

Conference call transcript

16 February 2017

RESIDUAL DEBT SERVICES FY2016

Operator

Good afternoon ladies and gentlemen and welcome to the RDS full year results for the 12 months ending 30 September 2016. All participants will be in listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference please signal an operator by pressing star and then zero. Please note that this conference is being recorded. I would now like to hand the conference over to the curator of Residual Debt Services Ltd, Tom Winterboer. Please go ahead, sir.

Tom Winterboer

Right. Thank you very much and welcome to everyone who is on the call. This will be the first set of results we talk to after the separation of the good assets into the new African Bank. So welcome. I'm going to go through the slides one by one and at the end we will obviously have some time for questions. If we look at slide two what are we going to talk about? It is just the results for Residual Debt Services, or RDS, which was placed under curatorship on 10 August 2014 when it was still named African Bank Ltd. RDS remains in curatorship at this reporting date and will remain under curatorship for the foreseeable future. The old African Bank was successfully restructured on 4 April 2016 by the means of a transfer of certain assets and restructured liabilities into a new entity with the same name. For the purpose of this I will often refer to the good bank or the new African Bank.

The assets and liabilities transferred to the new African Bank Ltd on 4 April are referred to as available for sale in the comparative numbers for the year ended 30 September 2015. So the RDS balance sheet therefore consists of the remaining assets together with the remaining liabilities which in the main have become known as the stub instruments for the liabilities. The full year results reflect the results for the restructured and the remaining business for the first six months and then just the remaining business for the last six months. And for purpose of this discussion I will probably focus more on the second six months as that will be the amounts and results going forward. So the presentation of results can be accessed on the address as on the slide. And we really just talk about the group overview, financial status, analysis, operational update and some concluding remarks.

If we then go to slide three that's the group overview. So African Phoenix was previously called ABL, just the holding. So they still hold 100% of Standard General Insurance Company, 100% of Residual Debt Services and 100% of EHL. But at the moment as there is not much prospects for African Phoenix the shareholders to recover any value under Residual Debt Services there is obviously not a position of control and a curator, as was reported in the past, obviously has control of RDS. We also understand that both RDS and the EHL investments have been fully impaired by African Phoenix Investments.

Right, if we then turn to slide four, just looking at the income statement, just a few highlights, loss for operations for the year was R945 million compared to a 2015 loss of R6.882 billion. And then the important thing there is just to distinguish the first half loss with R987 million compared to a profit of R42 million in the second half. The profit for the year as compared to the loss from operations was R2.366 billion whilst in 2015 a loss of R7.12 billion. First half loss was R646 million and then the second half was a profit of R3.012 billion.

RESIDUAL DEBT SERVICES LIMITED

(under curatorship)

If we look at the next bullet there the next important thing is then to say how did the R3.012 billion arise. Firstly included in there is a profit of R657 million on the recovery of previously fully impaired ABL and EHL loan accounts together with a profit of R2.654 billion on the sale of the business to new African Bank. This profit really comprises the difference between the book value carried in RDS and the fair value at which it was sold to the new African Bank and the new group then. Just briefly the balance sheet then. Assets of R4.399 billion and liabilities of R8.860 billion, resulting in negative equity of R4.461 billion.

If we then go to slide five we look at the financial statements analysis, just the income statement. There I will mainly focus on the second half. So if one looks at the interest income on advances, R219 million for the second half, clearly much lower than the first half because of the fact that it is only the remainder of the assets. And that really goes through for most of the income statement items for the second half. What is important though is the operating cost if we look at the R408 million there. At the moment there is an SLA, a service level agreement, between RDS and the new African Bank whereby new African Bank actually renders most of the services. The charge there is calculated firstly mainly on the advances. There is a fixed charge together with some commission-based charge. And at this stage this charge and total runs between R65 million and R70 million a month, but for that all the services would be provided. So that just gives you some idea of why the R408 million is there.

The second point to make it just under the capital items, the R2.970 billion. And we have referred to the two amounts, the recovery on the EHL and ABL loans and the profit on the sale of the book. So the big thing here is that going forward it will exclude capital items and really representing a rundown of the book being collected.

If we can then turn to slide six, and there I will just briefly deal with some of the balance sheet items, firstly is cash. Now, you will recall that the cash was set up at a float of about R500 million together with any other collections. The next one is the net advances. The gross was about R7 billion, provisioning of R4.1 billion, leaving us with the R2.9 billion. And that book continues to run off as we have said in the past. The other assets, the R791 million, that mainly relates to the subsequent true-up calculation that we've done, and that would be the amount that was subsequently paid to RDS from the new African Bank. Just to highlight also under the net advances that should present the new book value. The gross value written off book is R21.7 billion. And clearly a lot of effort still to try to collect that, but it is very difficult.

If one then looks at the liabilities side, other liabilities would mainly be for instance the amounts payable for the operating costs from RDS to African Bank. And then for note three there we have the senior unsecured stub R4.859 billion. So that would be the stub plus the accrued interest. And the subordinated unsecured stub was R3.842 billion. As we said before leaving net equity of R4.461 billion.

Right, if we then turn over to page seven there we deal with a bit of a payment waterfall just to try and give some more clarity. Firstly, we have the SARB loan facility of R3.3 billion. So this amount was fully repaid in September 2016 as was reported. Secondly, we have the normal and ongoing trade creditors, the R159 million. And it is just important to continue running the curatorship and collecting, so that is obviously the next important one. The indemnity guarantee of R3 billion is being set up at the moment and we expect that to be fully funded by December 2017. Just for a matter of interest, by the end of January this year we already had R1.7 billion of that collected, so we believe we are well on our way to get that collected by the end of the calendar year.

We then see the senior unsecured instruments of R4.859 billion. I believe the previous slide had R1 billion in there, but it is R4.859 billion. That's the next one. And the following slide, which I'm not turning to yet, will give you some sense as to what the variables on that would be. The next one is the subordinated stub instrument at

R3.842 billion. At this stage we do not believe there is any value expected there. And then lastly the shareholders where we believe there is no value at present. That just gives you a high level of the claims and where it goes.

If we then turn to slide eight, looking at the financial statement analysis and really the value of the claims, we have done two calculations. Firstly there is a base calculation where we say that the R3 billion claim would be called upon on indemnity, and really saying that we have used the weighted average cost of capital of 14% there. And that includes the expected cash flows from RDS' advances book for a 60 month future period. The base forecast, the first one assumes that the indemnity will be called on in full, the R3 billion spread evenly over a three-year period in six equal instalments and tranches then starting from March 2017. However I must stress that at this stage we haven't had any claims on that yet, but there is a value that could be out there. The second one is there is no claim, and that assumes that the indemnity will not be called on. So in the first base we say that the value would be R2.725 billion and the second basis a value of R4.376 billion. I know that the ranges are quite wide, but this gives you a sense of what we think it may be worth.

If we then turn to slide nine, just having a look at the advances overview, as I said earlier on the 2015 numbers would have the gross advances and looking at the top line there of R15.767 billion compared to R29 billion assets classified for resale. So that would be the assets that subsequently got sold to the new African Bank. But at high level we have talked about a gross book then at the end of September 2016 of R7.047 billion, an impairment of R4.136 billion against that, and a net position of R2.911 billion on that. The reduction in gross advances accelerated by net write-off of R6.3 billion, and that would mainly be as a result of prescription. The collections – and we will refer to a slide later on slide 11 – are slightly ahead of expectation and we are happy that it is moving in the right direction.

The overall provision coverage of 58.7% I think is a solid coverage there. And then the recoveries on advances previously written off amounted to R766 million. I think it probably makes sense to at this stage refer to one of the qualifications the auditors had where they said they believe we put no value on the memorandum ledger book, so that was recoveries of a book previously written off. They believe it may be worth R1.25 billion, but it is a very soft number and we believe that as most banks in South Africa and around the world we do not necessarily put a number on that memorandum ledger book. If we put a number last year we would have put R766 million, but it remains a soft number and therefore we haven't put it in.

It also makes sense just to refer to the second qualification that the auditors had on the financial statements. Their point was that they were unable to test the actual models, scoring models. So if we said to ourselves that everything with a score by example of 65 and lower would transfer to the good bank and the rest would remain in Residual Debt, they believe they couldn't verify that scorecard in particular. And just by way of further example on that, say if someone had been in a position for three months compared to someone else in a position for five years we would have a higher loading in terms of risk on that. And those numbers are subjective. So you would obviously in terms of your score if you put some further points on that you give someone a higher score, and I think it is difficult to verify that. But having said that we had separate exercises done and we have agreed on the fair value of the book sold between RDS and new African Bank. So we do not believe that qualification is significant in nature.

If we then turn to page ten talking about the SARB loan, we have spoken about this in the past. So RDS received a SARB loan of R3.3 billion enabling the appropriate asset transfer to give effect to the transaction of 4 April last year. The loan interest and principle rate is senior to any other instrument and for that matter any stub instrument. And the loan was fully settled by 30 September. It represents the initial success for the curatorship post the transaction. The SARB indemnity guarantee that we talked about earlier on, there is a provision of R3

billion indemnity to the new African Bank. It is really in respect of the assets transferred to the new bank and expires on the 8th anniversary of the restructuring of the transaction, so that would be 4 April 2024. The SARB has provided a matching supporting guarantee to the extent that RDS does not have the cash available. So it is important to note that. However, as I mentioned before at 31 January 2017 the indemnity guarantee reserve amounted to R1.7 billion in addition to an additional operating float of R500 million. So the current projections indicate that the indemnity reserve should be fully funded by [break in audio]. That repayment to the holders of the senior stub instruments can commence as soon as the fully R3 billion has been collected.

Right. If we look at slide 11, just two points to take note of. Firstly, the National Credit Regulator of South Africa is busy with an investigation into reckless lending allegations levelled against RDS. So that would be for lending done before curatorship date of August 2014. Certainly from our side we are fully cooperating with the ongoing investigation, and in fact I had a meeting with the CEO of the Credit Regulator last week. Certainly no liability has arisen or been provided for at date of reporting. And then other than the possible National Credit Regulator outcome there are no current legal proceedings. Should any liability arise that would obviously rank alongside the senior stub claims. On the same basis it is worth noting the ongoing matters with the South African Revenue Services in South Africa. A lot of those really date before curatorship date, together with the restatement of some of the numbers for the 2014 year. And they relate primarily to the deductibility of impairment provisions. Due to the current uncertainty on this matter and the future profitability no deferred tax asset has been raised, and neither has any possible liability.

If we then turn to page 12, just the monthly collections, you will see that there are quite a number of items we've got outlined there. If one just looks at the first bar there for April 2015, projected soft collections – those are the ones where there are no legal proceedings – that was at quite a good level there. But one would assume that by September 2016 that has come down to just over R100 million a month. And that's the expectation that this book is running down and will continue to run down. And then the actual collections, soft collections, as you can see there initially above projection and now coming more in line with it. On the projected hard collections we have put some huge efforts in via the SLA and a specialist that is working with our team, and we are slightly ahead of the collections on the hard collections side. But that just gives one a sense as to where things are going. We are revisiting these forecasts. We are getting an independent firm in just to see how that may pan out over the next period.

If we then turn to slide 13, just some concluding remarks, we believe the successful restructuring of African Bank has been completed with the new good bank out there. The continued collections of RDS are running smoothly. The SARB loan of R3.3 billion is fully repaid. The indemnity fund is expected to be fully funded by December of this calendar year. And the next six-monthly report in respect of October 2016 to March 2017 we expect to publish in June this year. So this was the quite rundown as to where we are and what we have. And we are now happy to take some questions if there are.

Operator

Thank you very much, sir. Ladies and gentlemen, at this time if you would like to ask a question you're welcome to press star and then one. That will place you in the question queue. If you however decide to withdraw the question you're welcome to press star and then two to remove yourself from the question queue. The first question comes from Elena Ilkova of RMB.

Elena Ilkova

Hi there. I would like to ask a question regarding gross advances accelerated net write-off of R6.3 billion. You mentioned that most of that is related to restriction debt. Can you give us a sense of how that played out during the year? Was that R6.3 billion written off before the transaction or how did that come up?

Tom Winterboer

In terms of the actual timing I couldn't give you the actual timing, but we would literally on a monthly basis provide write-offs. Some of it would have been before the transaction. But on a monthly basis as these amounts prescribe we sell it off. I also just want to add that we are selling off parts of the book as they are getting close to prescription to at least realise some value, and we have had three such sales of the book. Unfortunately the market isn't that great in terms of what we receive for it, but at least we are receiving some money for them.

Elena Ilkova

Thank you.

Operator

The next question comes from Constantine of JP Morgan.

Constantine

Hello. Thank you very much for the presentation. I have two questions to ask. The first question is about the numbers really. In the published financial statements that you made available today you noted R4.6 billion [inaudible segment] stub instruments. At the same time I'm looking at the memorandum that you published on February 4th before the transaction and it looks like the [unclear] was a bit above that at R5.5 billion. Could you please confirm the difference? Maybe repayments of obligations of Residual Debt Services through this period.

Tom Winterboer

Unfortunately I don't have the OIM with me. But we published a number of documents in preparation of the transaction. There was an initial document that was published in I think about September of 2015. And at that stage I don't think we actually considered the 10% in cash element. So that could be part of it. But certainly the amount that we have on the financial statements would have been the 10% of the initial R40 billion of senior bondholders together with the interest accruing subsequently. So that may not have been in the initial document. But this would be the position as of 30 September 2016. So I'm not sure if that answers your question.

Constantine

Yes. So the total of the senior stub instrument is R4.6 billion, just to confirm this?

Tom Winterboer

Ja, that's right. You had another question.

Constantine

Two more questions if possible on the indemnity. First of all could you please give us some estimate of your net debt predictions? What percentage of the total indemnity cover would be utilised by the African Bank? So what percent of this R3 billion do you really expect to be claimed to African Bank? And maybe a more narrow range compared to what you gave of complete [unclear] zero claims.

Tom Winterboer

Where we stand at the moment we are a number of months into the transaction, literally ten months into the transaction of 4 April, and we have had no claims. So it is extremely difficult to establish if there will be a claim. In fact there have been no indications of claims. So it is very difficult to put it in, and that's why we have put the range. Unfortunately we cannot get any closer. One would obviously hope that there are no claims going forward, but one just doesn't know at this stage.

Constantine

If possible two short questions going forward. First, how likely do you think that the indemnity will expire before the eight years of maturity? And a short question just to follow up, you mentioned there is R1.25 billion in the region of assets. Are these included in the calculations of the recovery on this year's stub instruments?

Tom Winterboer

Let's just deal with the expiry of the R3 billion indemnity. That is open and has to remain open until 4th April 2024. That was a condition of the consortium investing into the new African Bank to give them the comfort. So that has got to stay open until then unfortunately. Certainly for RDS and for current stub holders. In terms of the R1.25 billion of the memorandum ledger those amounts have been taken account of. What is the expected run-off of this book? What are the cash collections? So that would be in there in any event. So it is not as if it is an additional amount. We modelled all the expected cash flows. We have shown you the one with both the hard and soft collections. And that would all be in the numbers that would build up to the amounts and possible values on the stub instruments.

Constantine

One more question if possible.

Joachim

Thank you. My name is Joachim from JP Morgan. Thank you very much for your presentation and for your time. So on slide eight you are talking about recoveries over the next six months, but you also discount them at this 14% rate. Do you have any estimates of real cash flows? Do you disclose them before basically discounting them?

Tom Winterboer

As you would have seen on slide 12 we have got cash flows going out. And these amounts we arrived at after applying similar cash flows as the ones we've got here. So yes, those were based on forecasts, but those are the ones that we are revisiting and will report on that when we come to the end of March results sometime in June this year.

Joachim

Sorry, basically you are going to disclose the exact cash flows in a separate disclosure, the financial statements in March?

Tom Winterboer

No, what we are saying is we are not going to disclose everything. We will disclose what has happened, but the forecasts we will certainly re-forecast and use that in the calculation of the amounts that we have done on slide eight here. We are just saying that we will revisit that and one must obviously try and get it as accurate as possible because we know that the values at which the stubs are trading is obviously very dependent on what we have out in the market.

Joachim

Okay. Fine. Thank you.

Tom Winterboer

Right. Any other questions?

Operator

Yes sir. The next question comes from Thomas Hilger [?] of Goldman Sachs.

Thomas Hilger

Thanks. Hi. Just a quick follow-up question on slide 11 on the NCI investigation, just to confirm that is against RDS rather than against ABL so it would not be covered by the indemnity. And then on that, is there also a separate investigation on the same issues against ABL so there could be a claim on the indemnity and a direct claim against you, or can you exclude that?

Tom Winterboer

At the moment the investigation is only in respect of loans made by the RDS entity prior to curatorship. We do not expect it to move into the new bank, because if it did obviously it would impact that indemnity amount. But at this stage it is focussed on the RDS loans that were made. And I think the NCR were fairly clear on that. So that's where we are on our best understanding at this time.

Thomas Hilger

And can you give us any colour on the timeline for this investigation and when it might come to a conclusion?

Tom Winterboer

You know they have been on it for quite a number of months already. And we can only wait for them to come back to us. They said they would give us a sense when they are ready, but I don't think they are finished all their testing yet. So it is just very difficult to give you a timing on it. Most of these amounts would have been written off in any event, so we do not expect that there will be major impact. But there is nothing that precludes a possible fine or whatever they may want to do. But we will obviously do what is right in the circumstances. So if something is alleged to be reckless, and we check and we believe it is, we will certainly just write it off if it hasn't been written off before. But there is a good spirit of cooperation with the credit regulator. But timing unfortunately it is very difficult to give you. They can't give us something yet.

Thomas Hilger

Okay. Thank you.

Operator

The next question comes from Piers Marsden of Madison Associates.

Piers Marsden

Good afternoon, Mr Winterboer. Thank you for your time. I am representing a senior stub holder and I have two quick questions. The first one relates to payment to senior stub holders. I know that is only going to happen probably from the beginning of next year as you previously said. Is there some sort of claims process that the senior stub instrument holders need to follow in order to get paid out, or will they just get paid in accordance with their rights as a stub holder?

Tom Winterboer

We've got a record of the stub holders and that will certainly be in that fashion. But we will certainly make an announcement so soon as we are ready and able to pay. And certainly if a senior stub holder has not been informed they can obviously contact us. There is a website. But the work is being done by the new bank treasury department so it will obviously route via that. So if a notice goes out and the person hasn't received anything they are welcome to contact us via that channel.

Piers Marsden

Thank you very much. And the second question: is there an ability to or a market for the stub instruments to trade?

Tom Winterboer

We understand I think RMB has got a facility and they are trading. We understood that the latest trade in the senior stubs was about 26 cents on the Rand. And we believe on the subordinated stubs there was eight traded at 0.25 cent on the Rand. But we do not believe there is value in that. But it could be someone who wanted to realise a tax loss for tax purposes. We don't actually know. But yes, we understand that RMB has got a market for it.

Piers Marsden

Okay. Thank you.

Operator

Ladies and gentlemen, just a reminder, if you would like to ask a question you're welcome to press star then one. The next question comes from Prateek Puri of Blantyre Capital.

Prateek Puri

Hi Tom. Thanks for the update. I wanted to ask you, given the macro slowdown that you're seeing in South Africa what kind of recoveries on the remaining book do you expect going forward?

Tom Winterboer

You know the recoveries overall are really built into the assumptions that we've got on slide eight. So we are revisiting it. And we believe the R2.9 billion that we've got on the balance sheet we believe we should be able to collect, and clearly some of the monies on the memorandum ledger book. But all of that would have found its way into the model, giving the two parts of the ranges, the R2.725 billion up to the R4.376 billion on slide eight.

Prateek Puri

That's helpful. And that R2.9 billion, that is discounted at the same sort of WAP [?], 14% over time?

Tom Winterboer

No, that is... just for the purposes of the book we followed our normal provisioning against that. So that would just be a book amount. But certainly once you start doing the actual cash flows, all the related cash flows would have gone into the calculation on slide eight.

Prateek Puri

And in terms of actual cash that needs to be collected do you happen to know what the total gross amount is to be collect pre- and post-impairment.

Tom Winterboer

Look, pre-impairment if you look on slide nine you would have seen that gross would be R7 billion that needs to be collected. But clearly we are not going to be able to collect that, and that's why the provisioning has been put in place. And then there will also be gross collections. We refer to the book. The total amount out there is R21.7 billion which has been fully written off. So there are clearly some collections against that. But that is a very small amount to collect against that. But once again all of that has been brought into the model that we talk about in slide eight.

Prateek Puri

Thanks for that. The other question was on the NCR claim. Now, are we missing something? This would actually not be funded from the indemnity reserve. It would be at the same level as the senior stub holders. Is that right?

Tom Winterboer

Firstly to say that there is no claim yet by the NCR. But should there be a claim these loans would have been advanced from the RDS markdown book. So if for instance there was a claim it would be paid out of the cash resources of RDS. But the R3 billion would only be if there were claims or whatever else on new African Bank. So this R3 billion would not be utilised for anything in RDS, no.

Prateek Puri

Right. Thanks. Actually that's it. Thank you.

Tom Winterboer

Welcome.

Operator

We have a follow-up question from Elena of RBM.

Elena Ilkova

Thank you. That's Elena from RBM. My question is a bit more clarity if possible on the arrangement between RDS and the new African Bank. You did mention that there is a SLA in place and there is a combination of fixed and variable charge. How does that arrangement work? Can you give us a bit more detail?

Tom Winterboer

Yes. So there is a fixed amount on every ID number. The reason why that was put in place was that some people could have three or four loans. For every person that the SLA is for there is a fixed amount for that. And then there is a percentage of the collections, on hard collections a separate percentage, on soft collections a much lower percentage. And those are the only amounts where we would pay that over on a monthly basis after the collection numbers have come in. And for that the new bank would actually do all the other services like treasury services. We talk about the collection accounting services and the like. There is a very small skeleton staff, myself and a few others. But we are not here on a full time basis. And that is a separate charge. But those amounts are actually quite small in the overall scheme of things. But SLA is the big thing. Those are the three elements involved in it.

Elena Ilkova

Thank you.

Tom Winterboer

Welcome.

Operator

Ladies and gentlemen, just a final reminder, if you would like to ask a question you're welcome to press star and then one.

Tom Winterboer

Are there any other questions?

Operator

Gentlemen, there don't seem to be any further questions on the lines. Do you have any closing comments?

Tom Winterboer

Thanks very much again for joining us on the call. We will get the numbers together at the end of March and we will come out with the results then hopefully in June and give you an update as to where things are. I know that we've had some requests for separate meetings. Unfortunately one cannot share more with one participant than others. That will certainly be the next time that we will interact with you. But thanks very much again for joining us on the call.

Operator

On behalf of Residual Debt Services that concludes this afternoon's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT