REAL PEOPLE™

Real People Kenya Limited

FINANCIAL RESULTS

for the 9 months ended 31 December 2016

We are Real People for real people

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1. Introduction

In the nine months to December 2016, the business maintained its strategic focus of lending to its chosen target segment of micro and small enterprises. During the period under review adverse market and macroeconomic conditions has placed significant strain on the target segment's ability to service the credit facilities provided by Real People.

The level of non-performing loans continued to rise across the industry with Real People severely impacted over the period. The high levels of impairments experienced, combined with much lower loan origination levels during this time resulted in a halving of the loan portfolio over the past 9 months.

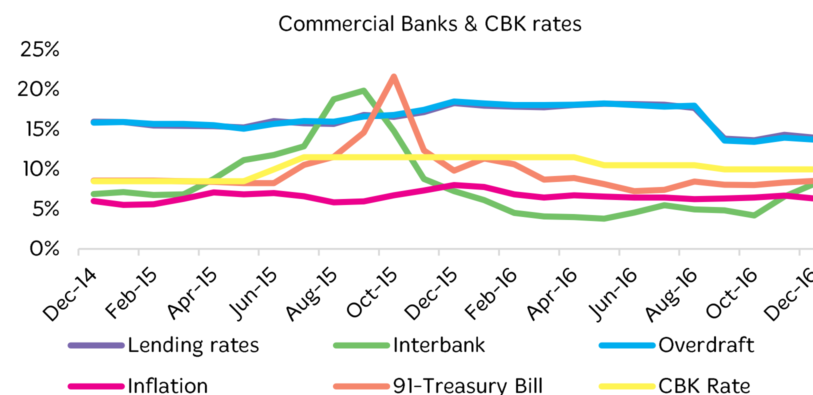
The business has been placed in a "steady state" position as management seeks to stabilise the business and halt any further erosion in capital and balance sheet shrinkage. Whilst the businesses collections capability has been bolstered through the introduction of additional call centre operators, the introduction of tangible collateral as loan security and a more proactive approach, operating costs are planned to be reduced by KES20m per month through both a staff rationalisation exercise as well as a reduction in non-staff costs.

The capital base of the business has been significantly eroded by the losses sustained from the high impairments with the capital ratio declining from 30.7% to 23.7% over the past 9 months. In the absence of a capital injection the covenanted level of 20% is thus in serious risk of being breached over the coming months should the business interventions implemented by management not result in a strong enough turnaround.

A change in executive management occurred in the third quarter with the resignations of the CEO, CFO and CIO.

2. Overview: Operating environment

The Central Bank of Kenya (CBK) retained the policy rate at 10% in November 2016, which was expected by the markets. A decline in private sector credit growth experienced over the last several months had stabilised at 4.6% in October. The inflation rate increased to 6.5% in October 2016 from 6.3% in September, remaining within the government's single digit target range. The foreign exchange market remained stable, reflecting a narrower current account deficit due to stabilised tourism earnings and export receipts from tea and horticulture exports, lower oil imports, lower imports of machinery and equipment and resilient diaspora remittances. The CBK is of the view that inflationary pressures were mild and inflation will remain within the government target range in the short-term.



3. Regulatory developments

The capping of interest and deposit rates on loans and deposits for commercial banks has had a ripple effect on the lending environment. While Banks are struggling with renewed strategies to deal with the new law (including significant staff rationalisation), our clients now also expect lower rates for loans.

4. Capital

Real People covenants to maintain a minimum capital level, for the protection of senior funders, of 20% of qualifying capital to total assets, where qualifying capital includes ordinary shareholder's equity, subordinated debt and preference shares. The business's capital levels have fallen significantly to 23.71% from 33.5% twelve months earlier as a result of the high impairments incurred although the capital ratio remains above the covenanted level.

KES million	Dec-15	Dec-16
Qualifying Capital	1 076	518
Total Assets	3 211	2 183
Capital Ratio	**33.51%**	**23.71%**

5. Funding and liquidity

5.1. Funding

The company is funded through a mix of local currency long-term debt raised from the local capital markets and shareholder's equity from the South African parent company.

5.2. Liquidity Management

Short-term liquidity Policy

Real People vigilantly manages liquidity risk through strict adherence to its liquidity policy. The short-term liquidity policy was developed from the principles of Basel II's Liquidity Coverage Ratio and is designed to ensure that the company is able to meet all of its short-term obligations during any 12 month rolling period as described:
Net cash position over the forthcoming 12 months is calculated as follows:

- Expected receipting less 10% haircut, less
- Committed operating expenses, less
- All contractual interest and capital repayments

Unencumbered cash together with unutilised committed credit facilities are required to cover any shortfall and, as at 31 December, comfortably meets this requirement as can be seen in the table below.

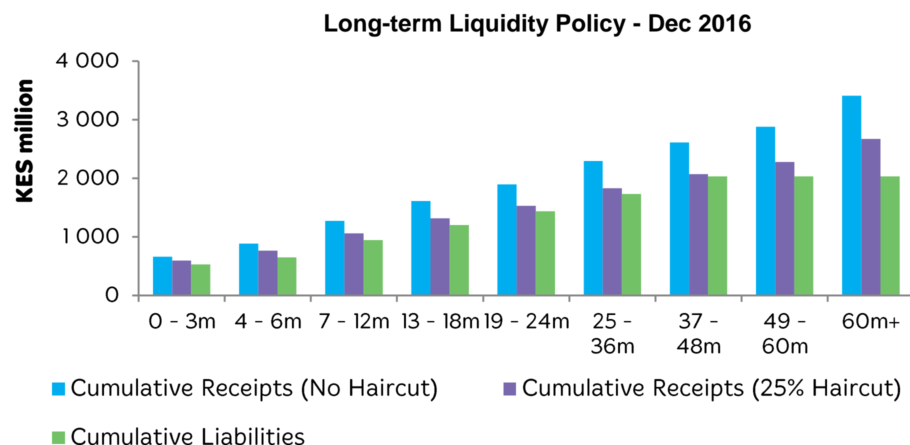
KES million	30-Sep-16	31-Dec-16
Receipting (10% haircut)	955	808
Committed expenses	(462)	(427)
Liability re-payment	(341)	(223)
Total net cash inflow/(outflow)	**152**	**158**
Available Cash	273	400
Available Facilities	-	-
Surplus	**425**	**558**

Whereas the company maintains a healthy liquidity position at present, the negative carry costs incurred on the excess cash balances weigh on the company's bottom line and capital ratio. Whilst the company is seeking to more rapidly deploy the excess cash into healthy productive assets, an approach to noteholders for the early retirement of a portion of its issued debt at current market rates is also under consideration.

Long-term liquidity risk management

In the long term, the business safeguards its debt obligations by ensuring that at any point on its funding profile the following limits are strictly adhered to:

- *Cumulative mismatch limit:* 75% of expected cumulative receipting must at any point on the funding profile exceed the cumulative cash outflows related to contractual debt payments (capital and interest). This is measured and monitored on a monthly basis.



The above graph illustrates the company's ability to repay its current outstanding long-term liabilities assuming a conservative cash yield on productive assets under a run-off situation.

6. Matters of emphasis

6.1. Business Stabilisation and Change in Executive Management

High levels of losses due to a severely impaired loan portfolio have persisted in Real People. Management action, including cost rationalisation, product simplification, the introduction of security and an improved collections capability have been implemented in an effort to improve credit quality and create income generating assets.

Concurrent leadership changes have taken place with Daniel Ohonde (CEO), Norman Ambunya (CFO) and James Mbui (CIO) all resigning in the past three months. Yvonne Godo (COO), has been appointed as acting CEO and Bennie Padachie, CFO of the group, as acting CFO with increased support from the South African parent until suitable replacements are found.

6.2. Asset carrying value adjustments

Real People has adjusted carrying values to accommodate current market best practice methodologies, highlighted by Deloitte & Touche during their recent review of the assets, and current collection performance.

This resulted in an increase in the Loss Identification Period (LIP) to twelve months. In line with the methodology update an estimated additional impairment provision of **KES 130.2m** was raised in December 2016.

7. Business Prospects

Management's current focus is on stemming the capital eroding losses and curtailing further balance sheet shrinkage. The PAL product has been discontinued and for the GPF product tangible security must now be provided for all new loans granted as well as any further drawdowns on existing facilities. Tangible assets include, if necessary and available, land. The collections call centre has been bolstered through the addition of ten new operators and the collections philosophy revised to a firmer approach including the early intervention of legal action if necessitated.

The business strategy is to tilt the current portfolio from an unsecured loan portfolio to a portfolio secured with tangible collateral as loans are repaid and new loans granted. The previous strategy of taking chattels as security to encourage good payment behaviour has proven ineffective as a means of enforcing payment once loans migrate into NPL.

The cost base is in the process of being reduced through a staff and non-staff rationalisation process which should translate into a monthly reduction of KES20 million in expenses within the first quarter of FY18. The staff rationalisation process was recently concluded with any further reductions to the staff compliment expected to occur through natural attrition during the course of the year.

8. Financial Results

Statement of financial performance

	Q1 FY2017 Jun KES'm	Q2 FY2017 Sep KES'm	Q3 FY2017 Dec KES'm	YTD FY2017 Dec KES'm	YTD FY2016 Dec KES'm	YTD FY2017 v FY2016 %
Gross yield from assets	301.0	287.5	223.9	812.4	762.0	7%
Impairment provision	(203.6)	(184.8)	(139.4)	(527.9)	(141.4)	> -100%
Net yield	**97.4**	**102.7**	**84.5**	**284.5**	**620.5**	**-54%**
Finance costs	(101.9)	(104.4)	(71.2)	(277.5)	(212.0)	-31%
Net margin	**(4.5)**	**(1.7)**	**13.3**	**7.1**	**408.5**	**-98%**
Operating expenditure	(128.7)	(118.4)	(134.8)	(381.9)	(369.0)	-3%
Normalised contribution	**(133.2)**	**(120.1)**	**(121.5)**	**(374.8)**	**39.5**	**> -100%**
Foreign exchange gain/(loss)	(2.4)	(41.6)	15.1	(28.9)	88.5	> -100%
Normalised (Loss)/profit before tax	**(135.6)**	**(161.8)**	**(106.4)**	**(403.7)**	**128.0**	**> -100%**
Restructure provision	(23.7)	-	-	(23.7)	-	**-100%**
Asset carrying value adjustment	-	-	(130.2)	(130.2)	-	-100%
(Loss)/profit before tax	**(159.3)**	**(161.8)**	**(236.5)**	**(557.6)**	**128.0**	**> -100%**

Net Yield and Impairments

The business has reported extraordinarily high impairment charges over the first 3 quarters of the financial year. The deterioration is largely attributable to the high NPLs arising from assets originated in the last 2 quarters of the 2015 calendar year and an inability to enforce payment once a loan had migrated into NPL status.

The business further updated the provisioning methodology of the book in line with best practice. This resulted in an increase in the Loss Identification Period (LIP) to twelve months. In line with the methodology update an additional provision of KES 130.2m was raised in December 2016.

Finance costs

The increase in finance costs year on year is attributable to the coupon rates on the outstanding bonds being higher than the internal Group rate charged on the repaid shareholder's loan.

Operating costs

Normalised operating costs increased marginally year on year by **3%** due to:

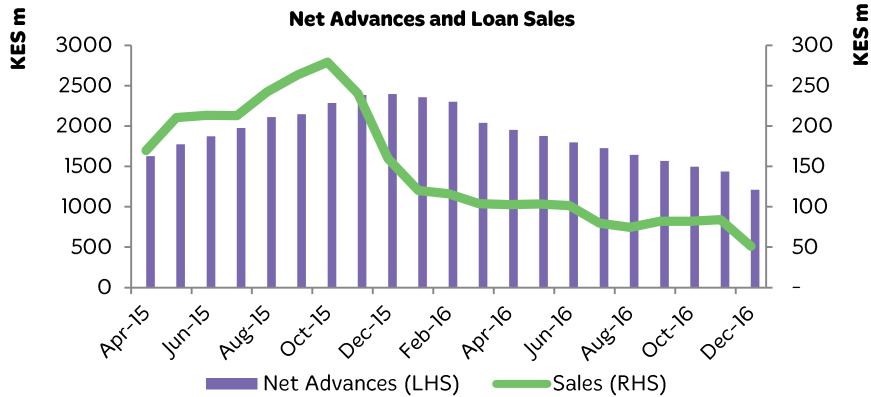
- Increased staff costs associated with medical cover and retirement benefits funding (at 5% from 4% to comply with the legal minimum) and a cost of living adjustment implemented in June 2016; and
- Property rental escalations.

A reduction in operating costs is to be expected in the coming months following the cost rationalisation exercise recently completed. ***Statement of financial position***

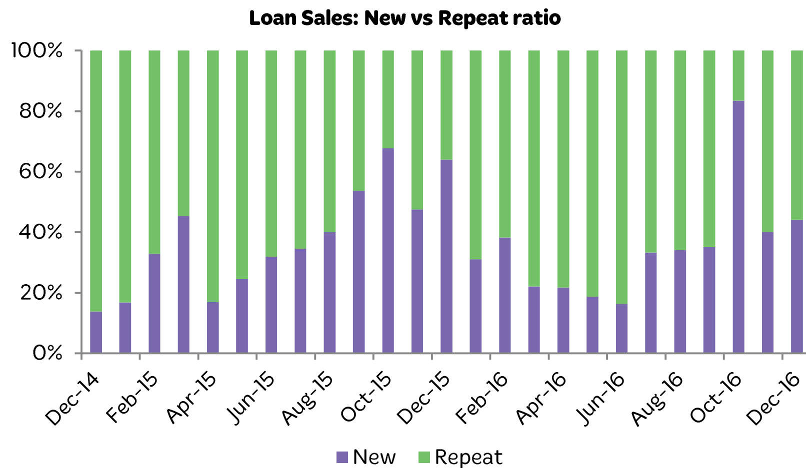
	Q1 FY2017 Jun R'm	Q2 FY2017 Sep R'm	Q3 FY2017 Dec KES'm	Q3 FY2016 Dec KES'm	Q3 FY2017 v FY2016 %
Assets					
Loans and advances	1,797.9	1,567.7	1,213.3	2,408	-50%
Property and equipment and intangibles	152.8	144.9	117.5	129	-9%
Other assets	352.9	393.4	466.5	172	> 100%
Cash and cash equivalents	577.8	264.4	385.5	502	-23%
Total assets	**2,881.4**	**2,370.3**	**2,182.9**	**3,211**	**-32%**
Equity and liabilities					
Equity	**758.5**	**687.7**	**517.6**	**1,076**	**-52%**
Liabilities					
Interest bearing borrowings	2,109.6	1,671.2	1,639.7	2,122	-23%
Other liabilities	13.3	11.4	25.5	13	99%
Total equity and liabilities	**2,881.4**	**2,370.3**	**2,182.9**	**3,211**	**-32%**

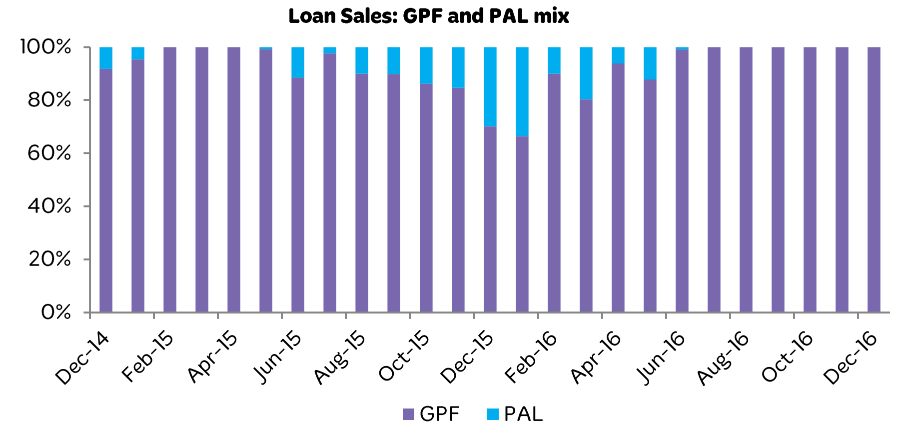
Origination

Origination volumes remain low as management focusses on improving portfolio quality through 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.



Net advances halved over the past twelve months due to the decline in loan originations as management tried to address the credit quality and collections issues, loan repayments and the high level of impairments that have bedevilled the industry and business.



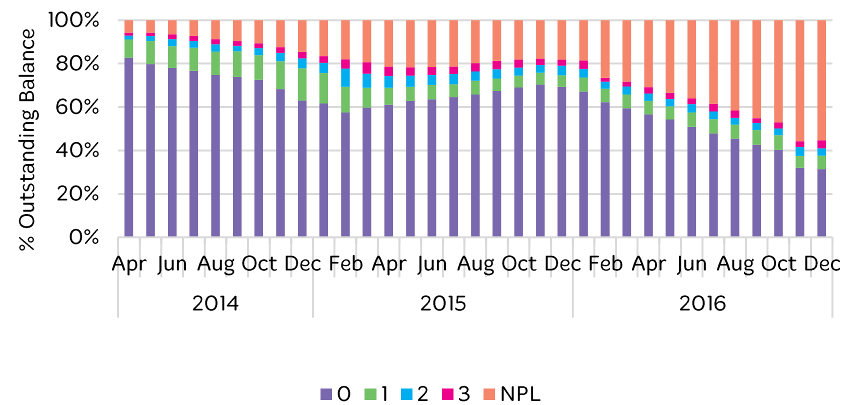


The discontinuation of the PAL product in June last year has resulted in all loan sales since then being for the GPF product.

9. Credit Quality

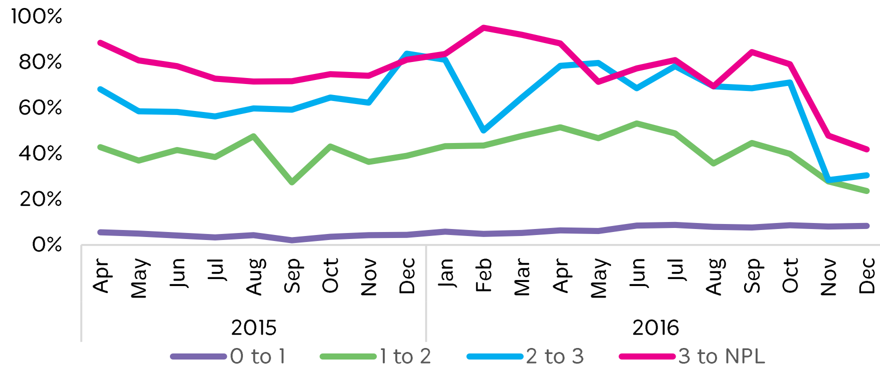
The deterioration in the total loan portfolio over the past 9 months is reflected in the credit metrics below. As described above, the impact of the discontinuation of the PAL product, the slowdown in loan originations in GPF and the extraordinary impairments experienced over the period have manifested in a portfolio that is currently comprised of 55% NPLs.

Arrears Mix (Gross)



Negative Roll Rates - GPF

It is hoped that the improved collections capacity together with a new approach to collections and the taking of tangible security will arrest the declining trend in the coming months with some evidence seen with a decline of later rolls from 1 month in arrears and beyond over the past quarter for the GPF portfolio.



P@R 30

P@R 30 is calculated as all amounts more than 30 days in arrears expressed as a percentage of the total amount outstanding excluding loans that have been written off. The gross P@R 30 has risen to 31% for the portfolio as the portfolio has declined and impairments risen although the gross P@R 30 for the GPF portfolio remains below that at 28% with a similar spread in the net P@R 30 metrics (29% vs 25%).