

African Bank Limited

Unaudited Interim Financial Statements
for the six months ended 31 March 2014



NCR Reg. No. NCRC5. An Authorised Financial Services and Registered Credit Provider.
Reg No. 1975/002526/06

**Unaudited interim financial statements
for the six months ended 31 March 2014**

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STATEMENT OF FINANCIAL POSITION
as at 31 March 2014

R million	% change	Unaudited March 2014	Restated March 2013	Audited September 2013
Assets				
Short-term deposits and cash	38	6 595	4 775	3 030
Statutory assets	3	3 807	3 691	3 859
Other assets	82	4 309	2 366	3 615
Other assets – EHL	4	801	770	569
Taxation	2	493	482	490
Net advances	(4)	47 494	49 218	49 910
Deferred tax asset	> 100	1 305	192	278
Amounts owing by holding company and fellow subsidiaries	(8)	520	567	1 337
Property and equipment	(6)	486	517	488
Intangible assets	(4)	117	122	129
Goodwill	(100)	-	4 000	-
Total assets	(1)	65 927	66 700	63 705
Liabilities and equity				
Short-term funding	39	7 111	5 109	7 513
Short-term funding – EHL	(61)	77	199	121
Other liabilities	(23)	1 044	1 351	1 543
Other liabilities – EHL	> 100	56	5	2
Bonds and other long-term funding	(3)	42 339	43 654	41 990
Subordinated bonds and loans	1	4 389	4 355	4 361
Amounts owing to fellow subsidiaries	92	504	263	374
Total liabilities	1	55 520	54 936	55 904
Ordinary share capital	-	121	121	121
Ordinary share premium	65	14 083	8 533	8 833
Reserves	> 100	(3 797)	3 110	(1 153)
Total equity (capital and reserves)	(12)	10 407	11 764	7 801
Total liabilities and equity	(1)	65 927	66 700	63 705

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INCOME STATEMENT
for the six months ended 31 March 2014

R million	% change	Unaudited	Restated	Audited
		6 months to March 2014	6 months to March 2013	
Interest income on advances	7	6 017	5 630	11 859
Non-interest income	2	1 712	1 682	3 566
Income from operations	6	7 729	7 312	15 425
Credit impairment charge	> 100	(7 987)	(3 866)	(9 096)
Risk-adjusted (loss) / income from operations	> 100	(258)	3 446	6 329
Other interest income	38	232	168	346
Interest expense	10	(2 400)	(2 191)	(4 528)
Operating costs	1	(1 323)	(1 306)	(2 787)
Indirect taxation: VAT	(41)	(22)	(37)	(88)
(Loss) / profit from operations	> 100	(3 771)	80	(728)
Capital items	-	-	-	(4 000)
(Loss) / profit before taxation	> 100	(3 771)	80	(4 728)
Direct taxation: normal	> 100	1 055	(34)	193
(Loss) / profit for the period	> 100	(2 716)	46	(4 535)

STATEMENT OF OTHER COMPREHENSIVE INCOME
for the six months ended 31 March 2014

R million	Unaudited	Restated	Audited
(Loss) / profit for the period	(2 716)	46	(4 535)
Other comprehensive income comprising items that are or may subsequently be reclassified to profit or loss:			
Movement in cash flow hedge reserve	72	323	608
IFRS2 reserve transactions (employee incentives)	-	(30)	3
Other comprehensive income for the period (net of tax)	72	293	611
Total comprehensive (loss) / income for the period	(2 644)	339	(3 924)

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STATEMENT OF CHANGES IN EQUITY
for the six months ended 31 March 2014

R million	Ordinary share capital	Ordinary share premium	Retained earnings	Share-based payment reserve	Cash flow hedging reserve	Total
Balance at 30 September 2012 (restated)	121	8 083	3 202	(3)	(428)	10 975
Total comprehensive income for the period	-	-	46	(30)	323	339
Ordinary shares issued	-	450	-	-	-	450
Balance at 31 March 2013 (restated)	121	8 533	3 248	(33)	(105)	11 764
Total comprehensive loss for the period	-	-	(4 581)	33	285	(4 263)
Ordinary shares issued	-	300	-	-	-	300
Balance at 30 September 2013 (audited)	121	8 833	(1 333)	-	180	7 801
Total comprehensive loss for the period	-	-	(2 716)	-	72	(2 644)
Ordinary shares issued	-	5 250	-	-	-	5 250
Balance at 31 March 2014 (unaudited)	121	14 083	(4 049)	-	252	10 407

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CASH FLOW STATEMENT
for the six months ended 31 March 2014

R million	Unaudited 6 months to March 2014	Restated 6 months to March 2013	Audited 12 months to September 2013
Cash generated from operations	3 985	4 755	10 339
Cash received from lending activities and cash reserves	8 087	7 534	15 928
Cash paid to clients, suppliers of funding, employees and agents	(4 102)	(2 779)	(5 589)
Increase in gross advances	(5 695)	(8 342)	(14 367)
Decrease / (increase) in income earning assets	50	(555)	(723)
Increase in customer deposits	72	16	85
Indirect and direct taxation paid	(25)	(242)	(284)
Cash outflow from operating activities	(1 613)	(4 368)	(4 950)
Cash inflow / (outflow) from investing activities	500	(673)	(1 308)
Acquisition of property and equipment (to maintain operations)	(52)	(47)	(80)
Acquisition of intangible assets (to maintain operations)	(12)	(8)	(36)
Decrease / (increase) in other investing activities	564	(618)	(1 192)
Cash inflow from financing activities	4 678	6 881	6 353
Cash (outflow) / inflow from funding activities	(572)	6 431	5 603
Ordinary shareholder's payments and transactions	5 250	450	750
Increase in cash and cash equivalents	3 565	1 840	95
Cash and cash equivalents at the beginning of the period	3 030	2 935	2 935
Cash and cash equivalents at the end of the period	6 595	4 775	3 030

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Supplementary information to the unaudited interim financial statements

Company profile

African Bank Limited offers unsecured personal loans and credit cards to individual customers across South Africa through more than 1 500 African Bank and EHL retail outlets.

Economic and business overview

The success of an unsecured lending business is based on the ability to correctly predict and price, through the economic cycles, for the associated credit risk by determining the future ability of customers to timeously meet their contractual repayment on loans granted and their credit card debt. Notwithstanding stricter underwriting standards and periodic pullbacks in risk, tough economic cycles negatively impact this ability.

The South African economy continues to experience difficult conditions, with downward revisions in GDP and increasing inflation trends signalling probable interest rate increases, both of which have had and will continue to have a negative impact on consumer confidence and their ability to meet their financial commitments. This is particularly true of the consumers in the medium to lower living standards measures (LSM 2 – 8). While the granting of credit has always been and continues to be a cyclical business, we do expect that the South African economy will continue to face substantial headwinds during the next two to three years.

The impact of this on the business has been significant pressure on collections, which has led to an increase in non-performing loans (NPLs), and lower collections on those NPLs. This is particularly true in respect of poorer quality business written pre July 2013 that continues to disproportionately impact the results through a significantly higher risk charge. Given the higher risk emergence during this period, the bank increased the general credit provision in order to protect it against further unanticipated risk emergence. The lower new business volumes and the higher NPL formation have also resulted in a lower income yield for the period. These factors have resulted in a significant loss for the period.

The loans written before July 2013 continue to produce an elevated level of NPLs each month. This, combined with materially higher provision coverage, has increased the risk charge significantly. Business written post June 2013 shows the expected level of reduced credit risk due to the significantly stricter underwriting interventions implemented in July 2013.

New business volumes of R9.9 billion for the six-month period have decreased as a result of these stricter underwriting policies and the weak operating environment, bringing them in line with those last experienced in 2011 (R10.1 billion). The quality of this business is meeting expectations and is better than equivalent tranches of business originated during 2012 and the first half of 2013, which represented the last stages of the high growth cycle of 2010 to mid-2013.

Financial performance

The bank reported a loss of R2.7 billion for the six months ended 31 March 2014 relative to the R46 million restated profit for the equivalent six months to 31 March 2013.

The bank was negatively impacted by lower disbursements and advances growth, a slight decrease in yield as a result of increased NPLs, as well as deteriorating asset quality with commensurate higher credit impairment charges. This was as a result of continuing risk emergence from loans advanced prior to the risk reduction in July 2013. Specific factors driving the increased risk charge were:

- An increase in specific provisions of approximately R600 million driven by the following factors:
 - NPL emergence on loans advanced before July 2013 being at higher than anticipated levels. The total NPL formation in the six months ended 31 March 2014 was approximately R6 billion which was R600 million more than the level anticipated; and
 - An increase in specific provision coverage on NPLs from 30 September 2013 to 31 March 2014. This is due to seasonal factors that impacted collections and a continued challenging collections environment;
- A decision to increase the general provision for credit impairment relating to performing loans by approximately R2.5 billion.

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The bank further reduced the granting of new loans to riskier customer segments during 2013 by means of curtailed credit risk appetite from July 2013. This resulted in a re-pricing and reduction of new business within the riskier segments of the customer base. This had an expected negative impact on the volume of new business written, with the relative positive impact of the new business still being masked by the risk emergence of business written pre July 2013.

Loan portfolio

As at 31 March 2014, the total gross advances to customers amounted to R61.6 billion compared to R58.8 billion at 31 March 2013.

Credit impairments for loans and advances

Overall asset growth remains muted, while the credit quality of the advances book has deteriorated during the six months ended 31 March 2014 as a result of a continuing tough operating environment. The loans advanced up to the end of June 2013 ("pre July 2013 business") continues to produce an elevated level of NPLs each month while the loans advanced after June 2013 shows the expected level of reduction in credit risk due to the stricter underwriting interventions implemented in July 2013.

Although the bank expected the slowdown in NPL formation to manifest, the decline is taking longer than originally anticipated. In light of the elevated level of NPLs emerging from the pre July 2013 business, the bank increased the general provision on performing loans to cover the abnormal increase of NPLs anticipated in the next six months and beyond.

Credit impairment provisions for loans and advances was R15.7 billion as at 31 March 2014, an increase of 41% from R11.1 billion as at 31 March 2013, with the growth in loans and advances being 5% over this period.

The credit impairment charge has increased by 107% to R8.0 billion for the six months (1H13: restated R3.9 billion). This charge as a percentage of the average gross advances book increased to 26.3% in the six months (1H13: 13.5%). The higher credit impairment charge is reflective of the difficult collections conditions, particularly during Q2 2014, which resulted in a higher than expected roll rate into NPLs and a higher than expected required coverage. As a result of credit quality trends and the subdued economic conditions, the portfolio provisions were also increased by R2.6 billion over the period.

The following table sets out the credit impairments for loans and advances:

R million	31 March 2014	31 March 2013	30 September 2013
Breakdown of gross advances			
Performing loans	42 071	41 607	42 338
Non-performing loans (NPLs)	19 552	17 192	16 622
Gross advances *	61 623	58 799	58 960
Written off book at net realisable value	1 321	1 489	1 321
Deferred administration fees	251	33	195
Gross advances including the written off book	63 195	60 321	60 476

* There are some loans on which an insured event has happened although such event has not yet been reported. An additional provision amounting to R500 million at 31 March 2014 covering those events are carried in the Standard and General Insurance company, a fellow ABIL group subsidiary. The effect of the payment of these claims will be a reduction in the advances balance and as such those loans are not subject to credit risk but rather to counterparty risk.

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R million	31 March 2014	31 March 2013	30 September 2013
Breakdown of impairment provisions			
Balance at the beginning of the period	10 566	9 825	9 825
Impairment provisions raised	8 167	3 975	9 470
Bad debts written off (gross)	(4 238)	(3 452)	(10 229)
Bad debts rehabilitated	1 206	755	1 500
Total impairment provisions	15 701	11 103	10 566
Impairment provisions are made up as follows:			
Portfolio impairment (IBNR)	3 229	299	585
Specific impairment	12 472	10 804	9 981
	15 701	11 103	10 566
Income statement charges			
Impairment provisions raised	8 167	3 975	9 470
Bad debts recovered	(180)	(109)	(374)
Charge for bad and doubtful advances	7 987	3 866	9 096
Ratios:			
NPLs as a % of gross advances	31.7	29.2	28.2
Impairment provisions as a % of NPLs	80.3	64.6	63.6
Impairment provisions as a % of gross advances	25.5	18.9	17.9
Credit impairment charge as a % of average gross advances	26.3	13.5	15.5
Net bad debts written off as a % of average gross advances	10.0	9.4	14.9

Asset quality

NPLs are defined as loans and advances that have more than three cumulative instalments in arrears. Once a loan is classified as a NPL, an impairment provision is made for such NPL. A loan is written off as a bad debt for accounting purposes when amounts are due and unpaid for a period of more than twelve months. The write-off policy also includes the use of scorecards to assess the probability of successful collections. Despite the fact that such loans are recorded as bad debts for accounting purposes, they are still pursued from a collections point of view unless settled by insurance as a result of an insured event taking place.

Collections during the first six months of 2014 continued to be challenging, which resulted in increased NPLs, and significant strain on the recovery of NPLs. The combined impact of these factors has resulted in a higher NPL ratio as a percentage of gross advances and a higher overall NPL coverage ratio. The NPL ratio increased to 31.7% as at March 2014 (compared to 29.2% as at 31 March 2013). The higher NPL migrations resulted in a significantly higher credit impairment charge for the period. The poorer collections experienced, particularly during January 2014, where net NPL migrations peaked at R1.2 billion, contributed significantly to the additional impairment charge.

Collections initiatives have been further intensified to stem the flow of performing loans to NPLs. These are focused on both good and bad faith clients, requiring a slightly different focus.

NPLs increased by 14% to R19.6 billion as at 31 March 2014 compared to R17.2 billion as at 31 March 2013.

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Personal loans

The bank provides short to long-term unsecured loans to individuals in South Africa. The eligibility criteria for the loans require individuals to be formally employed and to have a bank account in South Africa. The loan products are typically term facilities, having maturities of between 3 and 84 months (reduced to maximum 60 months with effect from May 2014) with fixed, equal monthly repayments. Personal loans granted by the bank are used predominantly for housing, education and debt consolidation purposes. The credit granting process involves extensive credit scoring, risk assessment and affordability calculation processes. As at 31 March 2014, the bank had approximately 2.44 million customers reflecting an 8.7% decrease from 30 September 2013.

The average loan term during the six months ended 31 March 2014 was approximately 54 months (compared to 49 months for the six months ended 31 March 2013) and the average loan size was R13 868 (compared to R12 215 for the six months ended 31 March 2013). The increase in average loan size and term was as a result of a reduction in the number of loans granted to higher risk customers with no increases having been made to term or loan sizes in this period.

The following table sets out information pertaining to new loans and credit cards:

		6 months to 31 March 2014	6 months to 31 March 2013	12 months to 30 September 2013
Disbursements (loans and credit card facilities granted)	R million	9 855	12 542	22 688
Number of new loans and credit cards	000	711	1 027	1 799
Average net loan size *	Rand	13 868	12 215	12 611
Average term	Months	54	49	51
Loan approval rate	%	67	70	68
Number of new customers	000	190	278	479

* Net loan size includes external debt settlements but excludes any internal settlements

Credit cards

To complement the unsecured loan products, the bank offers a variety of credit card products to its customers. Each credit card is treated as a revolving credit facility and is issued primarily to existing low-risk customers.

During the six months to 31 March 2014, the bank generated credit card sales of R1 250 million, down 0.4% compared to R1 255 million during the six months ended to 31 March 2013. In the same period, the number of new credit cards issued decreased by 20%. Despite lower sales, credit card advances grew by 13% to R8.7 billion (compared to total credit card advances of approximately R7.7 billion as at 31 March 2013) aided by credit card utilisation of R887 million.

The following table sets out a summary of the credit card portfolio:

		6 months to 31 March 2014	6 months to 31 March 2013	12 months to 30 September 2013
Disbursements	R million	1 250	1 255	2 307
Credit card advances	R million	8 742	7 744	8 151
Number of new cards sold	000	105	132	240
Number of cards in issue	000	951	946	959

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Capital adequacy

The bank complies with regulatory capital requirements. The Banks Act requires African Bank Limited to maintain a prescribed minimum level of capital.

The following table sets out the bank's actual capital position, employing the calculation methodology required in terms of the Banks Act and the Regulations thereto:

R million	Unaudited 31 March 2014	Unaudited 31 March 2013	Audited 30 September 2013
Total assets and commitments			
On-balance sheet assets	65 936	68 030	63 943
Off-balance sheet assets	9 642	4 209	7 889
Total	75 578	72 239	71 832
Risk-weighted assets	49 201	46 356	46 533
Total capital			
Tier 1	9 335	8 902	7 306
Tier 2 (subordinated bonds)	3 112	3 501	3 287
Tier 2 (other)	563	236	585
Total	13 010	12 639	11 178
Capital adequacy	%	%	%
Tier 1	19.0	19.2	15.7
Tier 2 (subordinated bonds)	6.3	7.6	7.1
Tier 2 (other)	1.1	0.5	1.3
Total	26.4	27.3	24.0

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Annexures to the unaudited interim financial statements

Basis of preparation

The preparation of these interim financial statements was supervised by the Chief Financial Officer, J Muller Strauss CA(SA).

This condensed financial information has been prepared in accordance with the framework concepts and the measurement and recognition requirements of the International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board, Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB, IAS 34 Interim Financial Reporting, the SAICA Financial Reporting Guides as issued by the Accounting Practices Committee and Financial Reporting Pronouncements as issued by the Financial Reporting Standards Council and the requirements of the Companies Act of South Africa (Act 71 of 2008).

The company has adopted the following standards and interpretations during the financial year, which did not have a material impact on the reported results except for additional disclosure:

- IFRIC 20 – Stripping Costs in the Production Phase of a Surface Mine
- IFRS 1 – First time adoption of International Financial Reporting Standards
- IFRS 7 – Financial Instruments: Disclosures
- IFRS 10 – Consolidated Financial Statements
- IFRS 11 – Joint Arrangements
- IFRS 12 – Disclosure of Interests in Other Entities
- IFRS 13 – Fair Value Measurement
- IAS 19 – Employee Benefits
- IAS 27 – Consolidated and Separate Financial Statements
- IAS 28 – Investments in Associates and Joint ventures
- IAS 34 – Interim Financial Reporting

The accounting policies and their application are consistent with those used for the company's 2013 annual financial statements.

Restatements and reclassifications

Presentation of the statement of cash flow

Following an internal review, the company's statement of cash flows has been improved to strictly show the cash flows on the direct method. The revised disclosure resulted in changes in cash flows from operating, investing and financing activities.

Impact of 2013 financial year restatements and reclassifications

In the September 2013 results certain comparative balances were restated. These restatements and reclassifications also affected the income statement, statement of other comprehensive income and statement of financial position for 31 March 2013 as follows:

- Change in loan impairment provisioning methodology:
The impact of the restatement on the statement of financial position is a decrease in net advances as at 31 March 2013 of R1.8 billion with a reduction in retained earnings of R1.3 billion, after accounting for current and deferred tax of R0.5 billion. The March 2013 income statement impact is an increase in credit impairment charge by R425 million and decrease in tax of R117 million resulting in a decrease in profit after tax of R308 million.
- Reclassification of software:
The impact of the reclassification on the statement of financial position is a decrease in the carrying value of property and equipment and increase in intangible assets amounting to R122 million.

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Other matters

During the reporting period the company issued bonds amounting to R3.6 billion. During the reporting period bonds amounting to R1 billion were redeemed by the company.

Events after the reporting period

The directors are not aware of any material events occurring between the reporting date and the date of authorisation of these condensed interim financial statements as defined in IAS 10 – Events after the reporting period.

Fair value disclosures

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the end of the reporting period. The quoted market price used for financial assets held by the company is the current bid price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The company uses a variety of methods and makes assumptions that are based on market conditions existing at the end of each reporting period. Quoted market prices or dealer quotes for similar instruments are used for long term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The carrying value less impairment provision of other receivables and payables are assumed to approximate their fair values due to their short term nature. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the company for similar financial instruments.

The fair value of financial assets and liabilities are determined as follows:

The fair value of financial assets and financial liabilities with standard terms and conditions, and traded on active liquid markets, are determined with reference to quoted market prices (includes redeemable notes, bills of exchange, debentures and perpetual notes).

The fair value of financial assets and financial liabilities (excluding those mentioned in the paragraph above and derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis, using prices from observable current market transactions and dealer quotes for similar instruments.

The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optimal derivatives, and option pricing models for optional derivatives. Foreign currency forward contracts are measured using quoted forward-exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts. Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into level 1 to 3 based on the degree to which the fair value is observable.

Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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Fair value disclosures (continued)

Level 1	Level 2	Level 3	Total	
31 March 2014				
Assets				
Financial assets				
Derivative instruments	-	4 216	-	4 216
Liabilities				
Financial liabilities				
Derivative instruments	231	316	-	547
31 March 2013				
Assets				
Financial assets				
Derivative instruments	-	2 196	-	2 196
Liabilities				
Financial liabilities				
Derivative instruments	74	404	-	478
30 September 2013				
Assets				
Financial assets				
Derivative instruments	-	3 529	-	3 529
Liabilities				
Financial liabilities				
Derivative instruments	266	272	-	538

There were no transfers between Level 1 and Level 2 during the period.

Transfers between the levels of the fair value hierarchy are only effected when there are changes in the observability of the inputs and are deemed to have occurred at the end of the reporting period.

For financial assets and financial liabilities not carried at fair value, the carrying amounts approximate their fair values.