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Real People Investment Holdings Limited

South Africa Financial Institution Analysis **June 2014**

Security class	Rating scale	Rating	Rating outlook	Expiry date
Long term	National	$BBB_{(ZA)}$	Negative	06/2015
Short term	National	$A2_{(ZA)}$	Negative	06/2015
Long term	International	BB	Negative	06/2015

Financial data:

(US$'m Comparative)

	31/03/13	31/03/14
R/US$ (avg.)	8.49	10.10
R/US$ (close)	9.23	10.57
Total assets	466.5	431.3
Total capital	108.5	67.9
Total borrowings	334.8	343.3
Net advances	368.8	328.3
Liquid assets	37.1	29.9
Operating income	187.0	135.4
Profit after tax	15.3	(20.2)
Market cap.	not listed	
Market share*	2.3%	
Market penetration[a]	5.7%	

**As a % of total unsecured credit extended for the 12-months ended 31 March 2012.*

[a] Market share based on direct peers only.

Rating history:

Initial rating (November 2011)
Long term: $BBB_{(ZA)}$
Short term: $A2_{(ZA)}$
Rating outlook: Stable

Last rating (February 2014)
Long term: $BBB_{(ZA)}$
Short term: $A2_{(ZA)}$
Rating outlook: Watch
Long term (International): BB
Rating outlook: Stable

Related methodologies/research:

Financial Institution Criteria (April 2014)
Glossary of Terms/Ratios (February 2014)
Previous Rating Reports (up to 2013)

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Summary rating rationale

The ratings are based on the following key factors:

- The ratings are constrained by Real People Investment Holdings Limited's ("the group") heightened level of business risk (shown by shortfalls in its capital and asset quality metrics), relatively high funding concentrations and its focus/exposure to the unsecured lending market/clientele. However, cognisance is taken of the group's growing finance and collection franchise, good risk management practices and strong business model.
- The current period proved to be amongst the most challenging in the group's history, on the back of a tightening operating environment in South Africa. Simultaneously, the group underwent a significant change in strategic direction aimed at ensuring its continuing businesses are well aligned to the correction expected post the unsecured credit supply boom.
- The change in the group's strategy is deemed cautiously positive and should reduce the overall risk profile of its loan book through the gradual reduction and/or workout of its general purpose, unsecured loan/advances portfolio; however, such strategy is not without its share of caution.
- While in previous years the group was in a capital accumulation cycle, in F14 the negative credit trend required substantial increases in provisioning levels and bad debt write-offs, which eroded the group's ability to retain earnings. Consequently, the buffer between required and actual capital reduced to suboptimal levels in a moderate-high stress scenario.
- The group's credit metrics and protection factors came under considerable pressure, as asset quality volatility (acquired debt and arrears portfolios) bucked all intervention measures.

Factors that could trigger a rating action may include:

Positive change/s: The group's fragile operating environment increases the error margin on all forward looking scenarios. This, combined with the downturn in the group's profitability and asset quality trends, makes an upgrade unlikely in the near term.

Negative change/s: A ratings downgrade may be triggered if asset quality remains under pressure, given the challenging operating conditions, and/or the group's recurring profitability continues to provide a weakened buffer to counter the inherent risk in its business model. Further negative rating pressure may result if the group fails to raise additional capital or is unable to gain access to sufficient market funding.

Organisational profile

Business overview[1]

The group, through its underlying businesses, is active across the entire credit spectrum, operating as a prime provider and outsourced administrator.

The group continued the process of refining its strategy into the 2014 financial year, specifically:

- Transforming its lending businesses from general purpose to purpose specific, with a focus on housing and business finance;
- Exiting its cellular and education product/ credit businesses due to the increased focus required by the retail product components of these businesses; and
- Concluding the sale of its local branch network which marked the group's exit from general purpose lending.

On the corporate finance side, the group concluded the following for the current review period:

- The acquisition of a South African Small-to-Medium Enterprises ("SME") lending business, 'Wizzit SME business', from Wizzit Financial Services for R4m to spearhead the group's entry into the local SME lending market; and
- A majority stake taken up in 'Empower Financial Services', a venture aimed at marketing the group's products to public sector employees.

As it stands then, and considering the realignment of the group's strategy, its focus henceforth will be more compact, targeting less risky segment/s.

Ownership structure

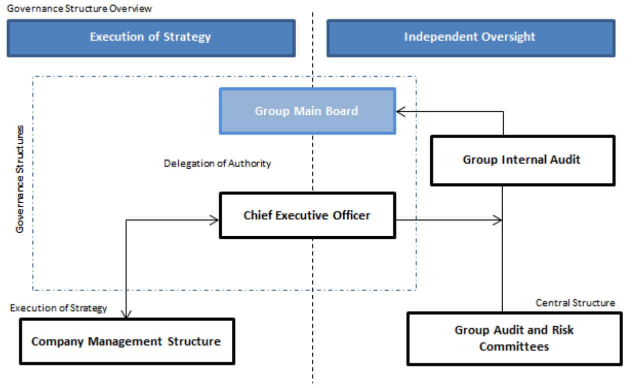
The table below provides a brief breakdown of the group's major shareholders as at end-March, 2014.

Table 1: Effective shareholding	%
Public shareholders	46.0
Private shareholders	54.0
With the latter split between:	
Directors and management	15.3
Staff incentive scheme	19.0
Other shareholders‡	19.7

‡Held mutually by private individuals/companies and several trusts.
Source: Real People.

Governance structure[2]

The layered group structure extends through all business entities, aimed at ensuring coherence in relation to strategy and also operational efficiency.



Control structure

Furthermore, the group's operations are subject to several layers of internal oversight and external control, all of which are considered as positive - augmenting control through the reporting process.

Human resources and staffing

Although the group underwent changes in key management positions during the period under review, with the appointment of a new CFO, CEO Responsible Finance South Africa and CEO DMC (Acquired Debt & Collections), the executive/senior management continues to combine a wealth of experience in cross cut credit fields, and has been instrumental in the business' evolution.

Table 2: Staffing breakdown		
By management layer:		**Avg. int. tenure**
Executive team		5 years
Senior management		10 years
Middle management		7 years
Servicing employees		4 years
By business function:		**# of employees**
	F13	**F14**
Business management	117	98
Financial control	41	40
Legal and compliance	22	17
IT and operations	909	806
Human resources & admin.	572	354

Source: Real People.

From a staffing perspective, the absolute number of hands is still considered adequate to support and/ or maintain the group's business flow/operations, despite cost-cutting across the board in F14.

Reporting structure and access to information

The group's accounts are prepared in-line with international accounting standards and the annual and interim financial information is reasonably detailed and transparent. However, being a private firm, access to performance, budgeting and risk memos/data is limited within the public domain.

[1] For a detailed breakdown of the group, refer to past rating reports.
[2] Given the intricacies associated with good corporate governance, GCR recommends an independent assessment to test compliance.

Financial profile

Likelihood of support

To date, the group has been well supported by its shareholders through term loan facilities, as well as a flexible or 'understanding' dividend policy - behaviour that should continue, all things equal.

Funding composition

Discussed below, are the observed y/y funding trends:

Table 3: Funding base	F13		F14	
	R'm	%	R'm	%
Medium-term facilities	2 166	70.1	2 507	69.1
Bi-lateral loans	*293*	*9.5*	*377*	*10.4*
Capital market loans	*1 873*	*60.6*	*2 130*	*58.7*
Other borrowings/loans†	924	29.9	1 122	30.9
Total	**3 090**	**100.0**	**3 629**	**100.0**

† Include loans from shareholders/related parties and overdrafts.
Source: Real People.

The negative sentiment towards microfinanciers has seen the appetite for long-term funding all but evaporate; also, the rising interest rate outlook further drove the market's appetite for short dated paper. As a counter to the above, the group leveraged off its shareholder credentials by raising mid-tenored cross border funding through the Nordic markets in order to further diversify its funding base.

Overall though, the group's utilisation strategy is conservative, matched to its lending business and focused on protecting its combined balance sheet.

Capital adequacy

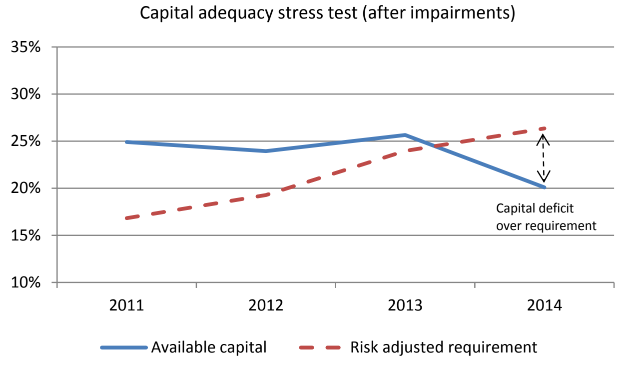
While in previous years the group was in a capital accumulation cycle, in F14 the negative credit trend required substantial increases in provisioning levels and bad debt write-offs, which eroded the group's ability to retain earnings.

Positively though, the group closed its first listed securitisation, so reducing its on balance sheet risk-weighted assets, while also raising subordinated debt, enhancing its secondary capital layer; albeit, gearing increased.

Table 4: Capitalisation	F13	F14
	R'm	R'm
Total reported capital	**1 010**	**733**
Paid up common shares	*432*	*432*
Eligible reserves	*578*	*301*
Less: Required deductions	(56)	(86)
Add: Other capital instruments	151	269
Total available capital	**1 105**	**916**
Total risk weighted assets	**3 187**	**2 887**
Selected ratios:		
Total capital: Total assets†	34.7%	31.7%
Total debt: Primary capital	3.2x	5.6x

† Internal benchmark at 30%. Source: Real People.

Under GCR's (depicted) stress test, the group's capital coverage at FYE14 would have been strained in a negative scenario including the write-off of existing impaired loans and the requirement for additional provisions on performing loans.



Based on this assessment, the group has inadequate reserves in a moderate-high stress scenario. However, it is envisaged that an initial R100m in new equity will be raised from existing and new shareholders in the form of a rights issue[3], with an additional R50m to follow (although the timelines of such could not be confirmed), and should revitalise the group's capital loss absorption capacity.

Other considerations

As part of its business model, the group runs an intended, positive funding gap strategy, whereby its liabilities' maturities exceed that of its assets - directed by the group's baseline liquidity rules.

Moreover, while market risk is deemed rather high, appetite is set at group level, and contingent funding plans are in place and continuously reviewed.

Operational profile

In January 2014, management took the decision to adjust the valuation of the group's loan book assets (both continuing and those earmarked for disposal) to reflect a deteriorating operating and challenging collections environment, which negatively affected the group's receipting performance. The change in assumptions necessitated a reduction in the expected future cash flows on the continuing business – as a result, a once off impairment of assets of R259m (or 6.9% of net advances) was provided for in October 2013, along with a corresponding R186m impairment in capital.

Further provisions were raised in 4Q F14, including:

- R75m to impair the carrying value of the cellular (R35m) and education (R40m) assets

[3] In-principle, commitments for a significant portion of this amount have been received, but negotiations with certain stakeholders are ongoing.

to more closely reflect their actual receipting performance[4];

- Within the group's Debt Rehabilitation division, its Portfolio Recovery Solutions book reflected early signs of stress which necessitated an additional impairment of R24m; and
- R22m for abnormal and non-recurring costs associated with the group's cost reduction programme.

Several other remedial actions to improve future profitability were undertaken, including:

- The lowering of acceptance rates and reducing loan sizes for higher-risk customers, while amending risk-based pricing to improve the yield/risk relationship;
- The launch of a new credit scoring model;
- Further enhancing group collection activities; and
- The containment of staff related costs.

Credit risk (strategic overview)

To offset the loss of origination out of its retail /consumer channel, the group focused on driving its home improvement finance and East Africa business instead.

Table 5: Credit risk exposure	F13		F14	
	R'm	%	R'm	%
Loans and placements	3 745	87.0	3 786	83.0
Net customer loans	*3 404*	*79.1*	*3 470*	*76.1*
Bank M/M deposits†	*341*	*7.9*	*316*	*6.9*
Other instruments	185	4.3	272	6.0
Total B/S assetsº	**4 306**	**91.3**	**4 559**	**89.0**

† Classified as part of liquid assets as term-to-maturity is ≤ 3-months.
º Total exposure to credit risk benched against total reported assets.
Source: Real People.

The total balance sheet, including non-risk items, can also be split along the group's operating units.

Table 6: Asset mix	F13		F14	
	R'm	%	R'm	%
Responsible Finance	1 740	40.4	2 162	47.4
Administration†	1 911	44.4	1 650	36.2
Disposal group‡	255	5.9	230	5.1
HO and support	400	9.3	517	11.3
Total B/S assets	**4 306**	**100.0**	**4 559**	**100.0**

† Includes the branch run-off book, transferred from Responsible Finance.
‡ Includes cellular receivables, transferred from Responsible Finance.
Source: Real People.

To provide context to the above, the activity and performance of these units are discussed below - as a precursor though, the data used is before any transfers and/or adjustments, thus specifics on separate business lines are somewhat limited.

[4] It was previously envisaged and communicated that the provision of R75m (aimed at stemming further losses in the Disposal Group) would be taken by the group as a capital reduction upon externalisation of the Disposal Group; however, with the externalisation not yet having been completed, the group decided to take it at year-end.

Responsible Finance

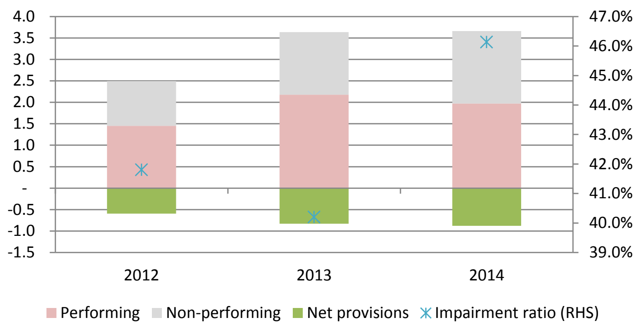
This unit focusses on the group's direct credit operations, and includes its incremental housing, business finance (in East Africa) and education finance units - also included for now is the discontinued book.

Responsible Finance year-end data†	% makeup	annual growth
Home finance	44.2	20.9
Business finance	10.1	83.2
Retail/branch finance‡	26.1	(26.7)
Education finance	19.6	(9.3)

† Based on a total gross book of R3.7bn, per the audited financials.
‡ Portfolio being run down, and was transferred to administration.

Though having to absorb the loss of its largest proportional contributor, the group did well to grow its other units; despite the trifecta of lower sales, slower collections and rebranding.

Responsible Finance portfolio, asset quality (in billions)



Performance wise, the group's credit metrics and protection factors came under considerable pressure, as asset quality volatility (acquired debt and arrears portfolios) bucked all intervention measures.

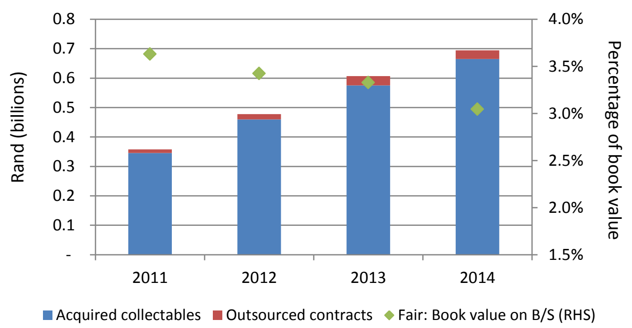
Responsible Finance year-end data†	% impairments	provision cover
Home, business, retail finance‡	37.9	0.7x
Education finance	80.4	1.0x

† Based on a total gross book of R3.7bn, per the audited financials.
‡ Retail/branch component, transferred to administration.

Administration (recovery and collections)

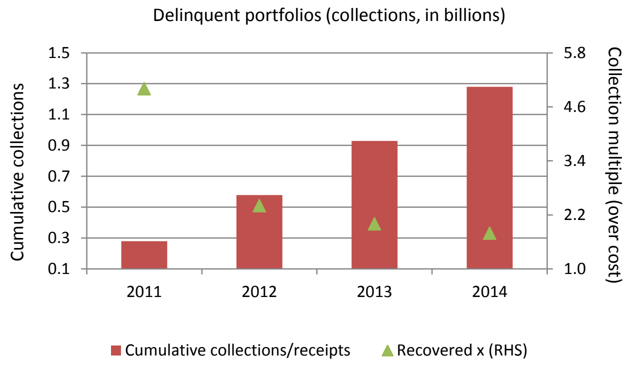
This unit focusses on the active rehabillitation of arrear loan portfolios, either as an outsourced administrator or by assuming ownership thereof.

Delinquent portfolios (performance indicators)



From an analysis point of view, standard growth and arrears markers are passed over, focussing on cash vintages and recoveries instead -

which showed a mixed result, yet still positive.



Disposal group (discontinued operations)

This unit holds the group's discontinued operations, which were restructured, as a sale in its current condition was not considered feasible.

Notable highlights and changes from the group's preceding review were identified and consist of:

- Based on its intentions, the group's cellular business was moved to the disposal group, with negotiations regarding its disposal at an advanced stage, however, should the transaction not be completed, the cellular business will in all likelihood be closed; and
- The group expects to unbundle its education business, and will be sold as a going concern[5].

Other considerations

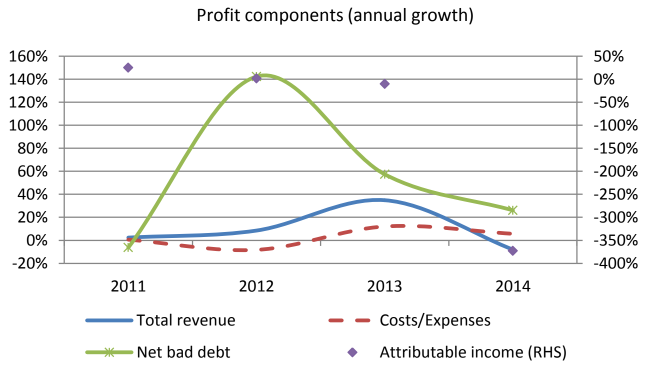
Overall, market and operational risk is deemed rather high - appetite/tolerance is self-defined, while contingent guidelines are continuously reviewed.

Financial performance

A 5-year financial synopsis is shown at the back of this report, accompanied by the commentary below.

The current period proved to be amongst the most challenging in the group's history, on the back of a tightening operating environment in South Africa which was characterised by slow economic growth, high levels of debt and forced consumer deleveraging, political and labour unrest and regulatory reform. Simultaneously, the group underwent a significant change in strategic direction aimed at ensuring its continuing businesses are well aligned to the environment expected post the unsecured credit supply boom.

That being said, the combined results of the group were heavily weighed down by margin compression and the significant increase in loan loss impairments.



Prospects and conclusion

The group's prospects are subject to high forecast risk given the current negative trends in the macroeconomic and credit cycles. As such, continuing external (macroeconomic/credit market) challenges are expected to restrain growth in the next 18-24 months. The group expects new business volume growth to remain moderate given a decline in credit demand coupled with reductions in maximum loan term and price caps.

In addition to restrained top-line growth, it seems unlikely that a return to strong profitability will take place in the short term, as pressure on margins will remain given expected increases in funding costs and increased resource allocation to collections.

Looking forward, the potential for further asset and cash flow volatility, in view of the more challenging operating/economic conditions, should not be overlooked.

[5] The disposal of the Aspire Group is still at an early stage and whilst interest has been expressed, no firm offer has yet been received. The board has resolved to focus on the disposal/closure of Cellular first, after which greater focus will be placed on Aspire.

Real People Investment Holdings Limited

(Rands in millions except as noted)

Year end: 31 March					
Income Statement	**2010**	**2011**	**2012**	**2013**	**2014**
Interest income	493	459	524	810	716
Interest expense	(139)	(141)	(209)	(286)	(355)
Net interest income	**354**	**319**	**316**	**525**	**361**
Other income	550	607	867	1 063	1 007
Total operating income	**904**	**926**	**1 183**	**1 588**	**1 368**
Bad debt charge	(224)	(210)	(510)	(802)	(1 011)
Operating expenditure	(559)	(562)	(515)	(577)	(610)
Profit (loss) before tax	**121**	**154**	**158**	**208**	**(253)**
Tax	(41)	(58)	(64)	(78)	50
Profit (loss) after tax	**80**	**95**	**95**	**130**	**(204)**
Other after-tax income / (expenses)	18	27	30	(19)	(100)
Attributable income / (expenses)	**98**	**122**	**124**	**111**	**(304)**
Balance Sheet					
Common shareholders equity	820	984	1 031	1 009	733
Minority interest	11	7	(6)	(9)	(15)
Total capital and reserves	**831**	**991**	**1 025**	**1 001**	**718**
Interest bearing borrowings	1 459	1 884	2 586	3 090	3 629
Other liabilities	223	736	666	215	213
Total capital and liabilities	**2 513**	**3 611**	**4 278**	**4 306**	**4 559**
Cash & liquid assets	339	850	657	342	316
Net loans and advances	1 498	1 844	2 727	3 404	3 470
Total interest earning assets	**1 837**	**2 694**	**3 384**	**3 745**	**3 785**
Fixed and intangible assets	38	53	50	52	75
Investments	533	< 1	< 1	101	168
Other assets	106	863	843	407	531
Total assets	**2 513**	**3 611**	**4 278**	**4 306**	**4 559**
Ratio Analysis (%)					
Financial management					
Interest expenses / Average gross advances	19.7	18.4	18.4	17.7	19.5
Interest expenses / Average funding liabilities	9.9	8.4	9.3	10.1	10.6
Interest bearing debt / Total capital (:1)	1.8	1.9	2.5	3.1	5.0
Total capital / Total assets	33.1	27.4	24.0	23.2	15.7
Internal capital generation	8.6	9.7	6.9	5.2	(14.1)
Cash and liquid assets / Total assets	13.5	23.5	15.4	7.9	6.9
Asset quality					
Bad debt charge / Average gross advances	15.9	13.7	22.4	24.8	27.8
Bad debt charge / Total operating income	24.8	22.7	43.1	50.5	73.9
Net charge-off ratio	(27.8)	(28.6)	(5.3)	(12.9)	(21.7)
Efficiency					
Operating expenses / Average gross advances	79.2	73.4	45.4	35.7	33.5
Operating expenses / Operating income	61.8	60.7	43.6	36.4	44.6
Profitability					
Net interest margin	25.1	20.8	13.9	16.2	9.9
Net interest income / Average gross advances	50.2	41.6	27.8	32.4	19.8
Non interest income / Total operating income	60.8	65.6	73.3	67.0	73.6
Net profit margin	13.4	16.6	13.4	13.1	(18.5)
Portfolio yield	147.9	139.3	122.5	115.8	94.6
ROaE	13.5	13.6	12.3	10.9	(34.9)
ROaA	4.1	4.0	3.2	2.6	(6.9)
Nominal growth indicators					
Total Assets	10.6	43.7	18.5	0.7	5.9
Total Advances	(6.7)	24.7	67.4	27.6	0.7
Shareholders equity	29.6	19.9	4.9	(2.1)	(27.4)
Net income	(22.2)	25.1	1.5	(10.4)	(372.7)

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SALEINT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity; c.) such rating was an independent evaluation of the risks and merits of the rated entity; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

Real People Investment Holdings Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of info received was considered adequate and has been independently verified where possible.

The credit ratings above were disclosed to Real People Investment Holdings Limited with no contestation of/changes to the ratings.

The information received from Real People Investment Holdings Limited and other reliable third parties to accord the credit rating included the latest audited annual financial statements for March 2014 (plus four years of comparative numbers), most recent year to date management accounts to May 2014, and a breakdown of facilities available and related counterparties.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.