International Personal Finance plc

IFRS 9 briefing

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What we are going to cover today

- Introduction to IFRS 9 and expected loss accounting
- Differences between current standard and IFRS 9 accounting models
- Key impacts of IFRS 9 on IPF
  - Net revenue recognition
  - Receivables and net assets
  - Seasonality
- Q&A
- Detailed financial guidance under IFRS 9 will follow 2017 full-year results

Introduction to IFRS 9

- Update to accounting standards in relation to how lenders recognise and measure financial instruments
- Addresses deficiencies in accounting standards highlighted by the financial crisis
- Move from incurred loss model to expected loss model
- Effective from 1 January 2018
  - Impact on 2018 opening balance sheet and P&L account from 2018 onwards
  - No restatement of prior year numbers

IFRS 9 is an accounting change only. No impact on business model, credit quality, cash flows and economic value or returns

Expected loss accounting

Introduction to IFRS 9: Incurred and expected loss models

Key differences between current standard and IFRS 9

Current standard	IFRS 9
Incurred loss model	*Expected loss model*

Current standard

- Trigger event e.g. missed payment or part-repayment must occur before impairment recognised
- Only past events and current conditions considered when determining impairment

IFRS 9

- Expected loss recognised on issue of loan. Receivables revalued weekly
- Forward-looking information considered in determining impairment

Introduction to IFRS 9: Expected loss model

Model does not differentiate between similar customers at the point a loan is issued

Some customers repay in full	Some customers don't repay in full
An expected loss will be booked, which will need to be reversed out	An expected loss will be booked, which may need to increase over time to equal the amount that the customer fails to repay

Differences between current standard and IFRS 9 accounting models

IFRS 9

Overview of treatments under the new standard

	Stage 1	Stage 2	Stage 3
Loan classification	Initial recognition	Assets with significant increase in credit risk	Credit impaired assets (Default)
	Change in credit quality since initial recognition		
Impairment treatment	Losses from defaults in next 12 months	Lifetime expected losses	
Revenue treatment	Effective interest on gross carrying amount		Effective interest on net carrying amount (i.e. net of credit allowance)

Classification of stages

Fundamental change in basis of segmenting the receivables portfolio under IFRS 9

Stage 1	Stage 2	Stage 3
Initial recognition Home credit: 0-29 DPD IPF Digital: 0-10 DPD	**Assets with significant increase in credit risk** Home credit: 30-89 DPD IPF Digital: 11-59 DPD	**Credit impaired assets (Default)** Home credit: 90+ DPD IPF Digital: 60+ DPD

Change in credit quality since initial recognition

Current standard

- Home credit - relative arrears stage model based on preceding 12 weeks' repayments
- IPF Digital - days past due (DPD) model used

IFRS 9

- All new loan agreements start in stage 1
- If credit quality deteriorates, the loan agreement moves through the stages
- DPD is the trigger for stage movement

How a loan agreement may move through the stages

Staging based on customer repayment performance

Stage 1	Stage 2	Stage 3
Initial recognition **Home credit: 0-29 DPD** **IPF Digital: 0-10 DPD**	**Assets with significant increase in credit risk** **Home credit: 30-89 DPD** **IPF Digital: 11-59 DPD**	**Credit impaired assets (Default)** **Home credit: 90+ DPD** **IPF Digital: 60+ DPD**

Change in credit quality since initial recognition

Impairment treatment

Impairment is recognised more quickly under IFRS 9

Stage 1 | **Stage 2** | **Stage 3**

Change in credit quality since initial recognition

Stage 1	Stage 2 and Stage 3
Losses from defaults in next 12 months	**Lifetime expected losses**

Current standard

- Trigger event e.g. missed or part payment must occur before impairment recognised
- Home credit and IPF Digital - expected losses predicted using historic credit performance

IFRS 9

- Stage 1: Expected losses booked when loan issued based on likelihood of loan agreement reaching default in 12 months
- Stage 2: Expected loss increases based on likelihood of loan agreement reaching default within lifetime of loan
- Stage 3: Larger expected loss recognised at default

Revenue treatment

Revenue recognised more quickly under IFRS 9

Stage 1 | **Stage 2** | **Stage 3**

Change in credit quality since initial recognition

Stages 1 and 2	Stage 3
Effective interest on gross carrying amount	**Effective interest on net carrying amount**

Current standard

- Home credit and IPF Digital - revenue generated by multiplying net carrying value of receivable (i.e. after loss provision) by an Effective Interest Rate (EIR)

IFRS 9

- Agreements in stages 1 and 2: Multiply gross carrying value of receivable (before loss provisions) by EIR
- Agreements in stage 3: Multiply net carrying value of receivable by EIR (same as current standard)

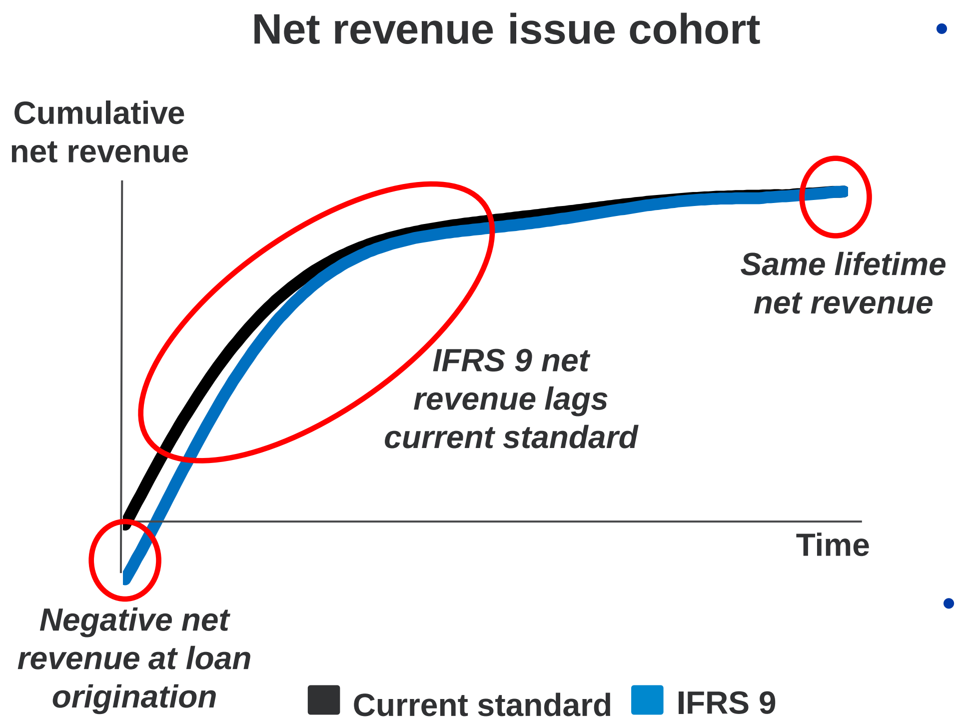
Overview of treatments under IFRS 9

Summary

- Fundamental change in how receivables portfolio is segmented
- Days past due methodology
- Impairment and revenue recognised more quickly under IFRS 9
- Receivables valuation will be lower under IFRS 9

What does this mean for net revenue recognition?

Net revenue will be earned more slowly under IFRS 9



- Recognising impairment at origination of loan will result in a different profit profile on a cohort of lending
  - Impairment charge booked at origination resulting in negative net revenue
  - Net revenue development lags current standard due to initial impairment hit
  - Lifetime net revenue will be the same under both accounting standards
- Impact of IFRS 9 bigger in growing markets due to more recent issue

Key impacts of IFRS 9 on IPF

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IFRS 9 is a change to accounting only - economics of the business model unchanged

- Net revenue recognition
- Receivables and net assets
- Seasonality of profitability
- No impact on financial covenants

Key impacts of IFRS 9 on IPF

Three key drivers of portfolio impact on net revenue under IFRS 9

- Stable portfolio size - no ongoing impact
- Growing portfolio - profit lower under IFRS 9
- Contracting portfolio - profit higher under IFRS 9

Key impacts: Established businesses

Profit impact driven by changes in portfolio size

European home credit

	IAS 39*	IFRS 9**
Net revenue	£391M	-
Impairment % revenue	23%	c.1ppt

- Overall portfolio size broadly stable in 2016
- Net revenue broadly unchanged due to:
  - Receivables book contraction in Northern Europe; offset by
  - Growth in Southern Europe resulting in lower net revenue
- Overall impairment % revenue marginally increased

* 2016 full-year reported numbers from continuing operations ** Based on modelling and therefore estimates provided for illustrative purposes only

Key impacts: Growth businesses

Net revenue will be lower in growth businesses and j-curve will be deeper

Mexico

	IAS 39	IFRS 9**
Net revenue	£119M	1% to 2% ↓
Impairment % revenue	36%	c.2 ppts ↑

- Portfolio grew by 10% in Mexico in 2016
- Portfolio growth drives lower net revenue
- Impairment % revenue increases by c.2 ppts

IPF Digital

	IAS 39	IFRS 9**
Net revenue	£40M	c.17% to 19% ↓
Impairment % revenue	31%	c.12 ppts ↑

- Growth in portfolio of c.80% in 2016
- Net revenue impact driven by portfolio growth and proportion of new markets receivables
- Significant impact on net revenue and impairment

** Based on modelling and therefore estimates provided for illustrative purposes only

Key impacts: Balance sheet

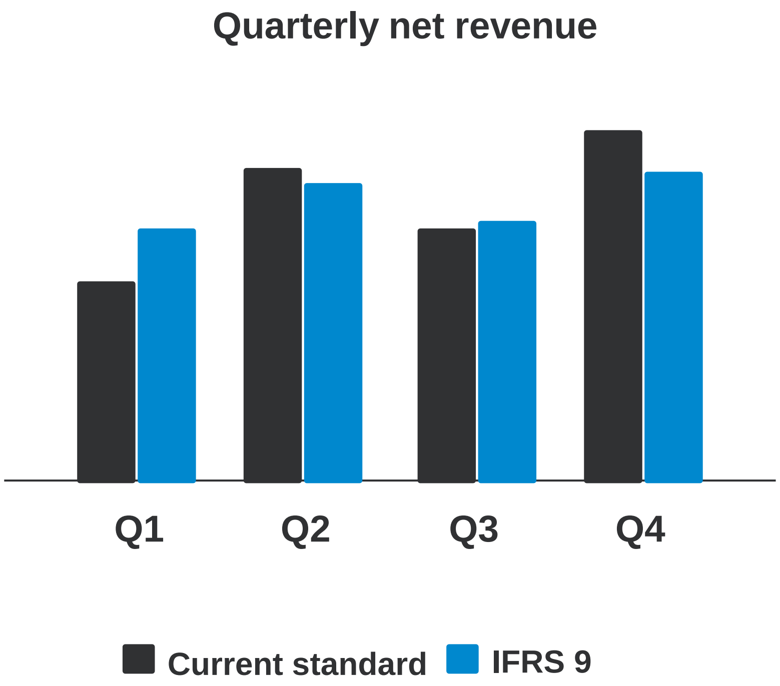
Receivables and net assets will be lower under IFRS 9

- Reduction in receivables of c.9% to 11% at December 2016
- Lower receivables due to impairment being recognised earlier
- Deferred tax asset increases due to longer time difference between tax and accounting
- Reduction in net assets of c.17% to 19%
- Day one impact at 1 January 2018 will be charged to equity

Impact data based on modelling and therefore estimates provided for illustrative purposes only

Key impacts: Seasonality

Seasonality of profit will change - quarterly profit will be smoother under IFRS 9



- Seasonality impacted by expected credit loss being recognised on issue of loan
- Current accounting standard - most profitable quarter is Q4 due to high sales and good collections
- IFRS 9 - higher Q4 sales will mean higher expected credit losses recognised resulting in lower profit in Q4

Summary

Summary

- IFRS 9 effective from 1 January 2018
- Move to an expected loss model from an incurred loss model
- Net revenue will be earned more slowly
- Balance sheet impact - receivables and net assets will be lower
- Seasonality of profit will change
- No impact on financial covenants
- Detailed financial guidance will follow 2017 full-year results

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Questions

Appendices

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Glossary

Term	Definition
Days past due (DPD)	The number of days a customer is in arrears
Issue cohort	A group of similar loan agreements issued within the same period
Relative arrears model	Segmentation of customers by repayment history over the past 12 weeks
12 month expected losses	Losses that result from default events occurring within the next 12 months
Lifetime expected losses	Losses that result from default events occurring within the lifetime of the loan
Effective Interest Rate (EIR)	The rate at which revenue is recognised on loans and by which receivables are discounted to their carrying value

Glossary

Term	Definition
Gross carrying amount	Receivables balance before loss provisions
Net carrying amount	Receivables balance after loss provisions
Net revenue	Revenue less impairment
Default	The failure of a customer to make a principal or interest payment in a timely manner and therefore the customer is considered credit impaired
Probability of default (PD)	Probability that a customer will go on to default on their loan
Exposure at default (EAD)	The total exposure on an agreement at the time the customer defaults on their loan
Loss given default (LGD)	The amount of money lost on a loan if a customer defaults
Expected loss (EL)	Expected loss = PD x EAD x LGD

- All data used in this slide deck is 2016 reported financials from continuing operations

- The calculations under IFRS 9 are based on modelling and therefore estimates provided for illustrative purposes only

- Detailed financial guidance will follow 2017 full-year results

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