

Residual Debt Services Limited (in curatorship)
Statement by C Du Plessis, curator of Residual Debt Services Limited
10 December 2018

Introduction

This is the fifth 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.

Audited Condensed Annual Financial Statements as at 30 September 2018

At the time of this statement, the audited condensed annual financial statements of RDS have been issued for the year ended 30 September 2018.

Highlights include:

- Two payments to holders of the senior unsecured stub instrument totalling R1.15 billion. It is anticipated that a third payment of approximately R650 million will be made by the end of January 2019;
- Cash on hand totalling R4.07 billion (FY2017: R3.675 billion) consisting of an operational cash float of R500 million, indemnity reserve of R3 billion and surplus cash of R570 million (which includes accrued interest on cash investments totalling R80 million);
- Assets at 30 September 2018 of R4.62 billion, with unsubordinated liabilities of R4.932 billion (including the senior unsecured stub instrument of R4.743 billion), and subordinated liabilities of R4.886 billion representing the contractual value of the subordinated unsecured stub instrument, resulting in negative equity of R5.198 billion;
- A loss from operations of R97 million (FY 2017: R774 million); and
- Credit Impairment reversal of R1 193 million (FY 2017: R614 million).

The audited annual financial statements for the year ended 30 September 2018 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 Distribution Waterfall. Two such payments totalling R1.15 billion were made to the holders of the senior unsecured stub instrument in the 2018 financial year.

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.

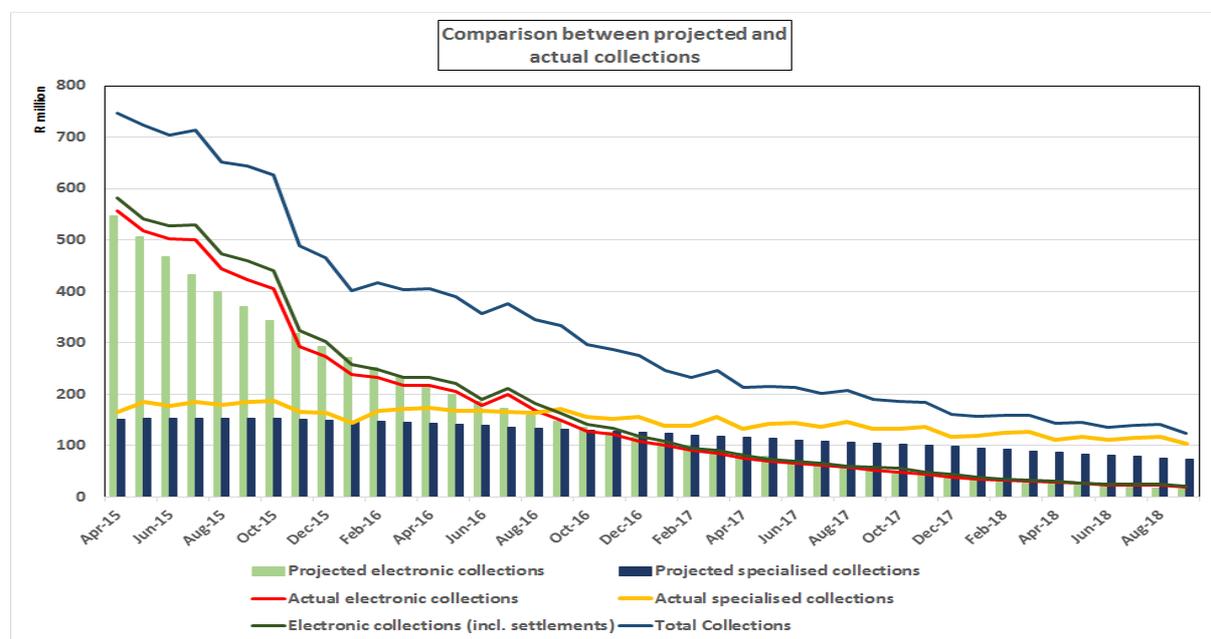
If, at the date of expiry of the indemnity (being 4 April 2024), no notice of claim has been received, then the reserve would be available to make payments to holders of the stub instruments according to the Distribution Waterfall.

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 30 April 2015 to 30 September 2018 is presented 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 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. 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 (to the nearest R50 million) in excess of R3.5 billion is then paid to the holders of the senior unsecured stub instrument every 6 months. The first and second payment to senior unsecured stub holders occurred in January and July 2018 respectively and totaled R1.15 billion. 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 30 September 2018, 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	30 September 2018			30 September 2017		
	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	2 472	2 421	2 525	2 820	2 760	2 882
Subordinated unsecured	Nil	Nil	Nil	Nil	Nil	Nil
Contractual carrying values of stub instruments						
Senior unsecured	4 743			5 380		
Subordinated unsecured	4 886			4 340		

Scenario 2: No claim against the indemnity reserve

An additional sensitivity scenario has been presented where it is assumed 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 (to the nearest R50 million) in excess of R3.5 billion is then paid to the holders of the senior unsecured stub instrument every 6 months. The first and second payment to senior unsecured stub holders occurred in January and July 2018 respectively and totaled R1.15 billion. 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 5.5 year risk free rate as at 30 September 2018 of 8.116% (FY 2017 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 and money market unit trust funds.

The table below illustrates the stub instruments' fair values under *Scenario 2* as at 30 September 2018, 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	30 September 2018			30 September 2017		
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	4 823	4 768	4 880	5 308	5 238	5 381
Subordinated unsecured	98	93	103	Nil	Nil	Nil
Contractual carrying values of stub instruments						
Senior unsecured	4 743			5 380		
Subordinated unsecured	4 886			4 340		

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 third payment of approximately R650 million will be made to holders of the senior unsecured stub instrument. This payment is expected to be made by the end of January 2019, which will bring the total payments to R1.8 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 financial statements.

Conference call

A conference call is being held today at 15h00 SAST. Interested parties are requested to pre-register for this conference call at <http://www.diamondpass.net/5059651> and follow the instructions provided. The call will be recorded and be made available via the company website www.residualdebtservices.co.za on 11 December 2018.

Next Update

It is expected that the unaudited financial statements for the six months ended 31 March 2019 and a further update will be provided by the curator in May 2019.

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