risk-weighted assets (given the drop-off of the legacy general lending loan book), a further drop in the capital levels will weigh on its ratings.

WHOLESALE FUNDING CONCENTRATIONS REMAIN HIGH AND SECURED LENDING IS INCREASING

While Real People remains under funding and liquidity pressure, following the capital increase funding and liquidity pressures have eased somewhat in comparison to the previous year. During 1H FYE2016, the group raised approximately ZAR350 million in funding through a successful listed bond programme in Kenya and secured funding in South Africa. As of September 2015, South African listed and unlisted bonds accounted for 24% of total funding, bilateral loans for 20%, securitisation for 19%, Nordic bonds for 17%, subordinated debt for 9%, Kenyan bonds for 6% and preference shares accounted for the remaining 5%.

However, high wholesale funding concentrations remain a rating constraint for Real People, as its top six funders accounted for a high percentage of total funding (around 75%). In addition, while the company has a moderate proportion of secured debt in its funding structure (September 2015: 18% of gross tangible assets; assets minus goodwill and adding back loan loss reserves), it has been increasing and will likely continue to increase in the next 12-18 months as the company relies more heavily on securitisations. Structural subordination could arise if the volume of secured funding exceeds one-third of total funding (currently at 27%), thus weighing on the company's unsecured debt ratings.

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 Companies", published in October 2015, 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.

NATIONAL SCALE RATINGS

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Implementation Guidance published in October 2012: "Mapping Moody's National Scale Ratings to Global Scale Ratings".

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

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