

Residual Debt Services Limited (under curatorship)
Statement by C Du Plessis, Curator of Residual Debt Services Limited
31 May 2019

Introduction

This is the sixth half yearly 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 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 a partial cash settlement, new instruments issued by African Bank Limited, together with certain residual claims on the assets of RDS comprising a “senior unsecured stub instrument” and a “subordinated unsecured stub instrument”.

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

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

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C Du Plessis replaced T Winterboer as Curator of RDS effective 1 April 2018. This follows T Winterboer’s resignation as Curator effective 31 March 2018, who was appointed as Curator of RDS (previously named African Bank Limited (the “Bank”)) on 10 August 2014 by the then 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.

Unaudited Condensed Interim Financial Statements as at 31 March 2019

At the time of this statement, the unaudited condensed interim financial statements of RDS have been issued for the period ended 31 March 2019.

Highlights include:

- Three payments to holders of the senior unsecured stub instrument totalling R1.8 billion. It is anticipated that a fourth payment of approximately R600 million will be made by the end of July 2019;
- Cash on hand totalling R3.9 billion (FY2018: R4.1 billion) consisting of an operational cash float of R500 million, indemnity reserve of R3 billion and surplus cash of R400 million;
- Assets at 31 March 2019 of R4.3 billion, with unsubordinated liabilities of R4.4 billion (including the senior unsecured stub instrument of R4.3 billion), and subordinated liabilities of R5.2 billion (representing the contractual value of the subordinated unsecured stub instrument), resulting in negative equity of R5.3 billion;
- A loss from operations of R116 million (H1 2018: R76 million); and
- Credit Impairment reversal of R477 million (H1 2017: R604 million).

The unaudited condensed interim financial statements for the period ended 31 March 2019 can be accessed on www.residualdebtsservices.co.za.

SARB indemnity guarantee

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

Having settled the SARB Loan in September 2016, RDS built up an indemnity reserve which was fully funded to the value of R3 billion on 1 September 2017 and an operational cash float of R500 million. Any free cash in excess of R3.5 billion will be utilised to make payments to the holders of the stub instruments according to the cash flow priority of payments ("Distribution Waterfall"). Three such payments totalling R1.8 billion were made to the holders of the senior unsecured stub instrument to date.

Claims against the indemnity

At the date of this statement, the Curator has not received notice of any identified claim against the indemnity provided to African Bank Limited.

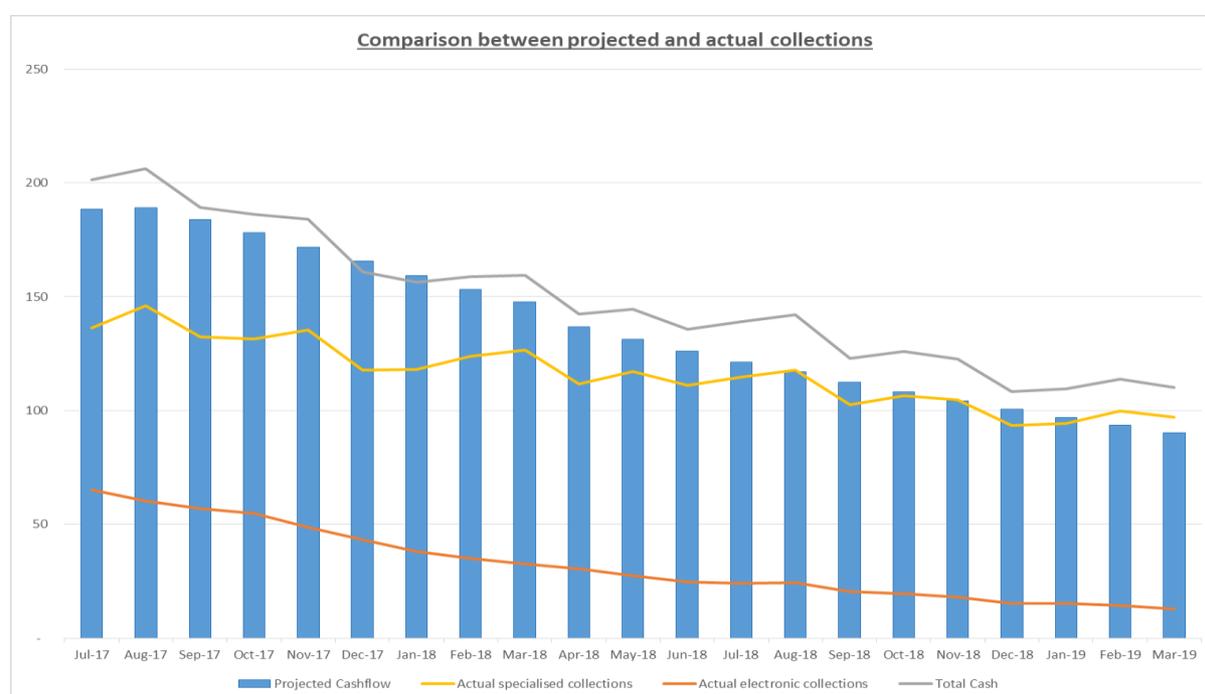
If, at the date of expiry of the indemnity (being 4 April 2024), no notice of claim has been received, then the reserve would be available to make payments to holders of the stub instruments according to the Distribution Waterfall.

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 African Bank Limited.

The monthly collections performance from July 2017 to March 2019 is presented below:

Monthly collections – projected vs. actual (R million)



Split between specialised and electronic collections	31 March 2018	30 September 2018	31 March 2019
Actual specialised collections	81%	84%	89%
Actual electronic collections	19%	16%	11%

African Bank Limited is contracted to collect such assets for which it charges a fee based on a services level agreement entered into between the parties. Additionally the Curator has retained the services of another independent service provider to conduct an assessment to ensure that approaches to recoveries are optimised.

Valuation of stub instruments

In estimating the fair value of liabilities, RDS 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 it is assumed that there is a full claim against the indemnity reserve, while under the second scenario it is assumed that there is no claim against 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 and a discounted cash flow valuation has been applied to estimate the projected outcome under each of these scenarios.

Scenario 1: Full claim against the indemnity reserve

The key assumptions RDS has made 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 are applied to the free cash flows;
- With regard to the indemnity reserve, it is assumed that 100% (R3 billion) will be utilised and paid out evenly over a three year period;
- As cash of R3.5 billion has been built up to fund the indemnity reserve and operational cash float, it is assumed that all surplus cash in excess of R3.5 billion is then paid to the holders of the senior unsecured stub instrument every 6 months. Three payments to senior unsecured stub holders totaling R1.8 billion have been made to date. It is assumed that further payments will be made on a six monthly basis thereafter (based on forecasted surplus cash balances at the applicable points in time) until the end of the 60 months period mentioned above. The operational cash float of R500 million will also be paid to the holders of the senior unsecured stub instrument at the end of such period;
- The model assumes that holders of the subordinated unsecured stub instrument will not receive any cash as the senior unsecured stub holders are not settled in full;
- An additional cash outflow totaling R200 million for potential future closure and associated costs is included; and
- The base case discount rate used to present value the expected future cash flows is 14.0% NACM; which represents a modified weighted average cost of capital (“WACC”) for RDS.

The table below illustrates the stub instruments’ fair values under *Scenario 1* as at 31 March 2019, together with the sensitivity if the discount rate is increased and decreased by 1% respectively. The contractual carrying values of the stub instruments have been disclosed for the sake of completeness.

Fair values and sensitivities overview (Scenario 1)

R million	31 March 2019			30 September 2018		
	Fair value @ 14.0% NACM	Fair value @ 15.0% NACM	Fair value @ 13.0% NACM	Fair value @ 14.0% NACM	Fair value @ 15.0% NACM	Fair value @ 13.0% NACM
Senior unsecured	2 219	2 173	2 267	2 472	2 421	2 525
Subordinated unsecured	Nil	Nil	Nil	Nil	Nil	Nil
Contractual carrying values of stub instruments						
Senior unsecured	4 322			4 743		
Subordinated unsecured	5 185			4 886		

Scenario 2: No claim against the indemnity reserve

The second scenario assumes that no amount is claimed against the indemnity reserve during the indemnity period, and thus the full R3 billion plus the operational cash float of R500 million is paid to holders of the senior unsecured stub instrument at the end of the indemnity period (being April 2024).

The key assumptions RDS has made 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 are applied to the free cash flows;
- As cash of R3.5 billion has been built up to fund the indemnity reserve and operational cash float, it is assumed that all surplus cash in excess of R3.5 billion is then paid to the holders of the senior unsecured stub instrument every 6 months. Three payments to senior unsecured stub holders totaling R1.8 billion have been made to date. It is assumed that further payments will be made on a six monthly basis thereafter (based on forecasted surplus cash balances at the applicable points in time) until the end of the 60 months period mentioned above;
- The model assumes that holders of the subordinated unsecured stub instrument will receive a small cash payout as the senior unsecured stub holders are expected to be settled in full;
- An additional cash outflow totaling R200 million for potential future closure and associated costs is included; and
- The base case discount rate used to present value the expected future cash flows is 14.0% NACM (which represents a modified WACC for RDS). However, the R3.5 billion cash mentioned above is not discounted using the WACC of 14.0% NACM, but is discounted

using the 5 year risk free rate of 7.487% NACQ as at 31 March 2019 (FY 2018: 8.116% 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 and money market unit trust funds.

The table below illustrates the stub instruments' fair values under *Scenario 2* as at 31 March 2019, together with the sensitivity if the discount rate is increased and decreased by 1% respectively. In addition, the contractual carrying values of stub instruments have been disclosed for the sake of completeness.

Fair values and sensitivities overview (Scenario 2)

R million	31 March 2019			30 September 2018		
Stub instrument	Fair value @ 14.0% NACM	Fair value @ 15.0% NACM	Fair value @ 13.0% NACM	Fair value @ 14.0% NACM	Fair value @ 15.0% NACM	Fair value @ 13.0% NACM
Senior unsecured	4 374	4 327	4 422	4 823	4 768	4 880
Subordinated unsecured	324	308	340	98	93	103
Contractual carrying values of stub instruments						
Senior unsecured	4 322			4 743		
Subordinated unsecured	5 185			4 886		

Sensitivity- change in assumption relating to regulatory and industry developments

Separate to the above indicative impacts of the sensitivity of the valuation of the stub instruments to a change in the WACC and changes in the assumption relating to a claim on the indemnity reserve, there are specific regulatory and industry developments, including the potential impact of the National Credit Amendment Bill, and the potential impact of the proposed changes to the debit order collections regime which may also impact the valuation of the stub instruments.

Given the uncertainties pertaining to these developments, it is not possible to accurately estimate the impact on the valuation of the stub instruments. Assuming that the impact results in a 10% reduction on the future cash flows derived from advances to customers, the fair value of the subordinated unsecured stub instrument will decrease by R103 million from R324 million to R221 million (using a WACC of 14%).

Fair value summary

A substantial recovery for holders of the senior unsecured stub instrument is expected, albeit that the timing of payments and quantum will be reliant on future performance of recoveries and the extent of any claims against the indemnity reserve.

A small payment to holders of the subordinated unsecured stub instrument is evident in Scenario 2.

No distributions to African Phoenix Investments Limited (the shareholder of RDS) is expected.

Senior unsecured stub instrument payment

It is anticipated that a forth payment of approximately R600 million will be made to holders of the senior unsecured stub instrument. This payment is expected to be made by the end of July 2019, which will bring the total payments to R2.4 billion.

Legal proceedings

There are currently no material ongoing legal proceedings.

If a liability were to arise from any legal proceedings, such claims would rank *pari passu* with the senior unsecured stub instrument.

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 condensed interim financial statements. Refer to the condensed interim financial statements for further information on the matter.

Conference call

A conference call is being held today at 11h00 SAST. Interested parties are requested to pre-register for this conference call at <http://www.diamondpass.net/8445092> and follow the instructions provided. The call will be recorded and be made available via the company website www.residualdebtsservices.co.za on 3 June 2019.

Next Update

It is expected that the audited financial statements for the year ended 30 September 2019 and a further update will be provided by the Curator in November 2019.

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