PERFORMANCE REVIEW CREDIT

AFRICA

Credit highlights

During the year under review, the South African economy and credit environment were characterised by significant challenges. The changes to credit legislation implemented during the previous year continued to impact the Group in the year under review with the implementation of the Affordability Regulations leading to a significant reduction in new credit origination. In spite of a flat interest rate environment, lower levels of investment and employment opportunities coupled with stubborn inflationary growth have continued to exert pressure on credit consumers.

The economies in other African countries where credit is offered have reflected differing levels of growth and opportunity. In spite of generally strong growth and the level of credit granted not being impacted by economic or political challenges in the relevant geographies, we still see a cautious approach to expansion in Africa and the continued adoption of conservative lending policies in this regard.

In spite of a challenging macroeconomic arena, and the market constraints generated through regulations, our credit business has continued to perform with resilience premised on appropriate, prudent and deliberate credit strategies, leading to sustained improvements in the quality of our portfolio. The construct of our debtors' book experienced significant improvement, reflecting our improved collections performance over the past few years. A focus on operational excellence and efficiency, has delivered sustainably lower expense levels.

Performance overview

The growth in interest income of 12,8% (2016: 12,9%) is based on a net book growth of 4,6% and the compound effect of interest rate increases in the prior financial year. The repo rate increased by 125 bps over the course of the prior financial year, increasing the average nominal rate in South Africa to 25,2% (2016: 23,3%). The interest yield on the portfolio increased to 21,7% (2016: 20,4%).

Net bad debt has contracted by 5,4% (2016: -7,4%), which is an impressive result. This is primarily due to a slower growth of gross write-offs, and sustained improvements in yields from post-write-off recoveries. Improvements in the effectiveness of collections as well as recoveries continue to be driven through data-enabled strategies. The effect of these strategies on the quality of our debtors' book has become evident over the past year and is reflected in the improved overall quality of the portfolio. Write-off, provisioning and re-age/restructure policies remain consistent with prior years.

Credit costs decreased by 2,9% (2016: 10,2% increase). This improvement has been achieved following increased efficiency enabled through our continued efforts in running an optimised workforce that is more flexible and appropriate for our business needs. There has been an unrelenting focus on operational excellence and, in particular, continued customer-facing process improvements. We have invested in the implementation of advanced, state-of-the-art decision-informing software to enable optimal risk assessment and credit allocation at the point of account origination. We believe this offers us a distinct competitive advantage at the point of customer interface.

Fraud incidences related to account origination as well as the level of disputed transactions remain below targeted levels and continue to reflect improvement on prior years.

We have continued to focus on and invest in the evolution of our Group Analytics team to employ data analytics and insights to improve and enhance commercial decision-making across the TFG Group. Our group analytics capability is maturing and is providing input into customer profiling from an engagement perspective, which optimises store stock allocations and size and range purchase strategies.

Credit performance

INTEREST INCOME
R1 703,8m
(2016: R1 510,7m)
12,8% CHANGE

NET BAD DEBT
R896,1m
(2016: R947,7m)
(5,4%) CHANGE

CREDIT COST
R235,8m
(2016: R242,9m)
(2,9%) CHANGE

PROFIT BEFORE TAX
R571,9m
(2016: R320,1m)
78,7% CHANGE

New regulations prescribing the affordability assessment that has to be undertaken when a consumer applies for credit continue to have an impact on the business and put pressure on new account opening volumes. Consumers who are informally employed and who could not provide acceptable proof of income (as per the regulations) were, as a consequence, denied credit. Account closures and write-offs still exceed the rate at which new accounts are opened, resulting in a reduction in overall account volumes.

As a result, the overall active account base contracted by 5,4% (2016: -4,4%).

Key credit statistics	2017	2016	↑/↓
Number of active accounts ('000)	**2 422,8**	2 560,7	↓
Credit sales as a percentage of total retail sales (TFG Africa) (%)	**48,9**	51,7	↓
Net debtors' book (Rm)	**7 000,7**	6 695,0	↑
Overdue value as a percentage of debtors' book (%)	**13,9**	14,0	↓
Net bad debt write-off as a percentage of credit transactions (%)	**8,2**	8,0	↑
Net bad debt write-off as a percentage of debtors' book (%)	**13,9**	13,4	↑
Net bad debt as a percentage of debtors' book (%)	**11,3**	12,3	↓
Doubtful debts provision as a percentage of debtors' book (%)	**11,8**	13,2	↓
Provision value (Rm)	**936,2**	1 015,0	↓
Percentage able to purchase (%)	**81,8**	81,0	↑

Future focus

01

We will increase our focus on customer experience and service and, in particular, the ease and convenience of account origination and activation in support of the Customer strategic pillar. Aligned with this will be an accelerated deployment of our digital application channel. This channel enables customers to apply for an account online and has an emphasis on fulfilment and sustained engagement to reduce account closures.

02

Given our ability to sustain the improvement in our collection and recoveries results, the quality of our existing debtors' book and improvements in our ability to use data and analytics when opening new accounts, we will look to test alternative account acquisition strategies, including the more extensive use of third-party origination channels. This will enable us to grow our credit sales in a responsible and sustainable manner.

03

We have engaged with the regulator concerning future potential regulatory changes relating to debt forgiveness. TFG remains committed to assisting customers in the interests of sustainable relationships where a mutually beneficial opportunity exists. The regulator has initiated proposals for an increase in their executive administrative powers.

04

Accelerating our investment in group analytics is critical to assist the Credit division and to provide direct input into optimising strategies for the retail trading divisions. This investment will provide returns through stock allocation optimisation and a more informed view of customer preferences. This will inform an increased understanding of customer behaviour over an extended period.

05

Significant resources are being invested to understand the impact of and to prepare us for the implementation of IFRS 9. IFRS 9 is the new standard in respect of impairment of financial assets that replaces IAS 39 and is required to be implemented for all financial years starting on or after 1 January 2018. The principal difference between the standards is that IFRS 9 will be based on an "expected loss" principle while IAS 39 was premised on an "incurred loss" principle where provisions are raised in respect of all trade receivables even before there is any objective evidence of impairment and where there are restrictions on the recognition of revenue in respect of impaired assets. The adoption of IFRS 9 is broadly expected to impact negatively on impairment provisions and revenue.