INTERIM REPORT

The Federated Employers' Mutual Assurance Company Proprietary Limited (RF) ("FEM")

for the six months ended 30 June 2014

Non-executive directors

NF Maas (Chairman)
H Walker (Lead independent director)
JR Barrow
MG Ilsley
CS Jiyane
APH Jammine
MA Letshele
H Ngakane
PL Siphayi

Executive directors

TT Pugh (Chief Executive Officer)
A Daya (Chief Financial Officer)
GM McIntosh (Chief Information Officer)

Company secretary

EJ Willis

Head office and registered address

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101 Central Street
Houghton
Johannesburg
2198

Private Bag 87109
Houghton
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Company registration number

1936/008971/07

www.fema.co.za

The Federated Employers' Mutual Assurance Company Proprietary Limited (RF)
Interim report for the six months ended 30 June 2014

HIGHLIGHTS

- Gross premium income increased by 15% to R724 million, driven by a 6% increase in the number of insured employees and above inflation wage increases
- Premium rebates to policyholders increased by 61% to R217 million
- Gross claims and benefits increased by 80% to R256 million
- Administration expenses remained well controlled, representing 4.8% of gross premium income income (2013: 4.9%)
- Accident prevention expenses and grants increased by 10% to R10 million
- Net investment income increased by 34% to R415 million
  - *Return on average investments of 15.9% per annum (2013: 15.3%)*
- After providing for increased merit rebates, total comprehensive income for the period decreased by 11%, a net profit of R295 million for the interim period.
- Total financial asset investments increased by 30% to R5.7 billion.

ABOUT FEM

FEM is a short term insurer registered in terms of the Short Term Insurance Act. More specifically, the Company operates as a mutual association licensed under the Compensation for Occupational Injuries and Diseases Act ("COID Act") to carry on the business of insurance of certain classes of employers within the construction industry against their liabilities to employees in terms of the COID Act.

Owing to the mutual shareholding structure of the Company, it is classified as a private company under the South African Companies Act. However, the provisions of the Company's Memorandum of Incorporation ("MOI") make it subject to the same extended accountability provisions as are applicable to a public company. In addition, the MOI contains unalterable provisions designed to protect policyholders' interests by entrenching the mutual status of the Company.

FINANCIAL REVIEW

The review of the Company's financial performance for the six months ended 30 June 2014 is focused on the insurance result and key line items of the statements of financial position, comprehensive income and cash flows.

Financial results

Gross premium income increased by 15% to R724 million, driven by a 6% increase in the number of insured employees and higher than inflation wage increases. Conversely, net earned premium decreased by 13% to R175 million as a result of a R82 million increase in premium rebates to policyholders that are deducted from gross premium income. Excluding premium rebates, the Company recorded a 17% increase in earned premium income.

Financial results continued

Gross claims and benefits payable to insured employees and their dependents totalled R256 million, representing an 80% increase over the comparable six month period. This substantial increase results from a R47 million adjustment to prior period claims estimates (2013: R30 million) and a pension valuation charge for the period of R135 million (2013: R43 million).

Administration expenses remain well controlled, totalling R34 million for the six months and representing 4.8% of gross premium income (2013: 4.9%).

Accident prevention expenses and grants increased by 10% to R10 million as a result of the Company's continued funding of Health & Safety Officers in the industry.

The Company recorded a net underwriting loss (before investment income) of R119 million at the half year compared to a profit of R24 million at the same point in the previous year. This position results from the increased gross claims and benefits expense for the current interim period and is inclusive of the full provision for premium rebates.

Net investment income totalled R415 million (2013: R309 million) for the six months, representing a 15.9% (2013: 15.3%) annualised return on average financial assets.

Notwithstanding the substantial increase in premium rebates and claims & benefits expense, the Company recorded a net bottom line profit of R295 million compared to R333 million for the previous period. This is an excellent result considering that premium rebate liabilities are fully provided for in the half year results, which will benefit the performance reported in the second six months.

Financial position and cash flows

The Company's total assets increased by R978 million or 20% during the six month period and totalled R5.9 billion at 30 June 2014. This resulted from the continued strong investment performance boosted by the annual premium receipts in the first half of the year.

Insurance liabilities increased by R685 million to R2.3 billion, R329 million of this increase results from the unearned premium liability raised on annual premiums booked in the first half of the year and R147 million relates to an increase in the valuation of the pensions liability.

The Company remained strongly cash generative with R489 million (2013: R513 million) in cash generated from operating activities during the six month period.

Investment strategy and returns

The Company's investment strategy is managed by the Investment sub-committee of the board, acting on the advice of specialist investment consultants. An asset-liability modelling exercise is performed annually to determine the optimum percentage strategic asset allocation to authorized classes of investments and ranges are specified within which tactical asset allocation decisions can be taken during the year. The objective is to enhance the Company's investment returns for the benefit of stakeholders, while ensuring that the Company remains adequately capitalized and has adequate liquid cash resources to meet its short and long term obligations.

The success of this strategy is borne out by the above inflation investment returns achieved during the current six months and over an extended period.

DIVIDENDS

In accordance with clause 3.1.6 of the MOI, the Company may not make any form of distribution to its shareholders in their capacity as shareholders.

PROSPECTS

Notwithstanding the challenging conditions in the construction industry, the Company has again achieved excellent results and returns for policyholders while fulfilling its mandate to fund claims and benefits for injured workers and their dependents. No material changes are anticipated to be made to the Company's current strategy and operations.

EVENTS AFTER THE REPORTING PERIOD

There have been no material changes in the affairs or financial position of the Company from 30 June 2014 up to the date of this report.

PREPARATION AND PRESENTATION OF THE INTERIM REPORT

The accompanying interim financial statements were prepared by the Company's Chief Financial Officer, Mr A Daya. These interim financial statements have not been audited or reviewed by the Company's external auditors.

On behalf of the board

Mr N Maas
Chairman

Mrs TT Pugh
Chief Executive Officer

16 September 2014

STATEMENT OF FINANCIAL POSITION

	Notes	6 months to June 2014 R'000	6 months to June 2013 R'000	December 2013 R'000
ASSETS				
Furniture, equipment and motor vehicles		**5 398**	4 159	4 752
Reinsurance assets		**5 670**	7 132	2 712
Financial assets measured at fair value	4	**5 734 805**	4 411 024	4 924 285
Other financial assets measured at amortized cost				
Insurance receivables		**99 751**	125 341	3 949
Other receivables		**6 608**	15 125	13 323
Cash and cash equivalents		**89 946**	78 666	15 143
Total assets		**5 942 178**	**4 641 447**	**4 964 164**
EQUITY AND LIABILITIES				
Ordinary share capital		**10**	10	10
Retained income	SOCE	**3 634 654**	2 720 128	3 339 158
Total equity		**3 634 664**	**2 720 138**	**3 339 168**
Insurance liabilities		**2 282 168**	1 898 557	1 597 076
Pension liabilities	5	**1 085 140**	938 813	938 633
Unpaid claim liabilities	6	**198 088**	222 044	205 313
Unearned premium liability		**423 403**	377 257	94 498
Premium rebate liability	7	**575 537**	360 443	358 632
Financial liabilities measured at amortized cost				
Trade and other payables		**25 346**	22 752	27 920
Total liabilities		**2 307 514**	**1 921 309**	**1 624 996**
Total equity and liabilities		**5 942 178**	**4 641 447**	**4 964 164**

STATEMENT OF COMPREHENSIVE INCOME

	Notes	6 months to 30 June 2014 R'000	6 months to 30 June 2013 R'000	Year end 31 Dec 2013 R'000
Gross premium income	8	**724 206**	627 853	608 915
Premium rebates to policyholders		**(216 903)**	(134 791)	(262 083)
Unearned premium		**(328 905)**	(288 059)	(5 301)
Gross earned premium		**178 398**	**205 003**	**341 531**
Insurance premium ceded to reinsurers		**(3 547)**	(3 824)	(10 791)
Net earned premium		**174 851**	**201 179**	**330 740**
Gross claims and benefits		**(255 578)**	**(141 807)**	**(215 120)**
Claims expense	6	**(120 329)**	(98 464)	(159 071)
Net charge to pension valuation	5	**(135 249)**	(43 343)	(56 049)
Claims recoveries from reinsurers		**6 108**	4 829	4 074
Net claims and benefits		**(249 470)**	**(136 978)**	**(211 046)**
Underwriting (loss) / profit before operating expenses		**(74 619)**	**64 201**	**119 694**
Administration expenses		**(34 409)**	(30 544)	(66 042)
Accident prevention expenses and grants		**(10 125)**	(9 199)	(16 336)
Underwriting (loss) / profit before investment income		**(119 153)**	**24 458**	**37 316**
Net investment income	9	**414 649**	**308 995**	**915 166**
Investment income		**422 904**	313 007	922 976
Investment expenses		**(8 255)**	(4 012)	(7 810)
Net profit for the period		**295 496**	**333 453**	**952 482**
Other comprehensive income		**-**	-	-
Total comprehensive income for the period		**295 496**	**333 453**	**952 482**

STATEMENT OF CHANGES IN EQUITY

	6 months to 30 June 2014 R'000	6 months to 30 June 2013 R'000	Year end 31 Dec 2013 R'000
Ordinary share capital			
Opening balance	**10**	10	10
Movement during period	**-**	-	-
Closing balance	**10**	**10**	**10**
Retained income			
Opening balance	**3 339 158**	2 386 676	2 386 676
Total comprehensive income for the period	**295 496**	333 453	952 482
Closing balance	**3 634 654**	**2 720 129**	**3 339 158**
Total equity			
Opening balance	**3 339 168**	2 386 685	2 386 686
Total movement for the period	**295 496**	333 453	952 482
Closing balance	**3 634 664**	**2 720 138**	**3 339 168**

STATEMENT OF CASH FLOWS

	6 months to June		Year end 31 Dec
	2014	2013	2013
	R'000	R'000	R'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net profit for the year	**295 496**	333 453	952 482
Adjustments for depreciation and other operating activities:	**(333 660)**	(244 567)	(781 581)
Depreciation	**1 044**	796	1 664
Impairment of insurance receivables	**(3 926)**	3 551	273
Net foreign currency gain on financial assets	**(24 259)**	(124 688)	(187 353)
Net valuation gain on financial assets measured at fair value	**(306 499)**	(124 226)	(596 093)
equipment and motor vehicles	**(20)**	-	(72)
Net movements in operating assets and liabilities	**619 142**	488 160	190 252
Interest and dividend income on financial assets measured at fair value	**(92 146)**	(64 093)	(139 530)
Cash generated from operating activities	**488 832**	**512 953**	**221 623**
CASH FLOWS FROM INVESTING ACTIVITIES			
Net cash invested in financial assets measured at fair value	**(504 505)**	(516 895)	(363 135)
Interest and dividend income on financial assets measured at fair value	**92 146**	64 093	139 530
Purchases of furniture, equipment and motor vehicles	**(1 689)**	(1 507)	(2 989)
Proceeds on disposals of furniture, equipment and motor vehicles	**19**	-	92
Cash applied to investing activities	**(414 029)**	**(454 309)**	**(226 502)**
Net increase / (decrease) in cash for the year	**74 803**	58 644	(4 879)
Cash and cash equivalents at beginning of year	**15 143**	20 022	20 022
Cash and cash equivalents at year end	**89 946**	**78 666**	**15 143**

NOTES TO THE INTERIM FINANCIAL STATEMENTS

1. Basis of presentation and accounting policies

These interim financial statements for the six months ended 30 June 2014 have been prepared in accordance with IAS 34 – Interim Financial Reporting. The interim financial statements do not include all of the information required by IFRS for full annual financial statements and should be read in conjunction with the annual financial statements for the year ended 31 December 2013, which have been prepared in accordance with IFRS.

New and revised International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") that became effective for the current financial year have had no material impact on the presentation of these interim financial statements and no retrospective adjustments were required to the financial position or results as previously reported.

The accounting policies adopted in the preparation of these interim financial statements are consistent with those of the previous financial year.

2. Estimates

The preparation of interim financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities (in particular, estimates of insurance liabilities). Actual results may differ from these estimates.

In preparing these interim financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the annual financial statements for the year ended 31 December 2013.

3. Capital and risk management

The principal capital management objective is to enhance the Company's investment returns for the benefit of stakeholders, while ensuring that the Company remains adequately capitalized and has adequate liquid cash resources to meet all of its short and long term obligations.

The Company is prohibited from making any borrowings and, therefore, no leverage is incorporated in the capital structure.

The Company's insurance activities expose it to insurance risk and to a much lesser extent reinsurance risk. Insurance risk includes pricing risk, reserving risk and accumulation risk. The risks associated with the statutory insurance contracts issued by the Company under the COID Act are complex and varied. There was no premium deficiency in the current period or previous financial year; however there remains significant reserving risk in relation to long-tail pension liabilities in relation to future pension increases, longevity of the lives covered and changes in the discount rate applied.

The Company has substantial investments held to fund its capital reserving requirements and insurance liabilities, including long-tail pension liabilities. Investment activities expose the Company to a variety of financial risks: market risk (including price, interest rate, foreign currency and derivatives risk), credit risk and liquidity risk.

These interim financial statements do not include all risk management information and disclosure required in the annual financial statements and should be read in conjunction with the annual financial statements for the year ended 31 December 2013.

4. Financial assets measured at fair value

	30 June 2014 R'000	30 June 2013 R'000	Year end 31 Dec 2013 R'000
Local:			
- Listed equity securities	988 079	654 078	856 126
- Balanced fund portfolios	439 835	398 484	392 816
- Listed debt securities: fixed interest rate	188 220	178 346	180 211
- Listed debt securities: inflation linked	1 149 052	756 398	1 031 412
- Illiquid corporate debt securities with derivative overlay (note 1)	437 627	404 627	408 335
- Derivative equity contract	(115)	2 528	(13 967)
- Money market securities	750 425	542 531	281 908
	3 953 123	2 936 992	3 136 841
Foreign:			
- Listed equity securities	786 988	624 308	751 327
- Listed corporate debt securities with derivative overlay (note 2)	324 476	294 131	316 534
- Derivative foreign exchange contract	982	(6 397)	(6 053)
- USD cash plus MSCI all country equity forward contract	492 612	475 024	567 682
- Derivative equity contract	13 887	(26 117)	16 384
- Listed corporate debt securities	90 835	64 639	82 050
- Unlisted equity securities	66 328	43 105	53 767
	1 776 108	1 468 693	1 781 691
Accrued income	5 574	5 339	5 752
	5 734 805	4 411 024	4 924 284

Note 1

The Company has invested through investment-linked insurance policies into unlisted and listed, but illiquid local corporate bonds with maturity dates of up to 5 years. As part of the so-called "credit opportunities/alpha transport" product structure:

-: interest rate duration risk on the bonds is immunized through interest rate swaps into short term rates; and

-: the Company purchases equity forward contracts for the same nominal value as the aggregate value of the corporate bonds.

Thus the Company effectively receives a local equity market return (based on an approximation of the JSE SWIX Total Return Index) plus the credit and liquidity spread on the bonds. Note that the corresponding capital amount invested is exposed to both equity pricing risk on the relevant market indices and credit default risk on the separate corporate bonds.

Note 2

The Company has invested through a protected cell structure into listed foreign corporate bonds and money market investments. As part of the so-called "credit opportunities/alpha transport" product structure:

-: interest rate duration risk and non-USD currency risk on the bonds is immunized through interest rate swaps into short term rates and foreign currency swaps into USD respectively;

-: the Company purchases equity forward contracts for the same nominal value as the aggregate value of the corporate bonds and money market investments.

Thus the Company effectively receives an equity market return (based on the MSCI All Country Index) plus the credit spread on the bonds. Note that the corresponding capital amount invested is exposed to both equity pricing risk on the forward equity contract and credit default risk on the separate corporate bonds and money market securities.

5. Pension liability

	30 June		Year end 31 Dec
	2014 R'000	2013 R'000	2013 R'000
Opening balance	938 633	864 550	864 550
Movement for the period	146 507	74 263	74 083
Pensions paid during the year	(36 941)	(32 997)	(69 440)
New pension awards (transferred from unpaid claim liabilities)	48 199	63 917	87 474
Net valuation charge to profit or loss	135 249	43 343	56 049
	1 085 140	938 813	938 633

6. Unpaid claims liabilities

Opening balance	205 313	244 962	244 962
Claims paid included in the existing estimate	(70 490)	(32 995)	(55 875)
Claims paid that were registered in the current year	(8 865)	(24 470)	(55 371)
	120 329	98 464	159 071
Estimate raised for current year claims	67 870	63 498	123 050
Adjustments to estimate for prior period claims	46 553	29 525	36 280
Movement in unreleased & un-awarded pension liability	(135)	(34)	(3 249)
Movement in ibnr claims	6 041	5 475	2 990
Pensions awarded	(48 199)	(63 917)	(87 474)
- from current year estimates	(18 135)	(29 715)	(20 201)
- from prior year estimates	(30 064)	(34 202)	(67 273)
	198 088	222 044	205 313

7. Premium rebate liability

	30 June 2014 R'000	30 June 2013 R'000	Year end 31 Dec 2013 R'000
Premium rebate liability relating to:			
Underwriting year ended February 2013 (2013: February 2012)	166 004	105 539	166 004
Underwriting year ended February 2014 (2013: February 2013)	192 628	116 203	192 628
Underwriting year ending February 2015 (2013: February 2014)	216 905	128 786	-
Premium rebate on pipeline premium	-	9 915	-
Total premium rebate liability	575 537	360 443	358 632
Analysis of movement in premium rebate liability:			
Opening balance	358 632	227 152	227 152
Premium rebate charge for the period	216 905	128 786	262 082
Current period – Allowance for premium rebates	216 905	128 786	187 218
Prior periods - Actual versus expected premium rebate payments	-	-	74 864
Premium rebates paid	-	-	(130 602)
Movement in pipeline premium rebate	-	4 505	
Closing balance	575 537	360 443	358 632

8. Gross premium income

	30 June 2014 R'000	30 June 2013 R'000	Year end 31 Dec 2013 R'000
	724 206	606 401	608 915
Initial premiums raised on declared wage returns	640 353	546 963	571 914
Prior period adjustment to estimates	83 853	59 438	37 001
	-	21 452	-
Pipeline premium accrual for the current period	-	47 216	-
Reversal of pipeline premium accrual raised in the previous period	-	(25 764)	-
Gross premium income	724 206	627 853	608 915

9. Net investment income

	30 June 2014 R'000	30 June 2013 R'000	Year end 31 Dec 2013 R'000
Investment income	422 904	313 007	922 976
Interest income on cash and cash equivalents	61 707	44 733	102 344
Dividend income	30 439	19 360	37 186
Net foreign currency gain on financial assets	24 259	124 688	187 353
Net valuation gain on financial assets measured at fair value	306 499	124 226	596 093
Investment expenses	(8 255)	(4 012)	(7 810)
Total net investment income	414 649	308 995	915 166

10. Income tax

The Company is exempt from income tax in accordance with section 10(1)(t)(xvi)(cc) of the Income Tax Act.