

Residual Debt Services Limited (in curatorship)
Statement by T Winterboer, curator of Residual Debt Services Limited
22 November 2017

Introduction

This is the third update by the curator following the successful implementation of the transaction on 4 April 2016, in accordance with an Offering Information Memorandum (“OIM”) issued on 4 February 2016. The OIM, inter alia, created a new bank (African Bank Limited) and transferred the core assets and business to the new African Bank Limited, which received an injection of R10 billion from its new parent, African Bank Holdings Limited (the “Transaction”).

The material liabilities of Residual Debt Services Limited (“RDS”) were exchanged, as part of the Transaction, for new instruments held in African Bank Limited, together with certain residual claims on the assets of RDS – “senior stub instruments” and “sub-ordinated stub instruments” and a partial cash settlement.

The reader is referred to the Transaction documents. Nothing in this statement should be considered to alter legal terms and conditions agreed to and detailed in the Transaction documents.

The aspects related to RDS covered in this statement are the following:

Topic	Page No
Annual Financial Statements as at 30 September 2017.....	2
SARB Loan	2
SARB indemnity guarantee	2
Claims against the indemnity.....	3
Asset recoveries	3
Valuation of stub instruments	4
Scenario 1: Full claim on indemnity reserve.....	4
Scenario 2: No claim on indemnity reserve.....	5
NCR and legal proceedings.....	6
SARS related matters.....	6
Conference call.....	7
Next Update	7

T Winterboer was appointed as curator of Residual Debt Services Limited (“RDS”), previously named African Bank Limited on 10 August 2014 by the Minister of Finance of the Republic of South Africa and pursuant to the Banks Act No. 94 of 1990 (as amended) to manage the affairs of RDS subject to the supervision of the Registrar of Banks.

Annual Financial Statements as at 30 September 2017

At the time of this statement, the audited annual financial statements of RDS have been issued for the year ended 30 September 2017. Please note the comparative numbers are for a six month period from 4 April 2016 to 30 September 2016, covering the first six months of operations of Residual Debt Services Limited, after the successful implementation of the transaction.

Highlights include:

- Cash on hand totalling R3 675 million (2016: R697 million) consisting of an operational cash float of R500 million, indemnity reserve fund of R3 000 million and surplus cash of R175 million (consisting mainly of accrued interest on cash investments totalling R105 million)
- Assets at 30 September 2017 of R4 738 million, with unsubordinated liabilities of R5 600 million (including the senior stub instruments of R5 380 million), and subordinated liabilities of R4 340 million representing the contractual value of the subordinated stub instruments, resulting in negative equity of R5 202 million
- A loss from operations of R774 million (2016 profit from operations of R42 million)
- Credit Impairment reversal of R614 million (2016: R657 million)

The audited annual financial statements for the year ended 30 September 2017 can be accessed on the following link; www.residualdebtservices.co.za.

SARB Loan

As part of the Transaction, RDS received a loan from SARB of R3.3 billion, which enabled the appropriate asset transfer to give effect to the Transaction. This loan and interest arising ranked for payment prior to any payments to stub instruments.

As reported in the prior set of results, this loan has been settled in full in the period up to 30 September 2016.

SARB indemnity guarantee

As part of the Transaction, RDS has provided a R3 billion indemnity to the new African Bank Limited in respect of assets transferred, with such indemnity expiring on the 8th anniversary of the Transaction, effectively 4 April 2024. The SARB provided to RDS a matching supporting guarantee for this indemnity, so that the indemnity could be honoured even where RDS did not have sufficient funds to cover any claim arising.

Any claim arising to the SARB from these indemnity guarantee arrangements has a priority ranking claim on the assets of RDS, after operational costs arising in the ordinary course of the curatorship but before the stub claims.

Accordingly, having settled the SARB Loan in September 2016, RDS accumulated an indemnity reserve fund, which was fully funded to the value of R3 billion at the 30 September 2017 financial year end. Any further funds collected (net of operating expenses) in addition to the operational cash float of R500 million will be utilised to provide payment to the senior stub instruments.

Claims against the indemnity

At the date of this statement, the curator has not received notice of any identified claim against the indemnity by the new African Bank Limited.

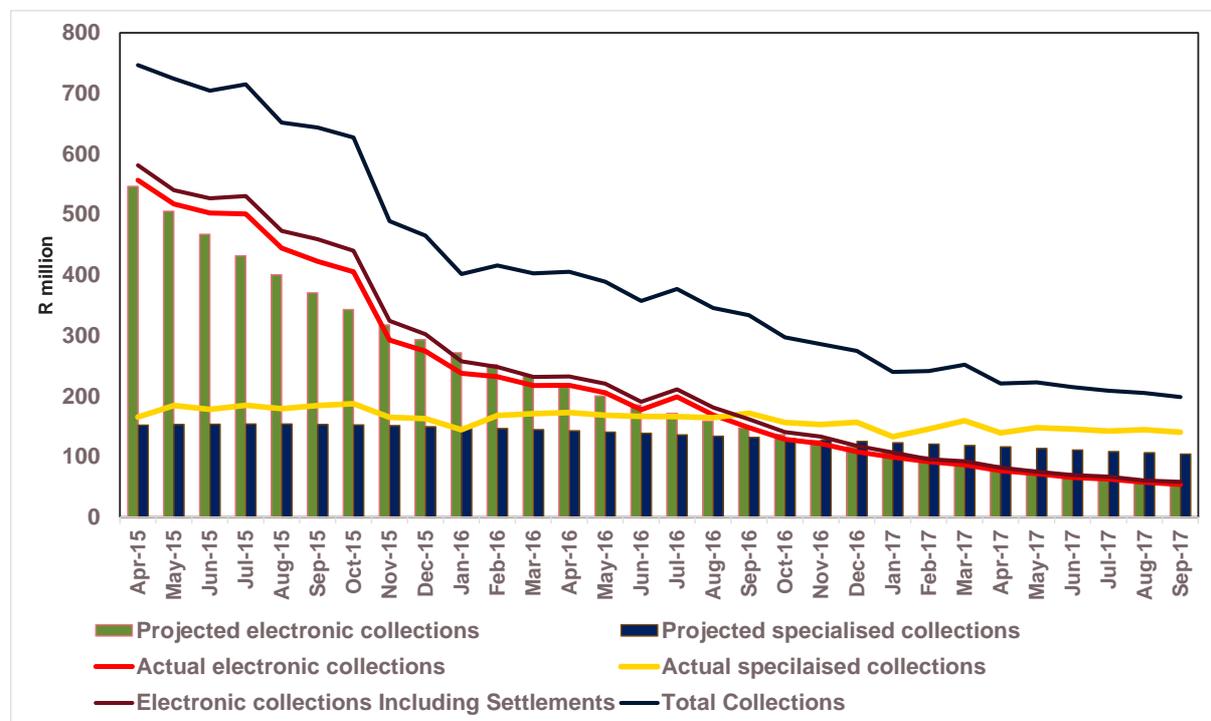
If, at the date of expiry of the indemnity, being 4 April 2024, no notice of claim has been received, then the reserve would be available to provide payment against stub claimants in accordance with agreed waterfall mechanisms detailed in the Transaction.

Asset recoveries

RDS continues to focus on recovery of the remaining assets held following the Transaction. The principal assets are loans made by RDS prior to the commencement of Curatorship that were not transferred to the new African Bank Limited.

The collections performance in the period to 30 September 2017 is included below:

Monthly collections – projected vs. actual (R million)



African Bank Limited is contracted to lead the recovery of such assets for which it charges a fee based on a service level agreement entered into between RDS and African Bank Limited.

Additionally the curator has retained the services of another independent service provider to provide a review and challenge to ensure that recovery approaches are optimal.

Valuation of stub instruments

In estimating the fair value of liabilities, the Company made a number of assumptions that gave rise to a range of projected outcomes in respect of the SARB Indemnity.

Two scenarios together with the associated interest rate sensitivities are presented below. Under the first scenario there is a full claim on the indemnity guarantee reserve, while under the second scenario there is no claim on the indemnity reserve. In practice, it is possible that a combination of outcomes would materialise and that these potential outcomes may be different from the ranges projected.

The expected future cash flows have been modelled based on the two scenarios. A discounted cash flow valuation technique has been applied to estimate the projected outcome under each of these outcomes.

Scenario 1: Full claim on indemnity reserve

The key assumptions the Company has taken in deriving the expected cash flows in this scenario are as follows:

- The expected cash flows derived from the remaining advances for a 60 month period;
- Using the expected cash flows derived from the remaining advances, application of the Distribution Waterfall requirements are applied to the free cash flows.
- With regard to the indemnity reserve, it is assumed that 100%, i.e. R3 billion, will be called upon by the entity currently trading as the new African Bank Limited and hence paid out over a three year period.
- As the cash of R3 billion has built up to satisfy any potential indemnity reserve claim as detailed above, it is assumed that all surplus cash in excess of the R500 million operational float (to the nearest R50 million) is then paid to Senior funders (every 6 months). The first payment to senior stub holders is anticipated to take place in January 2018 and then July 2018 again and so on until the end of the 60 months period mentioned above.
- The model assumes that subordinated unsecured stub instrument holders will not receive any cash as the senior stub holders are not satisfied in full.
- An additional cash outflow totaling R200 million has been incorporated for potential future closure and associated costs in the 30 September 2017 analysis. This was not included as at 30 September 2016.
- The discount rate used to present value the expected future cash flows is 14.0%; which represents a modified weighted average cost of capital (WACC) for the Company.

The table below illustrates the stub instruments' fair values under this *scenario 1* as at 30 September 2017, together with the sensitivity if the discount rate increases by 1%.

Fair value and sensitivity overview (Scenario 1)

R million	30 September 2017			30 September 2016		
	Fair value @ 14.0%	Fair value @ 15.0%	Difference	Fair value @ 14.0%	Fair value @ 15.0%	Difference
Senior	2 820	2 760	(60)	2 725	2 642	(83)
Subordinated	Nil	Nil	Nil	Nil	Nil	Nil

Scenario 2: No claim on indemnity reserve

An additional sensitivity scenario has been presented where it is assumed that no amount is claimed from the indemnity reserve for the duration of the indemnity period and thus the full R3 billion is paid to senior stub holders at the end of the indemnity period, together with the operating float of R500 million, being April 2024.

The key assumptions the Company has taken in deriving the expected cash flows in this scenario are as follows:

- The expected cash flows derived from the remaining advances for a 60 month period;
- Using the expected cash flows derived from the remaining advances, application of the Distribution Waterfall requirements are applied to the free cash flows.
- As the cash of R3 billion has built up to satisfy any potential indemnity reserve claim, it is assumed that all surplus cash in excess of the R500 million operational float (to the nearest R50 million) is then paid to senior stub holders (every 6 months). The first payment to senior stub holders is anticipated to take place in January 2018 and then July 2018 again and so on until the end of the indemnity period, being April 2024. The model assumes that subordinated unsecured stub instrument holders will not receive any cash as the senior stub holders are not satisfied in full.
- An additional cash outflow totaling R200 million has been incorporated for potential future closure and associated costs in the 30 September 2017 analysis. This was not included as at 30 September 2016.
- The discount rate used to present value the expected future cash flows is 14.0% (which represents a modified weighted average cost of capital (WACC) for the Company). However, the R3.5 billion cash flow mentioned above is not discounted using the WACC of 14.0%, but is discounted using the 7 year risk free rate as at 30 September 2017 of 7.536% NACQ. This is considered more appropriate as the full R3.5 billion has been collected to date and held on deposit with the major South African banks. This additional assumption was not applied as at 30 September 2016 as only a portion of the cash had been collected at that point in time.

The table below illustrates the stub instruments' fair values under this *scenario 2* as at 30 September 2017, together with the sensitivity if the discount rate increases by 1%.

Fair value and sensitivity overview (Scenario 2)

R million	30 September 2017			30 September 2016		
	Fair value @ 14.0%	Fair value @ 15.0%	Difference	Fair value @ 14.0%	Fair value @ 15.0%	Difference
Senior	5 308	5 238	(70)	4 376	4 188	(188)
Subordinated	Nil	Nil	Nil	Nil	Nil	Nil

Note * - All cash flows discounted at a WACC of 14.0% or 15.0% as indicated, except for the R3.5 billion indemnity reserve and operational float balance which is assumed to be paid in April 2024 and is discounted at the risk free rate at 30 September 2017 of 7.536% NACQ.

Fair value summary

A partial settlement against the senior stub holders is anticipated, albeit that timing of payments and quantum will be reliant on future recovery performance and the extent of any claims against the indemnity arrangements. Any payment will first apply against interest accrued.

No payment to sub-ordinated stub holders is expected.

No dividend distribution to the shareholder of RDS, being African Phoenix Investments Limited (previously known as African Bank Investments Limited), is anticipated.

NCR and legal proceedings

RDS is co-operating fully with the National Credit Regulators (NCR) into certain activity of RDS prior to curatorship in respect of potential reckless lending. No liability has arisen or been provided for.

Other than the possible NCR outcome, no legal proceedings are ongoing at this time, or have been identified for future action.

If a liability does arise from the NCR investigation or other legal proceedings, any such claim would rank alongside senior stub claims.

SARS related matters

RDS has open tax matters with SARS which primarily relate to the deductibility of historical impairments provisions. Due to the uncertainty relating to this matter, no deferred tax asset or liability has been raised in the financial statements.

Conference call

A conference call is being held today at 14h00 CAT. Interested parties are requested to pre-register for this conference call at <https://goo.gl/n3F34V> and follow the instructions provided. The call is being recorded and will be available via the company website www.residualdebt services.co.za on 23 November 2017.

Next Update

It is expected that the curator will provide a further update in May 2018, together with the interim financial statements.