

## CREDIT OPINION

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Update

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# Real People Investment Holdings Limited

## Update Following Recent Downgrade to Caa2 Negative

### Summary Rating Rationale

The Caa2/Not-Prime global scale issuer ratings (negative outlook) of Real People Investment Holdings Limited (Real People), mapping to a Caa2.za/NP.za national scale issuer ratings, reflects (1) recurring bottom-line losses that place pressure on Real People's Basel II capital adequacy ratio (CAR) of 31.6% as of December 2016, which is very close to the 30% minimum covenant level; and (2) heightened funding and liquidity challenges, particularly with regards to raising new funding that will allow the company to meet maturing liabilities and finance business growth and lending.

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

### Credit Challenges

- » Deteriorating solvency position, with the CAR very close to the 30% covenant minimum
- » Weak earnings generating capacity, with losses in East Africa likely to further erode capital
- » A weakened liquidity and funding position

### Rating Outlook

The negative outlook on Real People's ratings reflects Moody's view of an increased risk that a potential breach of the debt covenants and inability of the company to raise new capital could trigger cross-default clauses across Real People's debt structure, leading to a more acute disruption of its business than is currently anticipated, and ultimately to material losses for senior unsecured creditors.

## Factors that Could Lead to an Upgrade

There is currently limited upside pressure on Real People's ratings. Upward pressure could arise if the company raises additional capital while improving its recurring profitability, which will in turn ease funding and liquidity concerns.

## Factors that Could Lead to a Downgrade

Real People's ratings could be downgraded in case of a breach in its debt covenants and inability to raise new capital, resulting in an acute business disruption and material losses for senior unsecured creditors.

## Key Indicators

Exhibit 1

### Real People Investment Holdings Limited (Consolidated Financials) [1]

	12-16 <sup>2</sup>	3-16 <sup>2</sup>	3-15 <sup>2</sup>	3-14 <sup>2</sup>	3-13 <sup>2</sup>	Avg.
Total managed assets (ZAR million)	3,590.4	4,077.6	3,815.4	4,606.9	4,355.0	-2.9 <sup>3</sup>
Total managed assets (USD million)	262.6	277.2	314.9	438.0	471.4	-13.4 <sup>3</sup>
Pretax Preprovision profits / Average Managed Assets (%)	1.8	8.1	8.1	16.9	23.4	12.8 <sup>4</sup>
Net Income / Average Managed Assets (%)	-2.9	0.2	-7.9	-6.8	2.5	-1.6 <sup>4</sup>
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	12.2	12.3	13.3	14.9	22.9	15.6 <sup>4</sup>
Problem Loans / Gross Loans (Finance) (%)	-	34.2	53.4	38.0	30.8	34.3 <sup>4</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

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 [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

### Real People' Three Main Divisions:

(1) Home Finance - purpose-specific unsecured lending in South Africa - home improvement finance - through its cooperation with merchants (accounting for 36% of net loans and acquired assets as of December 2016, see Exhibit 2);

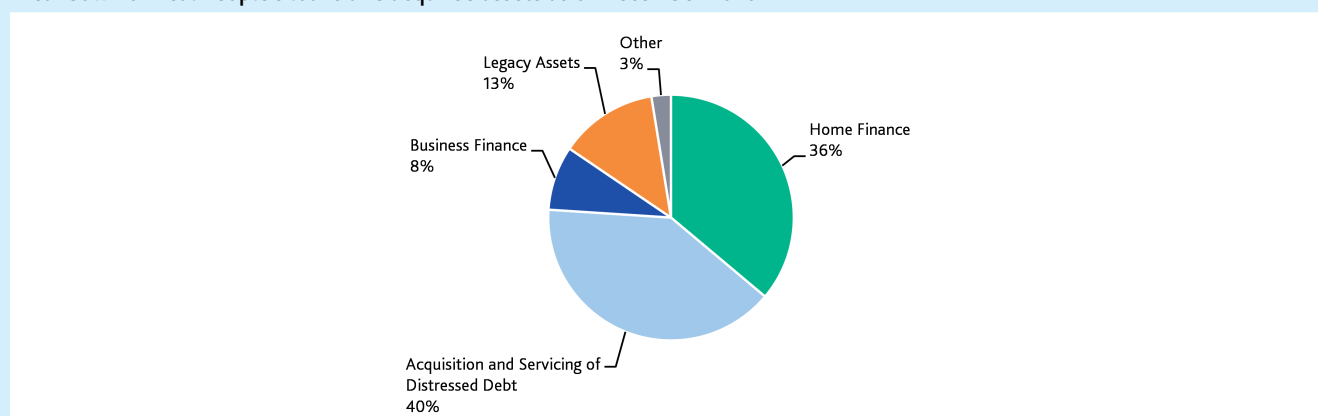
(2) Debt Management and Collections - the acquisition and servicing of non-performing unsecured debt portfolios in South Africa (40%), including outsourced collection services to other credit providers in the banking, retail and cellular phone industries; and

(3) Business Finance - business lending in East Africa (8%).

An additional 16% of loans relate to its South African discontinued operations (general-purpose lending, cellular receivables and education receivables) which are being run-down.

Exhibit 2

### Breakdown of Real People's loans and acquired assets as of December 2016



Source: Real People's Unaudited Financial Results

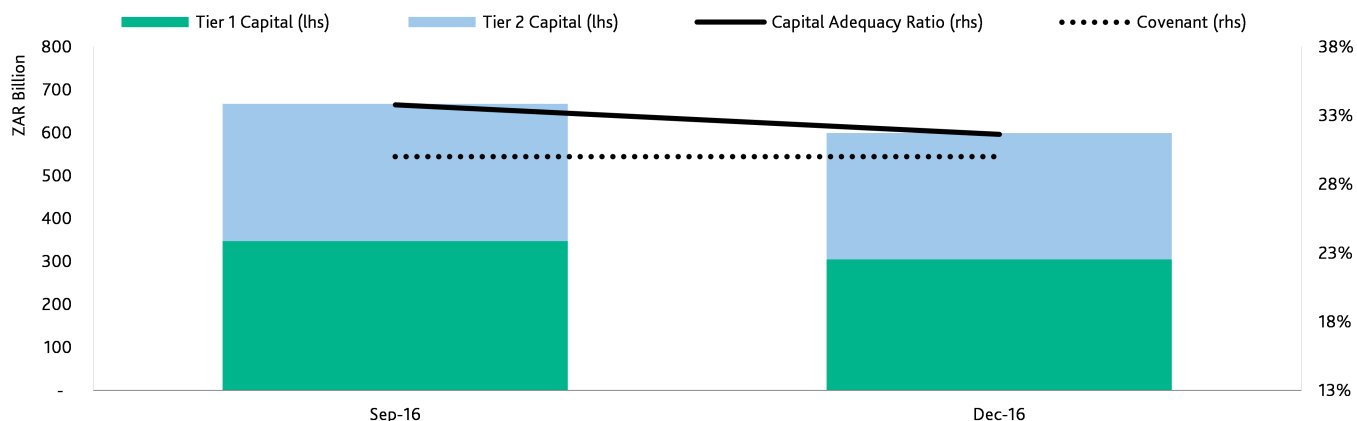
## Detailed Rating Considerations

### DETERIORATING SOLVENCY POSITION, WITH THE CAPITAL ADEQUACY RATIO VERY CLOSE TO THE 30% COVENANT LEVEL

Although Real People is not a registered bank, does not take deposits and is not regulated by the central bank (the South African Reserve Bank), it has covenants across its listed note programmes and funding agreements to maintain a minimum Basel II capital adequacy ratio of at least 30%. The total Basel II capital adequacy level has deteriorated to 31.6% as of December 2016, from 33.8% as of September 2016 (34.5% as of March 2016), below the company's internal target of 36% and close to the covenant level.

In addition, the tangible common equity (TCE)-to-tangible managed assets ratio dropped to 11.3% and the Tier 1 Capital Ratio to 16.1% as of December 2016. These capital ratios (which exclude subordinated debt and preference shares) are significantly lower than our comfort levels and well below what they used to be (TCE-to-tangible managed assets of 14.9% and Tier 1 of 22.4%, back in March 2014).

Exhibit 3

**Capital Adequacy Level very close to the covenant level**

Source: Real People's Unaudited Financial Results

A breach of this covenant is an event of default under the terms of the funding agreements and will likely result in the acceleration of all bond and loan repayments, unless a written waiver of the breach is obtained from funders. Under a scenario of an acceleration of debt repayments, the absence of a negotiated debt restructure would most likely lead to insolvency proceedings against Real People or the company being placed under South Africa's Business Rescue proceedings, which could lead to losses for creditors.

Real People is trying to bolster capital through a capital increase from new shareholders. The intention is not only to increase capital adequacy but also to replace a portion of the high-cost preference shares and subordinated notes with ordinary shares to restore the company's income generating capacity and a return to profitability. However, at this point, a degree of uncertainty surrounds the timing and amount of any capital increase.

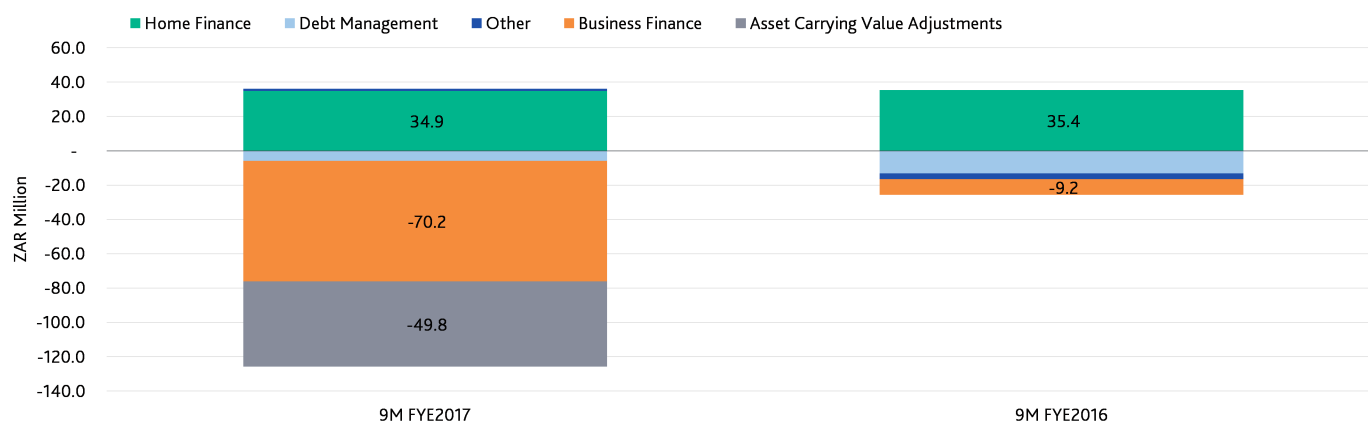
## REAL PEOPLE IS LIKELY TO REMAIN LOSS MAKING OVER THE NEXT 12 MONTHS, WITH CONTINUED LOSSES IN EAST AFRICA FURTHER ERODING CAPITAL

Real People reported ZAR86 million group loss for the nine months ending December 2016. The bottom line loss is primarily attributed to:

- (1) a 294% year-on-year spike in impairment provisions for its Business Finance division due to weakening asset quality. The non-performing loans (NPLs) to gross loans ratio for this division has almost doubled to 27.3% as of December 2016, from 15.7% in March 2016, amid poor lending decisions during the first half of the 2016 fiscal year.
- (2) a ZAR50 million negative carrying value adjustment to align with best market practice methodologies. This can be primarily attributed to a ZAR164 million negative adjustment in its discontinued branch lending operations (which marketed a 42% reduction in its value to ZAR222 million) and a ZAR18 million negative adjustment in the Business Finance division, partly countered by positive adjustments in other divisions.

Exhibit 4

### Losses in Business Finance (East Africa) and Asset Value Adjustment drive Capital Erosion



Source: Real People's Unaudited Financial Results

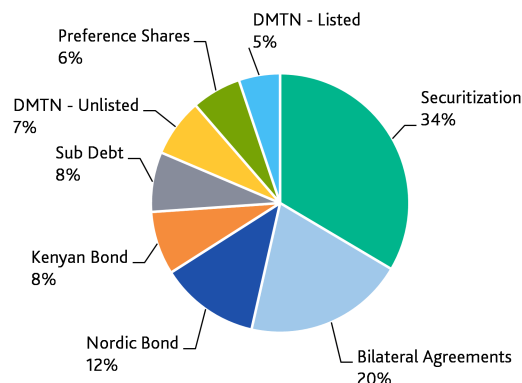
Going forward, we expect continued losses in the East African Business Finance division, while risks of further loan loss impairments and/or asset valuation adjustments across Real People's portfolio remain, given challenging operating conditions. This increases the risk that capital will be further eroded and leads to a heightened risk that the company will breach its debt covenants within the next 12 months.

### A WEAKENED LIQUIDITY AND FUNDING POSITION

Real People is also faced with increased funding and liquidity challenges. The company currently relies on the securitization of its loan portfolio, at the divisional level, to raise new funding, while according to our calculations Real People will need to raise new holding company funding in order to continue to meet its debt obligations during the fiscal year 2017. This reflects Real People's weakened liquidity position, with the 24-month coverage ratio declining to 29% as of December 2016, from 36% as of March 2016 (measured as the percentage of cash, cash equivalent and committed, unsecured bank lines that are available to cover maturing debt over the next 24 months).

We also note the high wholesale funding concentrations, with top six funders accounting for a high percentage of total funding (around 72%). As of December 2016, securitisation accounted for around 34% of total funding, bilateral loans for 20%, South African listed and unlisted bonds for 12%, Nordic bonds for 12%, subordinated debt for 8%, Kenyan bonds for 8% and preference shares accounted for the remaining 6%. The secured debt in its funding structure has been increasing (27% of gross tangible assets [assets minus goodwill and adding back loan loss reserves] as of December 2016, from 18% 12 months prior) and will likely continue to increase in the next 12-18 months, as Real People has limited access to unsecured funding.

Exhibit 5

**Securitisation Accounts for an Increasing Portion of Total Funding as of December 2016**

Source: Real People

**WHILE DOWNSIDE RISKS REMAIN SUBSTANTIAL, ASSET QUALITY IN SOUTH AFRICA HAS SHOWN SIGNS OF STABILISATION**

Real People's South African home finance asset quality has improved, with an improvement in recent NPL vintages following corrective measures taken. As of December 2016, Home Finance NPLs dropped to 36%, from 43% as of March 2016, while the provisioning coverage stood at 88%. As of December 2016, group NPLs stood at 34% of gross loans, down from 53% as of March 2015, and provisions strengthened to 93% of NPLs (March 2015: 78%), although IFRS 9 will likely necessitate even higher provisions in the next few years.

While we note the improvements, South Africa's challenging economic conditions continue to pose credit risks and any further deterioration could exert pressure on loan loss provisioning expenses and collections. Real People's (and other unsecured lenders') provisioning models have been proven to be quite sensitive to even small changes in ongoing collection and recovery rates or the model assumptions used, with changes typically leading to a material impact on loan loss provisions, profitability and capital given Real People's high stock of NPLs and written off loans. As such, Real People's high balance sheet exposure to net NPLs (NPLs net of provisions at 6% of total qualifying capital or ZAR34 million as of December 2016) and written off exposures held at fair value (at 69% of total qualifying capital) remain a significant risk.

**SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT**

Unless noted otherwise, we have sourced data relating to system-wide trends from the South African Reserve Bank and the National Credit Regulator. Company specific figures originate from company 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.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_187419](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_187419)) published on 12 February 2016.

**RATING METHODOLOGY**

The principal methodologies used in this rating were "Finance Companies", published in October 2015, and "Mapping National Scale Ratings from Global Scale Ratings" published in May 2016.

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.moody.com> for the most updated credit rating action information and rating history.

## Notching Considerations

### Global Scale Issuer Ratings

The company's Caa2/Not-Prime global scale issuer ratings capture the credit risk of senior unsecured obligations. The current positioning of the ratings indicates that there is no structural subordination of unsecured debt holders, as senior unsecured debt remains the majority. Structural subordination could arise for senior unsecured debt holders if secured funding (excluding securitisation) increases materially to above one-third of total funding (excluding securitisation) from 5% as of March 2016.

### National Scale Issuer Ratings

The national scale issuer ratings map to a Caa2.za/ NP.za. These are derived from the Caa2 global scale ratings using our South African national scale maps.

Moody's National Scale Credit 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 credit 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 credit ratings, please refer to Moody's Credit rating Methodology published in May 2016 entitled "Mapping National Scale Ratings from Global Scale Ratings". While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_189530](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_189530).

## Rating Methodology and Scorecard Factors

Exhibit 6

### Real People Investment Holdings Limited.

Rating Factors	Aa/A	Baa	Ba	B	Caa	Historical View	Forward View
<b>Non-Financial Factors</b>						B	B
<b>Factor: Franchise Positioning</b>						B	B
- Market Position and Sustainability				x			
- Operational Diversification				x			
<b>Factor: Risk Positioning</b>						Caa	Caa
- Potential Volatility of Assets/Cashflows					x		
- Governance and Management Quality			x				
- Risk Management					x		
- Key Relationship Concentrations		x					
- Liquidity Management					x		
<b>Factor: Operating Environment</b>						B	B
- Economic Strength			x				
- Institutional Strength		x					
- Susceptibility to Event Risk			x				
<b>Financial Factors</b>						B	Caa
<b>Factor: Profitability</b>						Caa	Caa
- PPI / AMA	6.00%						
- Net Income / AMA					-3.55%		
- Pre-tax Income Coefficient of Variation					-170.67%		
<b>Factor: Liquidity</b>						B	Caa
- 24 Month Coverage Ratio					29.29%		
- Secured Debt / Gross Tangible Assets			27.27%				
<b>Factor: Capital Adequacy</b>						Ba	Caa
Capital Bucket: Traditional Finance Company							
- TCE / TMA			11.33%				
<b>Factor: Asset Quality</b>						Caa	Caa
- Problem Loans / Gross Loans					40.53%		
- Problem Loans / (Shareholders Equity + LLR)					64.05%		
<b>Scorecard estimated stand-alone credit assessment:</b>						B3	Caa1
<b>Assigned Rating:</b>							Caa2

[1] Capped at B, The operating environment score will not exceed the weighted average of scores assigned to a firm's other non-financial factors.

Source: Moody's Investors Service

## Ratings

Exhibit 7

Category	Moody's Rating
<b>REAL PEOPLE INVESTMENT HOLDINGS LIMITED</b>	
Outlook	Negative
Issuer Rating - Dom Curr	Caa2
NSR Issuer Rating	Caa2.za
ST Issuer Rating - Dom Curr	NP
NSR ST Issuer Rating	NP.za

Source: Moody's Investors Service



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