

INTERIM REPORT

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

for the six months ended 30 June 2015

Non-executive directors

NF Maas (Chairman)
H Walker (Lead Independent Director)
JR Barrow
F Cardoso
MG Ilsley
CS Jiyane
APH Jammine
MA Letshele
K Moodley
H Ngakane

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

Building 2, 1st Floor
101 Central Street
Houghton
Johannesburg
2198

Private Bag 87109
Houghton
2041

Company registration number

1936/008971/07

www.fema.co.za

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HIGHLIGHTS

- ⇒ Gross premiums raised on initial wage declarations increased by 7%
- ⇒ After adjusting for reduced final wage declarations compared to the prior period and making full provision for annual premium rebates at the half year:
 - Net earned premium decreased by 7% to R163 million
 - The Company incurred underwriting losses (before investment income), of R159 million

In the absence of any unforeseen events or additional special premium rebates, the Company expects to grow net earned premiums and record an underwriting profit for the full year

- ⇒ Administration expenses, of R41 million, remain well controlled and within budget at the half year
- ⇒ Accident prevention expenses and grants increased by 36% to R14 million
- ⇒ Net investment income amounted to R297 million, representing an effective return on average investments of 9% per annum
- ⇒ Overall, the Company recorded a bottom line profit of R138 million for the period.

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 2015 is focused on the insurance result and key line items of the statements of financial position, comprehensive income and cash flows.

Financial results

Gross premiums raised based on initial wage declarations for the current year increased by 7% to R686 million. After adjustment for the finalisation of prior period wage declarations, gross premium income increased by 2% to R740 million for the period. Premium rebates to policyholders increased in line with the growth in gross premium income, totalling R222 million for the half (and full) year.

Resulting from the reduction in prior period adjustment to premium income, and after making a full provision for the expected premium rebates payable to policyholders in respect of the entire financial year, net earned premium decreased by 7% to R163 million.

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Financial results continued

Gross claims and benefits payable to insured employees and their dependents totalled R271 million, representing an increase of R16 million or 6% over the comparable period.

Administration expenses totalled R41 million for the six month period, representing 6% (2014: 5%) of gross premium income.

Accident prevention expenses and grants increased by 36% to R14 million as a result of the Company's continued funding of Health & Safety Officers and health & safety initiatives in the industry and the 1% of premium income fee payable to the Compensation Commissioner.

The Company recorded a net underwriting loss (before investment income), of R159 million for the six month period compared to an underwriting loss of R119 million at the same point in the previous year. This deterioration in position resulted mainly from the reduced net earned premium compared to the previous period and represents the position after making a full provision for the annual premium rebates to policyholders at the half year. The Company expects to make an underwriting profit for the full year.

Net investment income totalled R297 million (2014: R415 million) for the six months, representing a 9% (2014: 15%) annualised return on average financial assets.

Notwithstanding the decrease in net earned premium and reduced investment income, the Company recorded a net bottom line profit of R138 million compared to R295 million for the previous period.

Financial position and cash flows

Asset growth outstripped profit growth with the Company's total assets increasing by R874 million or 15% during the six month period and totalling R6.6 billion at 30 June 2015. This is typical of half year performance due to the receipt of annual premiums in advance in the first half of the year.

Insurance liabilities increased by R718 million to R2.7 billion during the six month period; R350 million of this increase results from the unearned premium liability raised on annual premiums booked in the first half of the year and R126 million relates to an increase in the valuation of the pensions liability.

The Company remained strongly cash generative with R537 million (2014: R489 million) in cash generated from operating activities during the six month period.

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STATEMENT OF FINANCIAL POSITION

	Notes	<u>6 months to June</u>		<u>December</u>
		<u>2015</u>	<u>2014</u>	<u>2014</u>
		R'000	R'000	R'000
ASSETS				
Furniture, equipment and motor vehicles		4 999	5 398	5 084
Reinsurance assets		5 009	5 670	3 591
Financial assets measured at fair value	1	6 460 761	5 734 805	5 684 488
Other financial assets measured at amortized cost				
Insurance receivables		62 901	99 751	14 096
Other receivables		2 929	6 608	9 047
Cash and cash equivalents		85 531	89 946	31 874
Total assets		6 622 130	5 942 178	5 748 180
EQUITY AND LIABILITIES				
Ordinary share capital		10	10	10
Retained income	SOCE	3 881 203	3 634 654	3 743 576
Total equity		3 881 213	3 634 664	3 743 586
Insurance liabilities		2 688 379	2 282 168	1 970 622
Pension liabilities	2	1 346 393	1 085 140	1 219 974
Unpaid claim liabilities	3	244 236	198 088	225 534
Unearned premium liability		457 647	423 403	107 218
Premium rebate liability	4	640 103	575 537	417 896
Financial liabilities measured at amortized cost				
Trade and other payables		52 538	25 346	33 972
Total liabilities		2 740 917	2 307 514	2 004 594
Total equity and liabilities		6 622 130	5 942 178	5 748 180

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STATEMENT OF COMPREHENSIVE INCOME

	Notes	<u>6 months to June</u>		<u>December</u>
		2015 R'000	2014 R'000	2014 R'000
Gross premium income		739 717	724 206	751 259
Premiums raised on initial wage declarations for the current year		685 721	640 353	665 246
Premiums raised on final wage declarations for the previous year		53 996	83 853	86 013
Premium rebates to policyholders		(222 175)	(216 903)	(330 152)
Unearned premium		(350 429)	(328 905)	(12 720)
Gross earned premium		167 113	178 398	408 387
Insurance premium ceded to reinsurers		(3 675)	(3 547)	(6 879)
Net earned premium		163 438	174 851	401 508
Gross claims and benefits		(271 153)	(255 578)	(537 753)
Claims expense:				
Claims estimates for the current year	3	(117 624)	(73 776)	(184 690)
Adjustment to prior period estimates	3	(34 346)	(46 553)	(57 406)
Other		(17 237)	-	(6 359)
Movement in provision for claims handling costs		-	-	(30 051)
Pension expense:				
Net charge to pension liability	2	(101 946)	(135 249)	(259 247)
Claims recoveries from reinsurers		3 537	6 108	8 150
Net claims and benefits		(267 616)	(249 470)	(529 603)
Underwriting (loss) / profit before operating expenses		(104 178)	(74 619)	(128 095)
Administration expenses		(40 882)	(34 409)	(80 012)
Accident prevention expenses and grants		(13 814)	(10 125)	(17 893)
Underwriting (loss) / profit before investment income		(158 874)	(119 153)	(226 000)
Net investment income	6	296 500	414 649	630 418
Investment income		303 812	422 904	643 711
Investment expenses		(7 312)	(8 255)	(13 293)
Net profit for the period		137 626	295 496	404 418
Other comprehensive income		-	-	-
Total comprehensive income for the period		137 626	295 496	404 418

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STATEMENT OF CHANGES IN EQUITY

	<u>6 months to June</u>		<u>December</u>
	<u>2015</u>	<u>2014</u>	<u>2014</u>
	<u>R'000</u>	<u>R'000</u>	<u>R'000</u>
Ordinary share capital			
Opening balance	10	10	10
Movement during period	-	-	-
Closing balance	10	10	10
Retained income			
Opening balance	3 743 576	3 339 159	3 339 159
Total comprehensive income for the period	137 627	295 495	404 417
Closing balance	3 881 203	3 634 654	3 743 576
Total equity			
Opening balance	3 743 586	3 339 169	3 339 169
Total movement for the period	137 627	295 495	404 417
Closing balance	3 881 213	3 634 664	3 743 586

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STATEMENT OF CASH FLOWS

	<u>6 months to June</u>		<u>December</u>
	2015	2014	2014
	R'000	R'000	R'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net profit for the period	137 626	295 496	404 418
Adjustments for depreciation and other operating activities:	(212 924)	(333 660)	(466 864)
Depreciation	1 212	1 044	2 241
Impairment of insurance receivables	975	(3 926)	(5 187)
Net foreign currency gain on financial assets	(21 807)	(24 259)	(101 641)
Net valuation gain on financial assets measured at fair value	(193 200)	(306 499)	(362 258)
Net profit on disposal of furniture, leasehold improvements, equipment and motor vehicles	(104)	(20)	(19)
Net movements in operating assets and liabilities	715 489	619 142	376 928
Interest and dividend income on financial assets measured at fair value	(102 742)	(92 146)	(179 812)
Cash generated from operating activities	537 449	488 832	134 670
CASH FLOWS FROM INVESTING ACTIVITIES			
Net cash invested in financial assets measured at fair value	(585 511)	(504 505)	(295 197)
Interest and dividend income on financial assets measured at fair value	102 742	92 146	179 812
Purchases of furniture, equipment and motor vehicles	(1 136)	(1 689)	(2 573)
Proceeds on disposals of furniture, equipment and motor vehicles	113	19	19
Cash applied to investing activities	(483 792)	(414 029)	(117 939)
Net increase in cash for the period	53 657	74 803	16 731
Cash and cash equivalents at beginning of year	31 874	15 143	15 143
Cash and cash equivalents at year end	85 531	89 946	31 874

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1. Financial assets measured at fair value

	<u>6 months to June</u>		<u>December</u>
	<u>2015</u>	<u>2014</u>	<u>2014</u>
	<u>R'000</u>	<u>R'000</u>	<u>R'000</u>
Local:			
- Listed equity securities	1 550 009	988 079	1 457 721
- Balanced fund portfolios	17 672	439 835	17 185
- Listed debt securities: fixed interest rate	208 899	188 220	203 254
- Listed debt securities: inflation linked	1 334 648	1 149 052	1 322 186
- Corporate debt securities with derivative overlay (note 1)	415 300	437 627	424 674
- Derivative equity forward contract	368	(115)	6 672
- Money market securities	939 051	750 425	379 174
	<u>4 465 947</u>	<u>3 953 123</u>	<u>3 810 866</u>
Foreign:			
- Listed equity securities	1 411 365	786 988	811 817
- Debt and money market securities with derivative overlay (note 2)	353 944	324 476	353 230
- Derivative equity contract	-	13 887	(2 735)
- Derivative foreign exchange forward contract	30	982	(4 798)
- USD cash	25 705	492 612	536 634
- Listed corporate debt securities	105 378	90 835	98 383
- Unlisted equity securities	91 214	66 328	74 231
	<u>1 987 636</u>	<u>1 776 108</u>	<u>1 866 762</u>
Accrued income	7 178	5 574	6 860
	<u>6 460 761</u>	<u>5 734 805</u>	<u>5 684 488</u>

Note 1

The Company has invested through investment-linked insurance policies into illiquid, unlisted and listed, local corporate bonds with maturity dates of up to 3,5 years. As part of this 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;
- : 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.

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Note 2

The Company has invested through a protected cell structure into foreign debt and money market instruments. As part of this so-called "credit opportunities/alpha transport" product structure:

- : interest rate duration risk and non-USD currency risk on the bonds are immunized where possible through interest rate swaps into short term rates and foreign currency swaps into USD respectively; and
- : 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 portfolio of debt and money market securities.

2. Pension liability

	6 months to June		December
	2015	2014	2014
	R'000	R'000	R'000
Opening balance	1 219 974	938 633	938 633
Movement for the period	126 419	146 507	281 341
Pensions paid during the year	(39 999)	(36 941)	(76 577)
New pension awards (transferred from unpaid claim liabilities)	64 472	48 199	98 671
Net valuation charge to profit or loss	101 946	135 249	259 247
Closing balance	<u>1 346 393</u>	<u>1 085 140</u>	<u>1 219 974</u>

3. Unpaid claims liabilities

Opening balance	225 534	205 313	205 313
Charge to profit and loss	151 970	120 329	272 147
Claims estimates for current year	117 624	73 776	184 690
Adjustments to prior period estimates	34 346	46 553	57 406
Movement in provision for claims handling costs	-	-	30 051
Claims paid in the period	(68 796)	(79 355)	(153 255)
Pensions awarded during the period	(64 472)	(48 199)	(98 671)
Closing balance	<u>244 236</u>	<u>198 088</u>	<u>225 534</u>

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4. Premium rebate liability

	<u>6 months to June</u>		<u>December</u>
	2015	2014	2014
	R'000	R'000	R'000
Premium rebate liability relating to:			
Underwriting year ended February 2014 (2014: February 2013)	192 628	166 004	192 628
Underwriting year ended February 2015 (2014: February 2014)	225 268	192 628	225 268
Underwriting year ended February 2016 (2014: February 2015)	222 207	216 905	-
Total premium rebate liability	640 103	575 537	417 896

Analysis of movement in premium rebate liability:

Opening balance	417 896	358 632	358 632
Premium rebate charge for the period	222 207	216 905	330 152
Current period – Allowance for special & normal premium rebates	222 207	216 905	325 347
Prior periods - Actual versus expected premium rebate payments	-	-	4 805
Premium rebates paid	-	-	(170 809)
Special rebates paid	-	-	(100 079)
Closing balance	640 103	575 537	417 896

5. Gross premium income

Initial premiums raised on declared wage returns	685 721	640 353	665 246
Prior period adjustment to estimates	53 996	83 853	86 013
Gross premium income	739 717	724 206	751 259

6. Net investment income

Investment income	303 812	422 904	643 711
Interest income on cash and cash equivalents	67 901	61 707	135 641
Dividend income	34 841	30 439	44 171
Net foreign currency gain on financial assets	21 807	24 259	101 641
Net valuation gain on financial assets measured at fair value	179 263	306 499	362 258
Investment expenses	(7 312)	(8 255)	(13 293)
Total net investment income	296 500	414 649	630 418

7. Income tax

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