

NET 1 UEPS TECHNOLOGIES INC  
Form 10-Q  
November 03, 2016

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2016

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND  
EXCHANGE ACT OF 1934**

For the transition period from To

Commission file number: **000-31203**

**NET 1 UEPS TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

**Florida**  
(State or other jurisdiction  
of incorporation or organization)

**98-0171860**  
(IRS Employer  
Identification No.)

**President Place, 4<sup>th</sup> Floor, Cnr. Jan Smuts Avenue and Bolton Road  
Rosebank, Johannesburg 2196, South Africa**

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **27-11-343-2000**

**Not Applicable**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company  
(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES  NO

As of November 2, 2016 (the latest practicable date), 52,521,345 shares of the registrant's common stock, par value \$0.001 per share, net of treasury shares, were outstanding.

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## Form 10-Q

## NET 1 UEPS TECHNOLOGIES, INC.

## Table of Contents

|   | Page No.  |
|---|-----------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>   |           |
| <u>Item 1. Financial Statements</u>   |           |
| <u>Unaudited Condensed Consolidated Balance Sheets at September 30, 2016 and June 30, 2016</u>                                    | <u>2</u>  |
| <u>Unaudited Condensed Consolidated Statements of Operations for the three months ended September 30, 2016 and 2015</u>           | <u>3</u>  |
| <u>Unaudited Condensed Consolidated Statements of Comprehensive Income for the three months ended September 30, 2016 and 2015</u> | <u>4</u>  |
| <u>Unaudited Condensed Consolidated Statement of Changes in Equity for the three months ended September 30, 2016</u>              | <u>5</u>  |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2016 and 2015</u>           | <u>6</u>  |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>   | <u>7</u>  |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                              | <u>25</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | <u>36</u> |
| <u>Item 4. Controls and Procedures</u>  | <u>37</u> |
| <b><u>PART II. OTHER INFORMATION</u></b>  |           |
| <u>Item 1. Legal Proceedings</u>  | <u>38</u> |
| <u>Item 1A. Risk Factors</u>  | <u>38</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | <u>39</u> |
| <u>Item 6. Exhibits</u>   | <u>39</u> |
| <u>Signatures</u>   |           |
| <u>EXHIBIT 31.1</u>   |           |
| <u>EXHIBIT 31.2</u>   |           |
| <u>EXHIBIT 32</u>   |           |

## Part I. Financial Information

## Item 1. Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Balance Sheets**

|   | <b>Unaudited<br/>September 30,<br/>2016</b> | <b>(A)<br/>June 30,<br/>2016</b> |
|---|---|----------------------------------|
|   | (In thousands, except share data)           |                                  |
| <b>ASSETS</b>   |   |                                  |
| <b>CURRENT ASSETS</b>   |   |                                  |
| Cash and cash equivalents   | \$ 205,329                                  | \$ 223,644                       |
| Pre-funded social welfare grants receivable (Note 2)                                | 1,738                                       | 1,580                            |
| Accounts receivable, net of allowances of September: \$1,453;<br>June: \$1,669      | 108,088                                     | 107,805                          |
| Finance loans receivable, net of allowances of September:<br>\$3,919; June: \$4,494 | 38,941                                      | 37,009                           |
| Inventory (Note 3)  | 10,694                                      | 10,004                           |
| Deferred income taxes   | 7,484                                       | 6,956                            |
| Total current assets before settlement assets                                       | 372,274                                     | 386,998                          |
| Settlement assets (Note 4)  | 593,503                                     | 536,725                          |
| Total current assets  | 965,777                                     | 923,723                          |
| <b>PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of</b>            |   |                                  |
| September: \$112,336; June: \$99,969  | 53,338                                      | 54,977                           |
| <b>EQUITY-ACCOUNTED INVESTMENTS</b>   | 25,560                                      | 25,645                           |
| <b>GOODWILL (Note 6)</b>  | 187,875                                     | 179,478                          |
| <b>INTANGIBLE ASSETS, net (Note 6)</b>  | 47,611                                      | 48,556                           |
| <b>OTHER LONG-TERM ASSETS, including reinsurance assets (Note 5 and Note 7)</b>     | 45,089                                      | 31,121                           |
| <b>TOTAL ASSETS</b>   | <b>1,325,250</b>                            | <b>1,263,500</b>                 |
| <b>LIABILITIES</b>  |   |                                  |
| <b>CURRENT LIABILITIES</b>  |   |                                  |
| Short-term credit facilities (Note 8)   | -   | -                                |
| Accounts payable  | 13,956                                      | 14,097                           |
| Other payables  | 42,535                                      | 37,479                           |
| Current portion of long-term borrowings (Note 9)                                    | 9,078                                       | 8,675                            |
| Income taxes payable  | 16,572                                      | 5,235                            |
| Total current liabilities before settlement obligations                             | 82,141                                      | 65,486                           |
| Settlement obligations (Note 4)   | 593,503                                     | 536,725                          |
| Total current liabilities   | 675,644                                     | 602,211                          |
| <b>DEFERRED INCOME TAXES</b>  | 11,397                                      | 12,559                           |
| <b>LONG-TERM BORROWINGS (Note 9)</b>  | 18,156                                      | 43,134                           |
| <b>OTHER LONG-TERM LIABILITIES, including insurance policy liabilities (Note 7)</b> | 2,793                                       | 2,376                            |
| <b>TOTAL LIABILITIES</b>  | <b>707,990</b>                              | <b>660,280</b>                   |
| <b>COMMITMENTS AND CONTINGENCIES (Note 17)</b>                                      |   |                                  |
| <b>EQUITY</b>   |   |                                  |

|   |  |                     |                     |
|---|--|---------------------|---------------------|
| <b>COMMON STOCK (Note 10)</b>                               |  |                     |                     |
| Authorized: 200,000,000 with \$0.001 par value;             |  |                     |                     |
| Issued and outstanding shares, net of treasury - September: |  |                     |                     |
| 52,521,345;   |  |                     |                     |
| June: 55,271,954  |  | 74                  | 74                  |
| <b>PREFERRED STOCK</b>                                      |  |                     |                     |
| Authorized shares: 50,000,000 with \$0.001 par value;       |  |                     |                     |
| Issued and outstanding shares, net of treasury: September:  |  |                     |                     |
| -; June: -  |  | -                   | -                   |
| ADDITIONAL PAID-IN-CAPITAL                                  |  | 222,637             | 223,978             |
| TREASURY SHARES, AT COST: September: 23,621,541;            |  |                     |                     |
| June: 20,483,932  |  | (273,238)           | (241,627)           |
| ACCUMULATED OTHER COMPREHENSIVE LOSS (Note                  |  |                     |                     |
| 11)   |  | (167,842)           | (189,700)           |
| RETAINED EARNINGS   |  | 724,954             | 700,322             |
| TOTAL NET1 EQUITY   |  | 506,585             | 493,047             |
| REDEEMABLE COMMON STOCK                                     |  | 107,672             | 107,672             |
| NON-CONTROLLING INTEREST                                    |  | 3,003               | 2,501               |
| <b>TOTAL EQUITY</b>   |  | <b>617,260</b>      | <b>603,220</b>      |
| <b>TOTAL LIABILITIES AND</b>                                |  |                     |                     |
| <b>SHAREHOLDERS EQUITY</b>                                  |  | <b>\$ 1,325,250</b> | <b>\$ 1,263,500</b> |
| (A) Derived from audited financial statements               |  |                     |                     |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Statements of Operations**

|  | <b>Three months ended</b>             |             |
|--|---------------------------------------|-------------|
|  | <b>September 30,</b>                  |             |
|  | <b>2016</b>                           | <b>2015</b> |
|  | (In thousands, except per share data) |             |
| REVENUE  | \$ 155,633                            | \$ 154,473  |
| EXPENSE  |                                       |             |
| Cost of goods sold, IT processing, servicing and support     | 74,780                                | 77,382      |
| Selling, general and administration                          | 38,468                                | 35,761      |
| Depreciation and amortization                                | 10,204                                | 10,115      |
| OPERATING INCOME   | 32,181                                | 31,215      |
| INTEREST INCOME  | 4,304                                 | 4,275       |
| INTEREST EXPENSE   | 796                                   | 974         |
| INCOME BEFORE INCOME TAX EXPENSE                             | 35,689                                | 34,516      |
| INCOME TAX EXPENSE (Note 16)                                 | 11,103                                | 10,897      |
| NET INCOME BEFORE EARNINGS FROM EQUITY-ACCOUNTED INVESTMENTS |                                       |             |
| INVESTMENTS  | 24,586                                | 23,619      |
| EARNINGS FROM EQUITY-ACCOUNTED INVESTMENTS                   | 659                                   | 188         |
| NET INCOME   | 25,245                                | 23,807      |
| LESS NET INCOME ATTRIBUTABLE TO NON-CONTROLLING INTEREST     | 613                                   | 787         |
| NET INCOME ATTRIBUTABLE TO NET1                              | \$ 24,632                             | \$ 23,020   |
| <b>Net income per share, in U.S. dollars</b> (Note 13)       |                                       |             |
| Basic earnings attributable to Net1 shareholders             | \$ 0.46                               | \$ 0.49     |
| Diluted earnings attributable to Net1 shareholders           | \$ 0.46                               | \$ 0.49     |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Statements of Comprehensive Income**

|  | <b>Three months ended<br/>September 30,</b> |                               |
|--|---|-------------------------------|
|  | <b>2016</b>                                 | <b>2015</b><br>(In thousands) |
| Net income   | \$ 25,245                                   | \$ 23,807                     |
| Other comprehensive income (loss)                                  |   |                               |
| Net unrealized income on asset available for sale, net of tax      | -   | 50                            |
| Movement in foreign currency translation reserve                   | 22,302                                      | (43,696)                      |
| Total other comprehensive income (loss), net of taxes              | 22,302                                      | (43,646)                      |
| Comprehensive income (loss)  | 47,547                                      | (19,839)                      |
| Less comprehensive income attributable to non-controlling interest | (1,057)                                     | (505)                         |
| Comprehensive income (loss) attributable to Net1                   | \$ 46,490                                   | \$ (20,344)                   |

See Notes to Unaudited Condensed Consolidated Financial Statements



## NET 1 UEPS TECHNOLOGIES, INC.

## Unaudited Condensed Consolidated Statement of Changes in Equity for the three months ended September 30, 2016 (dollar amounts in thousands)

|  |                        | Net 1 UEPS Technologies, Inc.<br>Shareholders |                                    |                    |   |                                  |                      |              | Accumulated<br>other<br>comprehensive<br>(loss) income |
|--|------------------------|---|------------------------------------|--------------------|---|----------------------------------|----------------------|--------------|--|
|  | Number<br>of<br>Shares | Amount  | Number<br>of<br>Treasury<br>Shares | Treasury<br>Shares | Number of<br>shares, net of<br>treasury | Additional<br>Paid-In<br>Capital | Retained<br>Earnings |              |  |
| Balance July 1,<br>2016                              | 75,755,886             | \$ 74   | (20,483,932)                       | \$ (241,627)       | 55,271,954                              | \$ 223,978                       | \$ 700,322           | \$ (189,700) |  |
| Repurchase of<br>common stock<br>(Note 10)           |                        |   | (3,137,609)                        | (31,611)           | (3,137,609)                             |                                  |                      |              |  |
| Restricted stock<br>granted (Note<br>12)             | 387,000                |   |                                    |                    | 387,000                                 |                                  |                      |              |  |
| Stock-based<br>compensation<br>charge (Note<br>12)   |                        |   |                                    |                    |   | 503                              |                      |              |  |
| Reversal of<br>stock comp<br>charge (Note<br>12)     |                        |   |                                    |                    |   | (1,827)                          |                      |              |  |
| Income tax<br>benefit from<br>vested<br>stock awards |                        |   |                                    |                    |   | (17)                             |                      |              |  |
| Dividends paid<br>to<br>non-controlling<br>interest  |                        |   |                                    |                    |   |                                  |                      |              |  |
| Net income   |                        |   |                                    |                    |   |                                  | 24,632               |              |  |
| Other<br>comprehensive<br>income<br>(Note 11)        |                        |   |                                    |                    |   |                                  |                      | 21,850       |  |
| Balance<br>September 30,                             | 76,142,886             | \$ 74   | (23,621,541)                       | \$ (273,238)       | 52,521,345                              | \$ 222,637                       | \$ 724,954           | \$ (167,840) |  |

2016

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Statements of Cash Flows**

|  | <b>Three months ended</b> |                   |
|--|---------------------------|-------------------|
|  | <b>September 30,</b>      |                   |
|  | <b>2016</b>               | <b>2015</b>       |
|  | (In thousands)            |                   |
| <b>Cash flows from operating activities</b>  |                           |                   |
| Net income   | \$ 25,245                 | \$ 23,807         |
| Depreciation and amortization  | 10,204                    | 10,115            |
| Earnings from equity-accounted investments   | (659)                     | (188)             |
| Fair value adjustments   | (83)                      | 1,433             |
| Interest payable   | 32                        | 709               |
| Loss (Profit) on disposal of property, plant and equipment   | 66                        | (95)              |
| Stock-based compensation (reversal) charge, net (Note 12)  | (1,324)                   | 726               |
| Facility fee amortized   | 36                        | 34                |
| Decrease (Increase) in accounts receivable, pre-funded social welfare grants receivable and finance loans receivable | 7,766                     | (17,278)          |
| Increase in inventory  | (104)                     | (931)             |
| Increase in accounts payable and other payables  | 3,040                     | 2,972             |
| Increase in taxes payable  | 10,956                    | 7,824             |
| Decrease in deferred taxes   | (1,632)                   | (1,026)           |
| <b>Net cash provided by operating activities</b>   | <b>53,543</b>             | <b>28,102</b>     |
| <b>Cash flows from investing activities</b>  |                           |                   |
| Capital expenditures   | (3,423)                   | (10,698)          |
| Proceeds from disposal of property, plant and equipment  | 69                        | 348               |
| Investment in MobiKwik   | (15,347)                  | -                 |
| Dividends received from equity accounted investments   | 370                       | -                 |
| Net change in settlement assets (Note 4)   | (37,394)                  | (23,496)          |
| <b>Net cash used in by investing activities</b>  | <b>(55,725)</b>           | <b>(33,846)</b>   |
| <b>Cash flows from financing activities</b>  |                           |                   |
| Acquisition of treasury stock (Note 10)  | (32,081)                  | -                 |
| Repayment of long-term borrowings (Note 9)   | (26,669)                  | -                 |
| Dividends paid to non-controlling interest   | (555)                     | -                 |
| Long-term borrowings utilized (Note 9)   | 247                       | 720               |
| Proceeds from issue of common stock  | -                         | 3,762             |
| Net change in settlement obligations (Note 4)  | 37,394                    | 23,496            |
| <b>Net cash (used in) provided by financing activities</b>   | <b>(21,664)</b>           | <b>27,978</b>     |
| Effect of exchange rate changes on cash  | 5,531                     | (14,207)          |
| <b>Net (decrease) increase in cash and cash equivalents</b>  | <b>(18,315)</b>           | <b>8,027</b>      |
| <b>Cash and cash equivalents beginning of period</b>   | <b>223,644</b>            | <b>117,583</b>    |
| <b>Cash and cash equivalents end of period</b>   | <b>\$ 205,329</b>         | <b>\$ 125,610</b> |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**

**Notes to the Unaudited Condensed Consolidated Financial Statements  
for the three months ended September 30, 2016 and 2015**

**(All amounts in tables stated in thousands or thousands of U.S. Dollars, unless otherwise stated)**

**1. Basis of Presentation and Summary of Significant Accounting Policies  
Unaudited Interim Financial Information**

The accompanying unaudited condensed consolidated financial statements include all majority-owned subsidiaries over which the Company exercises control and have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) and the rules and regulations of the United States Securities and Exchange Commission for quarterly reports on Form 10-Q and include all of the information and disclosures required for interim financial reporting. The results of operations for the three months ended September 30, 2016 and 2015, are not necessarily indicative of the results for the full year. The Company believes that the disclosures are adequate to make the information presented not misleading.

These financial statements should be read in conjunction with the financial statements, accounting policies and financial notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2016. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair representation of financial results for the interim periods presented.

References to the Company refer to Net1 and its consolidated subsidiaries, unless the context otherwise requires. References to Net1 are references solely to Net 1 UEPS Technologies, Inc.

**Recent accounting pronouncements adopted**

In February 2015, the FASB issued guidance regarding *Amendments to the Consolidation Analysis*. This guidance amends both the variable interest entity and voting interest entity consolidation models. The requirement to assess an entity under a different consolidation model may change previous consolidation conclusions. The guidance is effective for the Company beginning July 1, 2016. The adoption of this guidance did not have a material impact on the Company s financial statements.

**Recent accounting pronouncements not yet adopted as of September 30, 2016**

In May 2014, the FASB issued guidance regarding *Revenue from Contracts with Customers*. This guidance requires an entity to recognize revenue when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The guidance was to be effective for the Company beginning July 1, 2017, however in August 2015, the FASB issued guidance regarding *Revenue from Contracts with Customers, Deferral of the Effective Date*. This guidance defers the required implementation date specified in *Revenue from Contracts with Customers* to December 2017. Public companies may elect to adopt the standard along the original timeline. The Company expects that this guidance may have a material impact on its financial statements and is currently evaluating the impact of this guidance on its financial statements on adoption.

In August 2014, the FASB issued guidance regarding *Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern*. This guidance requires an entity to perform interim and annual assessments of its ability to continue as a going concern within one year of the date that its financial statements are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity s ability to continue as a going concern. The guidance is effective for the Company beginning July 1, 2017. Early adoption is permitted. The

Company is currently assessing the impact of this guidance on its financial statements disclosure.

In July 2015, the FASB issued guidance regarding *Simplifying the Measurement of Inventory*. This guidance requires entities to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market (market in this context is defined as one of three different measures). The guidance will not apply to inventories that are measured by using either the last-in, first-out ( LIFO ) method or the retail inventory method ( RIM ). The guidance is effective for the Company beginning July 1, 2017. Early adoption is permitted. The Company is currently assessing the impact of this guidance on its financial statements disclosure.

**1. Basis of Presentation and Summary of Significant Accounting Policies (continued)**  
**Recent accounting pronouncements not yet adopted as of September 30, 2016 (continued)**

In November 2015, the FASB issued guidance regarding *Balance Sheet Classification of Deferred Taxes*. This guidance requires that deferred tax liabilities and assets are to be classified as non-current in a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this update. This guidance is effective for the Company beginning July 1, 2017, with early adoption permitted on a prospective or retrospective basis. The Company is currently assessing the impact of this guidance on its financial statements disclosures.

In January 2016, the FASB issued guidance regarding *Recognition and Measurement of Financial Assets and Financial Liabilities*. The guidance primarily affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, the guidance clarifies the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. This guidance is effective for the Company beginning July 1, 2018, and early adoption is not permitted, with certain exceptions. The amendments are required to be applied by means of a cumulative-effect adjustment on the balance sheet as of the beginning of the fiscal year of adoption. The Company is currently assessing the impact of this guidance on its financial statements disclosure.

In February 2016, the FASB issued guidance regarding *Leases*. The guidance increases transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet. The amendments to current lease guidance includes the recognition of assets and liabilities by lessees for those leases currently classified as operating leases. The guidance also requires disclosures to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. This guidance is effective for the Company beginning July 1, 2019. Early adoption is permitted. The Company expects that this guidance may have a material impact on its financial statements and is currently evaluating the impact of this guidance on its financial statements on adoption.

In March 2016, the FASB issued guidance regarding *Improvements to Employee Share-Based Payment Accounting*. The guidance simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This guidance is effective for the Company beginning July 1, 2017. Early adoption is permitted. The Company is currently assessing the impact of this guidance on its financial statements disclosure.

In June 2016, the FASB issued guidance regarding *Measurement of Credit Losses on Financial Instruments*. The guidance replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, an entity is required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. This guidance is effective for the Company beginning July 1, 2020. Early adoption is permitted beginning July 1, 2019. The Company is currently assessing the impact of this guidance on its financial statements disclosure.

In June 2016, the FASB issued guidance regarding *Classification of Certain Cash Receipts and Cash Payments*. The guidance is intended to reduce diversity in practice and explains how certain cash receipts and payments are presented and classified in the statement of cash flows, including beneficial interests in securitization, which would impact the presentation of the deferred purchase price from sales of receivables. This guidance is effective for the Company beginning July 1, 2018, and must be applied retrospectively. Early adoption is permitted. The Company is currently

assessing the impact of this guidance on its financial statements disclosure.

**2. Pre-funded social welfare grants receivable**

Pre-funded social welfare grants receivable represents amounts pre-funded by the Company to certain merchants participating in the merchant acquiring system. The October 2016 payment service commenced on October 1, 2016, but the Company pre-funded certain merchants participating in the merchant acquiring system on the last two days of September 2016.

**3. Inventory**

The Company's inventory comprised the following category as of September 30, 2016 and June 30, 2016.

|                | <b>September 30,<br/>2016</b> | <b>June 30,<br/>2016</b> |
|----------------|-------------------------------|--------------------------|
| Finished goods | \$ 10,694                     | \$ 10,004                |
|                | \$ 10,694                     | \$ 10,004                |

**4. Settlement assets and settlement obligations**

Settlement assets comprise (1) cash received from the South African government that the Company holds pending disbursement to recipient beneficiaries of social welfare grants and (2) cash received from customers on whose behalf the Company processes payroll payments that the Company will disburse to customer employees, payroll-related payees and other payees designated by the customer.

Settlement obligations comprise (1) amounts that the Company is obligated to disburse to recipient cardholders of social welfare grants, and (2) amounts that the Company is obligated to pay to customer employees, payroll-related payees and other payees designated by the customer.

The balances at each reporting date may vary widely depending on the timing of the receipts and payments of these assets and obligations.

Net change in settlement assets and net change in settlement assets included in the unaudited condensed consolidated statement of cash flows for the three months ended September 30, 2015, have been increased by \$1.9 million as a result of the restatement described in Note 2 (Significant accounting policies Settlement assets and settlement obligations) to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended June 30, 2016.

**5. Fair value of financial instruments***Initial recognition and measurement*

Financial instruments are recognized when the Company becomes a party to the transaction. Initial measurements are at cost, which includes transaction costs.

*Risk management*

The Company seeks to reduce its exposure to currencies other than the South African rand through a policy of matching, to the extent possible, assets and liabilities denominated in those currencies. In addition, the Company uses financial instruments in order to economically hedge its exposure to exchange rate and interest rate fluctuations arising from its operations. The Company is also exposed to equity price and liquidity risks as well as credit risks.

*Currency exchange risk*

The Company is subject to currency exchange risk because it purchases inventories that it is required to settle in other currencies, primarily the euro and U.S. dollar. The Company has used forward contracts in order to limit its exposure in these transactions to fluctuations in exchange rates between the South African rand, on the one hand, and the U.S. dollar and the euro, on the other hand.

*Translation risk*



Translation risk relates to the risk that the Company's results of operations will vary significantly as the U.S. dollar is its reporting currency, but it earns most of its revenues and incurs most of its expenses in ZAR. The U.S. dollar to ZAR exchange rate has fluctuated significantly over the past three years. As exchange rates are outside the Company's control, there can be no assurance that future fluctuations will not adversely affect the Company's results of operations and financial condition.

*Interest rate risk*

As a result of its normal borrowing and leasing activities, the Company's operating results are exposed to fluctuations in interest rates, which it manages primarily through regular financing activities. The Company generally maintains limited investment in cash equivalents and has occasionally invested in marketable securities.

## **5. Fair value of financial instruments (continued)**

### ***Risk management (continued)***

#### *Credit risk*

Credit risk relates to the risk of loss that the Company would incur as a result of non-performance by counterparties. The Company maintains credit risk policies with regard to its counterparties to minimize overall credit risk. These policies include an evaluation of a potential counterparty's financial condition, credit rating, and other credit criteria and risk mitigation tools as the Company's management deems appropriate.

With respect to credit risk on financial instruments, the Company maintains a policy of entering into such transactions only with South African and European financial institutions that have a credit rating of BBB- or better, as determined by credit rating agencies such as Standard & Poor's, Moody's and Fitch Ratings.

#### *UEPS-based microlending credit risk*

The Company is exposed to credit risk in its UEPS-based microlending activities, which provides unsecured short-term loans to qualifying customers. The Company manages this risk by performing an affordability test for each prospective customer and assigns a creditworthiness score, which takes into account a variety of factors such as other debts and total expenditures on normal household and lifestyle expenses.

#### *Equity price and liquidity risk*

Equity price risk relates to the risk of loss that the Company would incur as a result of the volatility in the exchange-traded price of equity securities that it holds and the risk that it may not be able to liquidate these securities. The market price of these securities may fluctuate for a variety of reasons, consequently, the amount the Company may obtain in a subsequent sale of these securities may significantly differ from the reported market value.

Liquidity risk relates to the risk of loss that the Company would incur as a result of the lack of liquidity on the exchange on which these securities are listed. The Company may not be able to sell some or all of these securities at one time, or over an extended period of time without influencing the exchange traded price, or at all.

### **Financial instruments**

The following section describes the valuation methodologies the Company uses to measure its significant financial assets and liabilities at fair value.

In general, and where applicable, the Company uses quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology applies to Level 1 investments. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then the Company uses quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. These investments are included in Level 2 investments. In circumstances in which inputs are generally unobservable, values typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. Investments valued using such techniques are included in Level 3 investments.

#### ***Derivative transactions - Foreign exchange contracts***

As part of the Company's risk management strategy, the Company enters into derivative transactions to mitigate exposures to foreign currencies using foreign exchange contracts. These foreign exchange contracts are over-the-counter derivative transactions. Substantially all of the Company's derivative exposures are with counterparties that have long-term credit ratings of BBB- or better. The Company uses quoted prices in active markets for similar assets and liabilities to determine fair value (Level 2). The Company has no derivatives that require fair value measurement under Level 1 or 3 of the fair value hierarchy.

The Company's outstanding foreign exchange contracts are as follows:

As of September 30, 2016

| <b>Notional amount</b> | <b>Strike price</b> | <b>Fair market value price</b> | <b>Maturity</b>   |
|------------------------|---------------------|--------------------------------|-------------------|
| EUR 393,675.00         | ZAR 16.2911         | ZAR 15.5206                    | October 20, 2016  |
| EUR 302,368.50         | ZAR 16.4085         | ZAR 15.6389                    | November 21, 2016 |

10

**5. Fair value of financial instruments (continued)****Financial instruments (continued)**

As of June 30, 2016

| <b>Notional amount</b> | <b>Strike price</b> | <b>Fair market value price</b> | <b>Maturity</b>    |
|------------------------|---------------------|--------------------------------|--------------------|
| EUR 573,765.00         | ZAR 15.9587         | ZAR 16.3393                    | July 20, 2016      |
| EUR 554,494.50         | ZAR 16.0643         | ZAR 16.4564                    | August 19, 2016    |
| EUR 465,711.00         | ZAR 16.1798         | ZAR 16.582                     | September 20, 2016 |
| EUR 393,675.00         | ZAR 16.2911         | ZAR 16.7017                    | October 20, 2016   |
| EUR 302,368.50         | ZAR 16.4085         | ZAR 16.8301                    | November 21, 2016  |

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2016, according to the fair value hierarchy:

|   | <b>Quoted price in active markets for identical assets (Level 1)</b> | <b>Significant other observable inputs (Level 2)</b> | <b>Significant unobservable inputs (Level 3)</b> | <b>Total</b>  |
|---|--|--|--|---------------|
| <b>Assets</b>   |  |  |  |               |
| Related to insurance business (included in other long-term assets): |  |  |  |               |
| Cash and cash equivalents   | \$ 562   | \$ -   | \$ -   | \$ 562        |
| Other   | -  | 38   | -  | 38            |
| <b>Total assets at fair value</b>                                   | <b>\$ 562</b>  | <b>\$ 38</b>   | <b>\$ -</b>                                      | <b>\$ 600</b> |
| <b>Liabilities</b>  |  |  |  |               |
| Foreign exchange contracts  | \$ -   | \$ 39  | \$ -   | \$ 39         |
| <b>Total liabilities at fair value</b>                              | <b>\$ -</b>  | <b>\$ 39</b>   | <b>\$ -</b>                                      | <b>\$ 39</b>  |

The following table presents the Company's assets measured at fair value on a recurring basis as of June 30, 2016, according to the fair value hierarchy:

|   | <b>Quoted price in active markets for identical assets (Level 1)</b> | <b>Significant other observable inputs (Level 2)</b> | <b>Significant unobservable inputs (Level 3)</b> | <b>Total</b>  |
|---|--|--|--|---------------|
| <b>Assets</b>   |  |  |  |               |
| Related to insurance business (included in other long-term assets): |  |  |  |               |
| Cash and cash equivalents   | \$ 533   | \$ -   | \$ -   | \$ 533        |
| Foreign exchange contracts  | -  | 62   | -  | 62            |
| Other   | -  | 37   | -  | 37            |
| <b>Total assets at fair value</b>                                   | <b>\$ 533</b>  | <b>\$ 99</b>   | <b>\$ -</b>                                      | <b>\$ 632</b> |

Changes in the Company's investment in Finbond Group Limited, or Finbond, (Level 3 that are measured at fair value on a recurring basis) were insignificant during the three months ended September 30, 2015, respectively. There have been no transfers in or out of Level 3 during the three months ended September 30, 2016 and 2015, respectively.

**5. Fair value of financial instruments (continued)*****Assets and liabilities measured at fair value on a nonrecurring basis***

The Company measures its assets at fair value on a nonrecurring basis when they are deemed to be other-than-temporarily impaired. The Company has no liabilities that are measured at fair value on a nonrecurring basis. The Company reviews the carrying values of its assets when events and circumstances warrant and considers all available evidence in evaluating when declines in fair value are other-than-temporary. The fair values of the Company's assets are determined using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded when the cost of the assets exceeds its fair value and the excess is determined to be other-than-temporary. The Company has not recorded any impairment charges during the reporting periods presented herein.

**6. Goodwill and intangible assets, net****Goodwill**

Summarized below is the movement in the carrying value of goodwill for the three months ended September 30, 2016:

|  | <b>Gross<br/>value</b> | <b>Accumulated<br/>impairment</b> | <b>Carrying<br/>value</b> |
|--|------------------------|-----------------------------------|---------------------------|
| Balance as of June 30, 2016                | \$ 179,478             | \$ -                              | \$ 179,478                |
| Foreign currency adjustment <sup>(1)</sup> | 8,397                  | -                                 | 8,397                     |
| Balance as of September 30, 2016           | \$ 187,875             | \$ -                              | \$ 187,875                |

<sup>(1)</sup> Represents the effects of the fluctuations between the South African rand, Euro and the Korean won, and the U.S. dollar on the carrying value.

Goodwill has been allocated to the Company's reportable segments as follows:

|  | <b>South<br/>African<br/>transaction<br/>processing</b> | <b>International<br/>transaction<br/>processing</b> | <b>Financial<br/>inclusion and<br/>applied<br/>technologies</b> | <b>Carrying<br/>value</b> |
|--|---|---|---|---------------------------|
| Balance as of June 30, 2016                | \$ 20,425   | \$ 136,185  | \$ 22,868   | \$ 179,478                |
| Foreign currency adjustment <sup>(1)</sup> | 1,357   | 5,907   | 1,133   | 8,397                     |
| Balance as of September 30, 2016           | \$ 21,782   | \$ 142,092  | \$ 24,001   | \$ 187,875                |

<sup>(1)</sup> Represents the effects of the fluctuations between the South African rand, Euro and the Korean won, and the U.S. dollar on the carrying value.

**Intangible assets, net*****Carrying value and amortization of intangible assets***

Summarized below is the carrying value and accumulated amortization of the intangible assets as of September 30, 2016 and June 30, 2016:

|                                     | <b>As of September 30, 2016</b>     |                                   |                                     | <b>As of June 30, 2016</b>          |                                   |  |
|-------------------------------------|-------------------------------------|-----------------------------------|-------------------------------------|-------------------------------------|-----------------------------------|--|
| <b>Gross<br/>carrying<br/>value</b> | <b>Accumulated<br/>amortization</b> | <b>Net<br/>carrying<br/>value</b> | <b>Gross<br/>carrying<br/>value</b> | <b>Accumulated<br/>amortization</b> | <b>Net<br/>carrying<br/>value</b> |  |

Finite-lived  
intangible  
assets:

|                                    |            |             |           |            |             |           |
|------------------------------------|------------|-------------|-----------|------------|-------------|-----------|
| Customer relationships             | \$ 97,992  | \$ (55,956) | \$ 42,036 | \$ 94,529  | \$ (51,557) | \$ 42,972 |
| Software and unpatented technology | 32,502     | (30,009)    | 2,493     | 31,452     | (28,791)    | 2,661     |
| FTS patent                         | 2,764      | (2,764)     | -         | 2,592      | (2,592)     | -         |
| Exclusive licenses                 | 4,506      | (4,506)     | -         | 4,506      | (4,506)     | -         |
| Trademarks                         | 6,986      | (3,904)     | 3,082     | 6,685      | (3,762)     | 2,923     |
| Total                              | \$ 144,750 | \$ (97,139) | \$ 47,611 | \$ 139,764 | \$ (91,208) | \$ 48,556 |

Aggregate amortization expense on the finite-lived intangible assets for the three months ended September 30, 2016 and 2015, was approximately \$2.9 million and \$3.3 million, respectively.

**Intangible assets, net (continued)**

Future estimated annual amortization expense for the next five fiscal years and thereafter, assuming exchange rates that prevailed on September 30, 2016, is presented in the table below. Actual amortization expense in future periods could differ from this estimate as a result of acquisitions, changes in useful lives, exchange rate fluctuations and other relevant factors.

|            |    |        |
|------------|----|--------|
| 2017       | \$ | 12,607 |
| 2018       |    | 11,692 |
| 2019       |    | 11,061 |
| 2020       |    | 10,352 |
| 2021       |    | 4,453  |
| Thereafter | \$ | 368    |

**7. Reinsurance assets and policy holder liabilities under insurance and investment contracts**  
**Reinsurance assets and policy holder liabilities under insurance contracts**

Summarized below is the movement in reinsurance assets and policy holder liabilities under insurance contracts during the three months ended September 30, 2016:

|  | <b>Reinsurance<br/>assets<sup>(1)</sup></b> | <b>Insurance<br/>contracts<sup>(2)</sup></b> |
|--|---|--|
| Balance as of June 30, 2016                                  | \$ 171                                      | \$ (1,078)                                   |
| Increase in policy holder benefits under insurance contracts | 231   | (754)  |
| Claims and policyholders benefits under insurance contracts  | (229)                                       | 682  |
| Foreign currency adjustment <sup>(3)</sup>                   | 12  | (71)   |
| Balance as of September 30, 2016                             | \$ 185                                      | \$ (1,221)                                   |

(1) Included in other long-term assets.

(2) Included in other long-term liabilities.

(3) Represents the effects of the fluctuations between the ZAR against the U.S. dollar.

The Company has agreements with reinsurance companies in order to limit its losses from large insurance contracts, however, if the reinsurer is unable to meet its obligations, the Company retains the liability.

The Company determines its reserves for future policy benefits under its life insurance products using a model which estimates claims incurred that have not been reported at the balance sheet date. This model includes best estimate assumptions of experience plus prescribed margins, as required in the markets in which these products are offered, namely South Africa. The best estimate assumptions include those assumptions related to mortality, morbidity and claim reporting delays, and the main assumptions used to calculate the reserve for future policy benefits include (i) mortality and morbidity assumptions reflecting the Company's most recent experience and (ii) claim reporting delays reflecting Company specific and industry experience.

**Assets and policy holder liabilities under investment contracts**

Summarized below is the movement in assets and policy holder liabilities under investment contracts during the three months ended September 30, 2016:

|  | <b>Assets<sup>(1)</sup></b> | <b>Investment<br/>contracts<sup>(2)</sup></b> |
|--|-----------------------------|---|
| Balance as of June 30, 2016                | \$ 528                      | \$ (528)                                      |
| Foreign currency adjustment <sup>(3)</sup> | 35                          | (35)  |



|                                  |    |     |    |       |
|----------------------------------|----|-----|----|-------|
| Balance as of September 30, 2016 | \$ | 563 | \$ | (563) |
|----------------------------------|----|-----|----|-------|

- (1) Included in other long-term assets.
- (2) Included in other long-term liabilities.
- (3) Represents the effects of the fluctuations between the ZAR against the U.S. dollar.

The Company does not offer any investment products with guarantees related to capital or returns.

## **8. Short-term credit facilities**

The Company's short-term credit facilities are described in Note 12 to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended June 30, 2016.

### **South Africa**

The aggregate amount of the Company's short-term South African credit facility with Nedbank Limited is up to ZAR 400 million (\$28.8 million) and consists of (i) a primary amount of up to ZAR 200 million (\$14.4 million), which is immediately available, and (ii) a secondary amount of up to ZAR 200 million (\$14.4 million), which is not immediately available (all amounts denominated in ZAR and translated at exchange rates applicable as of September 30, 2016). The primary amount comprises an overdraft facility of up to ZAR 50 million (\$3.6 million) and indirect and derivative facilities of up to ZAR 150 million (\$10.8 million), which include letters of guarantee, letters of credit and forward exchange contracts (all amounts denominated in ZAR and translated at exchange rates applicable as of September 30, 2016). As of September 30, 2016, the interest rate on the overdraft facility was 9.35%. The Company has ceded its investment in Cash Paymaster Services Proprietary Limited as security for its repayment obligations under the facility.

A commitment fee of 0.35% per annum is payable on the monthly unutilized amount of the overdraft portion of the primary amount. The Company is required to comply with customary non-financial covenants, including, without limitation, covenants that restrict its ability to dispose of or encumber its assets, incur additional indebtedness or engage in certain business combinations.

As of September 30, 2016 and June 30, 2016, respectively, the Company had not utilized any of its overdraft facility. As of September 30, 2016, the Company had utilized approximately ZAR 131.1 million (\$9.5 million, translated at exchange rates applicable as of September 30, 2016) of its ZAR 150 million indirect and derivative facilities to obtain foreign exchange contracts from the bank and to enable the bank to issue guarantees, including stand-by letters of credit, in order for the Company to honor its obligations to third parties requiring such guarantees (refer to Note 17). As of June 30, 2016, the Company had utilized approximately ZAR 131.1 million (\$8.9 million, translated at exchange rates applicable as of June 30, 2016) of its ZAR 150 million indirect and derivative facilities.

### **Korea**

The Company had not utilized any of its KRW 10 billion (\$9.1 million, translated at exchange rates applicable as of September 30, 2016) overdraft facility as of September 30, 2016 or June 30, 2016. As of September 30, 2016, the interest rate on the overdraft facility was 3.31%. The facility expires in January 2017.

## **9. Long-term borrowings**

The Company's Korean senior secured loan facility is described in Note 13 to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended June 30, 2016. The current carrying value as of September 30, 2016, is \$27.2 million. As of September 30, 2016, the carrying amount of the long-term borrowings approximated fair value. The interest rate in effect on September 30, 2016, was 4.46%.

On July 29, 2016, the Company utilized approximately KRW 0.3 billion (\$0.2 million) of its Facility C revolving credit facility to pay interest due. On the same day, the Company made unscheduled payments of KRW 20 billion (\$17.8 million) towards its Facility A loan and KRW 10 billion (\$8.9 million) towards its Facility C revolving credit facility. The next scheduled principal payment of \$9.1 million (translated at exchange rates applicable as of September 30, 2016) will be made on April 29, 2017.

Interest expense incurred during the three months ended September 30, 2016 and 2015, was \$0.5 million and \$0.7 million, respectively. Prepaid facility fees amortized during each of the three months ended September 30, 2016, and

2015, was \$0.04 and \$0.03 million, respectively.

**10. Capital structure**

The following table presents reconciliation between the number of shares, net of treasury, presented in the unaudited condensed consolidated statement of changes in equity during the three months ended September 30, 2016 and 2015, respectively, and the number of shares, net of treasury, excluding non-vested equity shares that have not vested during the three months ended September 30, 2016 and 2015, respectively:

|   | September 30,<br>2016 | September 30,<br>2015 |
|---|-----------------------|-----------------------|
| Number of shares, net of treasury:  |                       |                       |
| Statement of changes in equity  | 52,521,345            | 47,322,702            |
| Less: Non-vested equity shares that have not vested (Note 12)                             | (904,356)             | (589,447)             |
| Number of shares, net of treasury excluding non-vested equity shares that have not vested | 51,616,989            | 46,733,255            |

**Common stock repurchases***Executed under share repurchase authorizations*

In February 2016, the Company's Board of Directors approved the replenishment of its share repurchase authorization to repurchase up to an aggregate of \$100 million of common stock. The authorization has no expiration date. On June 29, 2016, the Company adopted a Rule 10b5-1 trading plan for the purpose of repurchasing approximately \$50 million of its common stock, which was included within the original share repurchase authorization. During the three months ended September 30, 2016, the Company repurchased 3,137,609 shares for approximately \$31.6 million under its share repurchase authorization. The Company did not repurchase any of its shares during the three months ended September 30, 2015.

**11. Accumulated other comprehensive loss**

The table below presents the change in accumulated other comprehensive (loss) income per component during the three months ended September 30, 2016:

|  | Accumulated<br>foreign<br>currency<br>translation<br>reserve | Three months ended<br>September 30, 2016<br>Accumulated<br>net<br>unrealized<br>income on<br>asset<br>available for<br>sale, net of<br>tax | Total        |
|--|--|--|--------------|
| Balance as of June 30, 2016                      | \$ (189,700)   | \$ -   | \$ (189,700) |
| Movement in foreign currency translation reserve | 21,858   | -  | 21,858       |
| Balance as of September 30, 2016                 | \$ (167,842)   | \$ -   | \$ (167,842) |

There were no reclassifications from accumulated other comprehensive loss to comprehensive (loss) income during the three months ended September 30, 2016 or 2015, respectively.



**12. Stock-based compensation****Stock option and restricted stock activity***Options*

The following table summarizes stock option activity for the three months ended September 30, 2016 and 2015:

|                     |                    | Number of<br>shares | Weighted<br>average<br>exercise<br>price<br>(\$) | Weighted<br>average<br>remaining<br>contractual<br>term<br>(in years) | Aggregate<br>intrinsic<br>value<br>(\$ 000) | Weighted<br>average<br>grant date<br>fair value<br>(\$) |
|---------------------|--------------------|---------------------|--|---|---|---|
| Outstanding         | June 30, 2016      | 2,077,524           | 15.92  | 3.65  | 926   |   |
| Expired unexercised |                    | (474,443)           | 22.51  |   |   |   |
| Outstanding         | September 30, 2016 | 1,603,081           | 13.98  | 4.50  | 452   |   |
| Outstanding         | June 30, 2015      | 2,401,169           | 15.34  | 4.74  | 11,516                                      |   |
| Exercised           |                    | (323,645)           | 11.62  |   | 2,669                                       |   |
| Outstanding         | September 30, 2015 | 2,077,524           | 15.92  | 4.33  | 7,509                                       |   |

No stock options were awarded during the three months ended September 30, 2016 or 2015. There were no forfeitures during the three months ended September 30, 2016 or 2015; however, during the three months ended September 30, 2016, 474,443 stock options awarded in August 2006, expired unexercised.

The following table presents stock options vested and expecting to vest as of September 30, 2016:

|                              |                    | Number of<br>shares | Weighted<br>average<br>exercise<br>price<br>(\$) | Weighted<br>average<br>remaining<br>contractual<br>term<br>(in years) | Aggregate<br>intrinsic<br>value<br>(\$ 000) |
|------------------------------|--------------------|---------------------|--|---|---|
| Vested and expecting to vest | September 30, 2016 | 1,603,081           | 13.98  | 4.50  | 452   |

These options have an exercise price range of \$7.35 to \$24.46.

The following table presents stock options that are exercisable as of September 30, 2016:

|             |                    | Number of<br>shares | Weighted<br>average<br>exercise<br>price<br>(\$) | Weighted<br>average<br>remaining<br>contractual<br>term<br>(in years) | Aggregate<br>intrinsic<br>value<br>(\$ 000) |
|-------------|--------------------|---------------------|--|---|---|
| Exercisable | September 30, 2016 | 1,448,278           | 14.28  | 4.11  | 452   |

During the three months ended September 30, 2016 and 2015, respectively, 154,803 and 330,967 stock options became exercisable. No stock options were exercised during the three months ended September 30, 2016. The Company received approximately \$3.8 million from the exercise of 323,645 stock options, during the three months ended September 30, 2015. The Company issues new shares to satisfy stock option exercises.



**12. Stock-based compensation (continued)****Stock option and restricted stock activity (continued)***Restricted stock*

The following table summarizes restricted stock activity for the three months ended September 30, 2016 and 2015:

|            |                    | <b>Number of<br/>shares of<br/>restricted<br/>stock</b> | <b>Weighted<br/>average grant<br/>date fair value<br/>(\$ 000)</b> |
|------------|--------------------|---|--|
| Non-vested | June 30, 2016      | 589,447   | 7,622  |
| Granted    | August 2016        | 387,000   | 4,145  |
| Vested     | August 2016        | (72,091)  | 735  |
| Non-vested | September 30, 2016 | 904,356   | 11,142   |
| Non-vested | June 30, 2015      | 341,529   | 1,759  |
| Granted    | August 2015        | 319,492   | 581  |
| Vested     | August 2015        | (71,574)  | 1,435  |
| Non-vested | September 30, 2015 | 589,447   | 7,622  |

The August 2016 grants comprise 350,000 and 37,000 shares of restricted stock awarded to executive officers and non-employee directors, respectively. The shares of restricted stock awarded to executive officers in August 2016 are subject to time-based and performance-based vesting conditions. In order for any of the shares to vest, the recipient must remain employed by the Company on a full-time basis on the date that it files its Annual Report on Form 10-K for the fiscal year ended June 30, 2019. If that condition is satisfied, then the shares will vest based on the level of Fundamental EPS the Company achieves for the fiscal year ended June 30, 2019 ( 2019 Fundamental EPS ), as follows:

One-third of the shares will vest if the Company achieves 2019 Fundamental EPS of \$2.60;

Two-thirds of the shares will vest if the Company achieves 2019 Fundamental EPS of \$2.80; and

All of the shares will vest if the Company achieves 2019 Fundamental EPS of \$3.00.

At levels of 2019 Fundamental EPS greater than \$2.60 and less than \$3.00, the number of shares that will vest will be determined by linear interpolation relative to 2019 Fundamental EPS of \$2.80. Any shares that do not vest in accordance with the above-described conditions will be forfeited. All shares of restricted stock have been valued utilizing the closing price of shares of the Company's common stock quoted on The Nasdaq Global Select Market on the date of grant.

The August 2015 grants comprise 301,537 and 17,955 shares of restricted stock awarded to employees and non-employee directors, respectively. The shares of restricted stock awarded to employees in August 2015 are subject to time-based and performance-based vesting conditions. In order for any of the shares to vest, the recipient must remain employed by the Company on a full-time basis on the date that it files its Annual Report on Form 10-K for the fiscal year ended June 30, 2018. If that condition is satisfied, then the shares will vest based on the level of Fundamental EPS the Company achieves for the fiscal year ended June 30, 2018 ( 2018 Fundamental EPS ), as follows:

One-third of the shares will vest if the Company achieves 2018 Fundamental EPS of \$2.88;

Two-thirds of the shares will vest if the Company achieves 2018 Fundamental EPS of \$3.30; and

All of the shares will vest if the Company achieves 2018 Fundamental EPS of \$3.76.

At levels of 2018 Fundamental EPS greater than \$2.88 and less than \$3.76, the number of shares that will vest will be determined by linear interpolation relative to 2018 Fundamental EPS of \$3.30. Any shares that do not vest in accordance with the above-described conditions will be forfeited. All shares of restricted stock have been valued utilizing the closing price of shares of the Company's common stock quoted on The Nasdaq Global Select Market on



the date of grant. The Company has reversed the stock-based compensation charge recognized to date related to the 301,537 shares of restricted stock because it believes that it is unlikely that the 2018 Fundamental EPS target will be achieved due to the dilutive impact on the fundamental EPS calculation as a result of issuance of the approximate 10 million shares to the IFC in May 2016.

**12. Stock-based compensation (continued)****Stock option and restricted stock activity (continued)*****Restricted stock (continued)***

The fair value of restricted stock vesting during the three months ended September 30, 2016 and 2015, respectively, was \$0.7 million and \$1.4 million.

**Stock-based compensation charge and unrecognized compensation cost**

The Company has recorded a stock-based compensation (reversal) charge, net of (\$1.3 million) and \$0.7 million, respectively, during the three months ended September 30, 2016 and 2015, which comprised:

|   | <b>Total<br/>charge</b> | <b>Allocated to cost<br/>of goods sold, IT<br/>processing,<br/>servicing and<br/>support</b> | <b>Allocated to<br/>selling, general<br/>and<br/>administration</b> |
|---|-------------------------|--|---|
| <b>Three months ended September 30, 2016</b>                      |                         |  |   |
| Stock-based compensation charge                                   | \$ 503                  | \$ -   | \$ 503  |
| Reversal of stock compensation charge related to restricted stock | (1,827)                 | -  | (1,827)   |
| <b>Total three months ended September 30, 2016</b>                | <b>\$ (1,324)</b>       | <b>\$ -</b>  | <b>\$ (1,324)</b>   |
| <b>Three months ended September 30, 2015</b>                      |                         |  |   |
| Stock-based compensation charge                                   | \$ 726                  | \$ -   | \$ 726  |
| <b>Total three months ended September 30, 2015</b>                | <b>\$ 726</b>           | <b>\$ -</b>  | <b>\$ 726</b>   |

The stock-based compensation charges have been allocated to selling, general and administration based on the allocation of the cash compensation paid to the employees.

As of September 30, 2016, the total unrecognized compensation cost related to stock options was approximately \$0.6 million, which the Company expects to recognize over approximately one year. As of September 30, 2016, the total unrecognized compensation cost related to restricted stock awards was approximately \$4.5 million, which the Company expects to recognize over approximately two years. This amount excludes the total unrecognized compensation cost as of September 30, 2016, related to restricted stock awards that the Company expects will not vest due to it not achieving the 2018 Fundamental EPS of approximately \$6.0 million. As of September 30, 2016, the cumulative unrecorded stock-based compensation charge related to these awards of restricted stock that the Company has determined are expected not to vest and has not expensed in its consolidated statement of operations is approximately \$2.5 million (which amount includes the \$1.8 million reversed).

As of September 30, 2016 and June 30, 2016, respectively, the Company has recorded a deferred tax asset of approximately \$1.5 million and 1.8 million related to the stock-based compensation charge recognized related to employees and directors of Net1 as it is able to deduct the grant date fair value for taxation purposes.

**13. Earnings per share**

The Company has issued redeemable common stock which is redeemable at an amount other than fair value. Redemption of a class of common stock at other than fair value increases or decreases the carrying amount of the redeemable common stock and is reflected in basic earnings per share using the two-class method. There were no redemptions of common stock, or adjustments to the carrying value of the redeemable common stock during the three months ended September 30, 2016 or 2015. Accordingly the two-class method presented below does not include the

impact of any redemption. The Company's redeemable common stock is described in Note 14 to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended June 30, 2016.

Basic earnings per share include shares of restricted stock that meet the definition of a participating security because these shares are eligible to receive non-forfeitable dividend equivalents at the same rate as common stock. Basic earnings per share have been calculated using the two-class method and basic earnings per share for the three months ended September 30, 2016 and 2015, reflects only undistributed earnings. The computation below of basic earnings per share excludes the net income attributable to shares of unvested restricted stock (participating non-vested restricted stock) from the numerator and excludes the dilutive impact of these unvested shares of restricted stock from the denominator.

**13. Earnings per share (continued)**

Diluted earnings per share have been calculated to give effect to the number of shares of additional common stock that would have been outstanding if the potential dilutive instruments had been issued in each period. Stock options are included in the calculation of diluted earnings per share utilizing the treasury stock method and are not considered to be participating securities as the stock options do not contain non-forfeitable dividend rights. The calculation of diluted earnings per share includes the dilutive effect of a portion of the restricted stock granted to employees in August 2013, August 2014, November 2014, August 2015 and August 2016, as these shares of restricted stock are considered contingently returnable shares for the purposes of the diluted earnings per share calculation and the vesting conditions in respect of a portion of the restricted stock had been satisfied. The vesting conditions for awards made in August 2016 and August 2015 are discussed in Note 12 and the vesting conditions for all other awards are discussed in Note 18 to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended June 30, 2016.

The following table presents net income attributable to Net1 (income from continuing operations) and the share data used in the basic and diluted earnings per share computations using the two-class method:

|  | <b>Three months ended</b>                              |             |
|--|--|-------------|
|  | <b>September,</b>                                      |             |
|  | <b>2016</b>  | <b>2015</b> |
|  | (in thousands except percent<br>and<br>per share data) |             |
| <b>Numerator:</b>  |  |             |
| Net income attributable to Net1  | \$ 24,632  | \$ 23,020   |
| Undistributed earnings   | 24,632   | 23,020      |
| Percent allocated to common shareholders (Calculation 1)   | 99%  | 99%         |
| Numerator for earnings per share: basic and diluted  | \$ 24,276  | \$ 22,817   |
| <b>Denominator:</b>  |  |             |
| Denominator for basic earnings per share: weighted-average common shares outstanding                                   | 53,053   | 46,209      |
| Effect of dilutive securities:   |  |             |
| Stock options  | 91   | 460         |
| Denominator for diluted earnings per share: adjusted weighted average common shares outstanding and assumed conversion | 53,144   | 46,669      |
| <b>Earnings per share:</b>   |  |             |
| Basic  | \$ 0.46  | \$ 0.49     |
| Diluted  | \$ 0.46  | \$ 0.49     |
| <b>(Calculation 1)</b>   |  |             |
| Basic weighted-average common shares outstanding (A)   | 53,053   | 46,209      |
| Basic weighted-average common shares outstanding and unvested restricted shares expected to vest (B)                   | 53,832   | 46,620      |
| Percent allocated to common shareholders (A) / (B)   | 99%  | 99%         |

Options to purchase 812,919 shares of the Company's common stock at prices ranging from \$10.59 to \$24.46 per share were outstanding during the three months ended September 30, 2016, but were not included in the computation of diluted earnings per share because the options' exercise price were greater than the average market price of the

Company's common stock. The options, which expire at various dates through August 27, 2024, were still outstanding as of September 30, 2016.

**14. Supplemental cash flow information**

The following table presents supplemental cash flow disclosures for the three months ended September 30, 2016 and 2015:

|                             | <b>Three months ended</b> |       |             |       |
|-----------------------------|---------------------------|-------|-------------|-------|
|                             | <b>September 30,</b>      |       |             |       |
|                             | <b>2016</b>               |       | <b>2015</b> |       |
| Cash received from interest | \$                        | 4,285 | \$          | 4,265 |
| Cash paid for interest      | \$                        | 1,076 | \$          | 939   |
| Cash paid for income taxes  | \$                        | 1,503 | \$          | 4,066 |

**14. Supplemental cash flow information (continued)**

Treasury shares, at cost included in the Company's condensed consolidated balance sheet as of June 30, 2016, includes 47,056 shares of the Company's common stock acquired for approximately \$0.5 million which were paid for on July 1, 2016. The liability for this payment was included in accounts payable on the Company's condensed consolidated balance sheet as of June 30, 2016. The payment of approximately \$0.5 million is included in acquisition of treasury stock in the Company's condensed consolidated statement of cash flows for the three months ended September 30, 2016.

**15. Operating segments**

The Company discloses segment information as reflected in the management information systems reports that its chief operating decision maker uses in making decisions and to report certain entity-wide disclosures about products and services, major customers, and the countries in which the entity holds material assets or reports material revenues. A description of the Company's operating segments is contained in Note 23 to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended June 30, 2016.

The reconciliation of the reportable segments revenue to revenue from external customers for the three months ended September 30, 2016 and 2015, respectively, is as follows:

|  | <b>Revenue</b>                |                           |  |
|--|-------------------------------|---------------------------|--|
|  | <b>Reportable<br/>Segment</b> | <b>Inter-<br/>segment</b> | <b>From<br/>external<br/>customers</b> |
| South African transaction processing                   | \$ 57,568                     | \$ 5,401                  | \$ 52,167                              |
| International transaction processing                   | 46,190                        | -                         | 46,190                                 |
| Financial inclusion and applied technologies           | 63,542                        | 6,266                     | 57,276                                 |
| Total for the three months ended September 30,<br>2016 | \$ 167,300                    | \$ 11,667                 | \$ 155,633                             |
| South African transaction processing                   | \$ 55,639                     | \$ 3,627                  | \$ 52,012                              |
| International transaction processing                   | 41,229                        | -                         | 41,229                                 |
| Financial inclusion and applied technologies           | 67,360                        | 6,128                     | 61,232                                 |
| Total for the three months ended September 30,<br>2015 | \$ 164,228                    | \$ 9,755                  | \$ 154,473                             |

The Company does not allocate interest income, interest expense or income tax expense to its reportable segments. The Company evaluates segment performance based on segment operating income before acquisition-related intangible asset amortization which represents operating income before acquisition-related intangible asset amortization and allocation of expenses allocated to Corporate/Eliminations, all under GAAP. The reconciliation of the reportable segments measure of profit or loss to income before income taxes for the three months ended September 30, 2016 and 2015, respectively, is as follows:

|   | <b>Three months ended<br/>September 30,</b> |             |
|---|---|-------------|
|   | <b>2016</b>                                 | <b>2015</b> |
| Reportable segments measure of profit or loss | \$ 34,548                                   | \$ 36,608   |
| Operating income: Corporate/Eliminations      | (2,367)                                     | (5,393)     |
| Interest income                               | 4,304                                       | 4,275       |
| Interest expense                              | (796)                                       | (974)       |
| Income before income taxes                    | \$ 35,689                                   | \$ 34,516   |



**15. Operating segments (continued)**

The following tables summarize segment information which is prepared in accordance with GAAP for the three months ended September 30, 2016 and 2015:

|  | <b>Three months ended<br/>September,</b> |             |
|--|--|-------------|
|  | <b>2016</b>                              | <b>2015</b> |
| <b>Revenues</b>                              |  |             |
| South African transaction processing         | \$ 57,568                                | \$ 55,639   |
| International transaction processing         | 46,190                                   | 41,229      |
| Financial inclusion and applied technologies | 63,542                                   | 67,360      |
| Total  | 167,300                                  | 164,228     |
| <b>Operating income (loss)</b>               |  |             |
| South African transaction processing         | 13,548                                   | 13,511      |
| International transaction processing         | 5,817                                    | 6,543       |
| Financial inclusion and applied technologies | 15,183                                   | 16,554      |
| Subtotal: Operating segments                 | 34,548                                   | 36,608      |
| Corporate/Eliminations                       | (2,367)                                  | (5,393)     |
| Total  | 32,181                                   | 31,215      |
| <b>Depreciation and amortization</b>         |  |             |
| South African transaction processing         | 1,157                                    | 1,795       |
| International transaction processing         | 5,836                                    | 4,696       |
| Financial inclusion and applied technologies | 337                                      | 240         |
| Subtotal: Operating segments                 | 7,330                                    | 6,731       |
| Corporate/Eliminations                       | 2,874                                    | 3,384       |
| Total  | 10,204                                   | 10,115      |
| <b>Expenditures for long-lived assets</b>    |  |             |
| South African transaction processing         | 407                                      | 1,447       |
| International transaction processing         | 2,799                                    | 8,038       |
| Financial inclusion and applied technologies | 217                                      | 1,213       |
| Subtotal: Operating segments                 | 3,423                                    | 10,698      |
| Corporate/Eliminations                       | -  | -           |
| Total  | \$ 3,423                                 | \$ 10,698   |

The segment information as reviewed by the chief operating decision maker does not include a measure of segment assets per segment as all of the significant assets are used in the operations of all, rather than any one, of the segments. The Company does not have dedicated assets assigned to a particular operating segment. Accordingly, it is not meaningful to attempt an arbitrary allocation and segment asset allocation is therefore not presented.

It is impractical to disclose revenues from external customers for each product and service or each group of similar products and services.

**16. Income tax****Income tax in interim periods**

For the purposes of interim financial reporting, the Company determines the appropriate income tax provision by first applying the effective tax rate expected to be applicable for the full fiscal year to ordinary income. This amount is then adjusted for the tax effect of significant unusual or extraordinary items, for instance, changes in tax law, valuation allowances and non-deductible transaction-related expenses that are reported separately, and have an impact on the tax charge. The cumulative effect of any change in the enacted tax rate, if and when applicable, on the opening balance of deferred tax assets and liabilities is also included in the tax charge as a discrete event in the interim period in which



the enactment date occurs.

For the three months ended September 30, 2016, the tax charge was calculated using the expected effective tax rate for the year. The Company's effective tax rate for the three months ended September 30, 2016, was 31.1% and was higher than the South African statutory rate as a result of additional taxes payable resulting from the finalization of a tax review in South Korea, non-deductible expenses and the tax impact attributable to distributions from our South African subsidiary.

## **16. Income tax (continued)**

### **Income tax in interim periods (continued)**

For the three months ended September 30, 2015, the tax charge was calculated using the expected effective tax rate for the year. The Company's effective tax rate for the three months ended September 30, 2015, was 31.6% and was higher than the South African statutory rate as a result of a valuation allowance for foreign tax credits and non-deductible expenses (including consulting and legal fees).

### **Uncertain tax positions**

The Company utilized approximately \$0.3 million of its unrecognized tax benefits during the three months ended September 30, 2016 as a result of the finalization of a tax review in South Korea. As of September 30, 2016, the Company had accrued interest related to uncertain tax positions of approximately \$0.1 million on its balance sheet.

The Company does not expect changes related to its unrecognized tax benefits will have a significant impact on its results of operations or financial position in the next 12 months.

As of September 30, 2016 and June 30, 2016, the Company has unrecognized tax benefits of \$1.7 million and \$1.9 million, respectively, all of which would impact the Company's effective tax rate. The Company files income tax returns mainly in South Africa, South Korea, India, the United Kingdom, Botswana and in the U.S. federal jurisdiction. As of September 30, 2016, the Company's South African subsidiaries are no longer subject to income tax examination by the South African Revenue Service for periods before June 30, 2012. The Company is subject to income tax in other jurisdictions outside South Africa, none of which are individually material to its financial position, results of operations or cash flows.

## **17. Commitments and contingencies**

### **Guarantees**

The South African Revenue Service and certain of the Company's customers, suppliers and other business partners have asked the Company to provide them with guarantees, including standby letters of credit, issued by a South African bank. The Company is required to procure these guarantees for these third parties to operate its business.

Nedbank has issued guarantees to these third parties amounting to ZAR 127.4 million (\$9.2 million, translated at exchange rates applicable as of September 30, 2016) and thereby utilizing part of the Company's short-term facility. The Company in turn has provided nonrecourse, unsecured counter-guarantees to Nedbank for ZAR 127.4 million (\$9.2 million, translated at exchange rates applicable as of September 30, 2016). The Company pays commission of between 0.4% per annum to 2.0% per annum of the face value of these guarantees and does not recover any of the commission from third parties.

The Company has not recognized any obligation related to these counter-guarantees in its consolidated balance sheet as of September 30, 2016 and June 30, 2016. The maximum potential amount that the Company could pay under these guarantees is ZAR 127.4 million (\$9.2 million, translated at exchange rates applicable as of September 30, 2016). The guarantees have reduced the amount available for borrowings under the Company's short-term credit facility described in Note 8.

### **Contingencies**

The Company is subject to a variety of insignificant claims and suits that arise from time to time in the ordinary course of business.

Management currently believes that the resolution of these matters, individually or in the aggregate, will not have a material adverse impact on the Company's financial position, results of operations or cash flows.

**18. Subsequent events**

**Sale of common stock**

On October 6, 2016, the Company entered into stock purchase agreements with two investors under which the Company agreed to sell each of the investors 2.5 million shares of the its common stock at a price of \$9.00 per share, for aggregate gross proceeds to the Company of \$45.0 million. Closing of the transactions is scheduled to occur on or about November 9, 2016.

## 18. Subsequent events (continued)

### Strategic investments

#### *Blue Label Telecoms*

On October 4, 2016, the Company entered into a Share Subscription Agreement (the Blue Label Subscription Agreement) with Blue Label Telecoms Limited (Blue Label), a JSE-listed company which is a leading provider of prepaid electricity and airtime in South Africa. Pursuant to the Blue Label Subscription Agreement, the Company will purchase approximately 117.9 million ordinary shares of Blue Label at a price of ZAR 16.96 per share, for an aggregate purchase price of ZAR 2.0 billion (\$144.3 million, translated at exchange rates applicable as of September 30, 2016) in cash. The Company expects that the proceeds from its investment in Blue Label will be used to partially fund Blue Label's acquisition of a 45% shareholding in Cell C (Proprietary) Limited, a leading mobile provider in South Africa. Closing of the Company's investment in Blue Label is subject to closing conditions and is expected to occur simultaneously with the closing of Blue Label's Cell C investment.

The Company expects to fund the transaction through a combination of cash on hand, a portion of a ZAR 1.4 billion loan facility to be provided to Net1 Applied Technologies South Africa (Pty) Ltd (Net1 SA) from FirstRand Bank Limited (acting through its Rand Merchant Bank division) (RMB) as described below and the sale of common stock referred to above.

#### *Finbond*

On October 7, 2016, the Company provided a loan of ZAR 139.2 million to Finbond in order for Finbond to partially finance its expansion strategy in the United States. Finbond expects to conclude a rights offering during the first quarter of calendar 2017 and the Company has provided an irrevocable undertaking to participate in the rights offering and convert the ZAR 139.2 million loan to Finbond shares as part of this process.

#### **RMB Loan Facilities**

On October 20, 2016, Net1 SA entered into a Common Terms Agreement, a Senior Facility A Agreement, Senior Facility B Agreement, Senior Facility C Agreement, Subordination Agreement, Security Cession & Pledge and certain ancillary loan documents (collectively, the Loan Documents) with RMB, pursuant to which, among other things, Net1 SA may borrow up to an aggregate of ZAR 1.4 billion (\$101.0 million, translated at exchange rates applicable as of September 30, 2016) to finance a portion of its working capital requirements and a portion of its investment in Blue Label. The amounts available under these loans and an escrow deposit of ZAR 600 million (\$43.3 million, translated at exchange rates applicable as of September 30, 2016) made by Net1 SA serve as security for a guarantee issued by RMB in favor of Blue Label (the Guarantee). Net1 and certain of the Company's other subsidiaries have agreed to guarantee the obligations of Net1 SA to RMB and subordinate any claims they may have against Net1 SA and certain of its subsidiaries to RMB's claims against such persons. The Loan Documents provide for a Facility A term loan of up to ZAR 500 million (\$36.1 million), a Facility B term loan of up to ZAR 900 million (\$64.9 million), amounts translated at exchange rates applicable as of September 30, 2016, and a Facility C term loan in an amount equal to the aggregate amount of voluntary prepayments of the outstanding principal amount of the Facility A loan.

Interest on the loans is payable monthly based on the Johannesburg Interbank Agreed Rate (JIBAR) in effect from time to time plus a margin of 1.35% for the Facility A and Facility C loans and 2.75% for the Facility B loan. The JIBAR rate was 7.1% on October 20, 2016.

Principal repayments on the Facility A and Facility B loans are due in eight equal quarterly installments, beginning on January 31, 2017, and all of the loans mature on October 20, 2018. Principal repayment on the Facility C loan is due in quarterly installments to be determined by RMB subject to the date of borrowing thereunder. Voluntary

prepayments are permitted without early repayment fees or penalties.

The loans are secured by a pledge by Net1 SA of its entire equity interest in Blue Label. The Loan Documents contain customary covenants that require Net1 SA to maintain a specified total net leverage ratio and restrict the ability of Net1 SA, and certain of its subsidiaries to make certain distributions with respect to their capital stock, prepay other debt, encumber their assets, incur additional indebtedness, make investment above specified levels, engage in certain business combinations and engage in other corporate activities.

**18. Subsequent events (continued)**

**Acquisitions**

***C4U Malta***

In November 2016, the Company acquired a 100% interest in C4U Malta ( C4U ), a licensed Maltese Financial Services Authority-supervised electronic money institution, for approximately \$3.9 million. C4U 's license has been passported across all member states of the European Union. The Company intends to apply for a principal membership with the major card associations as soon as possible and to integrate a robust and reliable issuing and acquiring processing platform in C4U to enable the issuance of electronic money instruments, such as electronic money accounts, prepaid cards and virtual cards, after a transitional period of integration and technology adaption. The Company plans to build and reinforce C4U such that it operates as its principal regulated electronic money institution with the ability to cover all of the Company 's financial services activities and business in the European Union.

The purchase price allocation has not been finalized, as management has not yet analyzed in detail the assets acquired and liabilities assumed. The Company expects to finalize the purchase price allocation on or before June 30, 2017.

***Pros Software (Pty) Ltd***

In October 2016, the Company acquired a 100% interest in Pros Software (Pty) Ltd ( Pros Software ), a software development and consulting services based near Johannesburg, South Africa, for ZAR 25.0 million (\$1.8 million, translated at exchange rates applicable as of September 30, 2016). Pros Software performs software development and consulting services for a number of clients, including for the Company.

The purchase price allocation has not been finalized, as management has not yet analyzed in detail the assets acquired and liabilities assumed. The Company expects to finalize the purchase price allocation on or before June 30, 2017.

Pro forma results of operations have not been presented because the effect of the C4U and Pros Software acquisitions, individually and in the aggregate, were not material to the Company. During the three months ended September 30, 2016, the Company incurred acquisition-related expenditure of \$0.1 million related to these acquisitions.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended June 30, 2016, and the unaudited condensed consolidated financial statements and the accompanying notes included in this Form 10-Q.

### **Forward-looking statements**

Some of the statements in this Form 10-Q constitute forward-looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed, implied or inferred by these forward-looking statements. Such factors include, among other things, those listed under Item 1A. Risk Factors and elsewhere in our Annual Report on Form 10-K for the year ended June 30, 2016 and in this Quarterly Report on Form 10-Q. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, would, expects, plans, intends, anticipates, believes, estimates, predicts, potential or con such terms and other comparable terminology.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we do not know whether we can achieve positive future results, levels of activity, performance, or goals. Actual events or results may differ materially. We undertake no obligation to update any of the forward-looking statements after the date of this Form 10-Q to conform those statements to reflect the occurrence of unanticipated events, except as required by applicable law.

You should read this Form 10-Q and the documents that we reference herein and the documents we have filed as exhibits hereto and thereto and which we have filed with the Securities and Exchange Commission completely and with the understanding that our actual future results, levels of activity, performance and achievements may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

### **Recent Developments**

#### ***Progress of financial inclusion initiatives in South Africa***

At October 26, 2016, we had more than 1.6 million active EPE accounts, compared to 1.4 million at August 18, 2016. EPE is a fully transactional account created to serve the needs of South Africa's unbanked and under-banked population, and is available to all consumers regardless of their financial or social status or whether they are SASSA recipients. The EPE account offers customers a comprehensive suite of financial and various financial inclusion services, such as prepaid products, in an economical, convenient and secure solution. EPE provides account holders with a UEPS-EMV debit MasterCard, mobile and internet banking services, ATM and POS services, as well as loans, insurance and other financial products and value-added services. However, SASSA is challenging the ability of beneficiaries to freely transact with the grants that they receive. See Part II, Item 1. Legal Proceedings Litigation Regarding Legality of Debit Orders under Social Assistance Act Regulations for additional details.

In order for us to address the sizeable opportunity for EPE and related financial inclusion services in South Africa, we have had to expand our brick-and-mortar financial services branch infrastructure and supplement our nationwide distribution with a UEPS/EMV-enabled ATM network, as well as a dedicated sales force. At September 30, 2016, we had 142 branches, 909 ATMs, and 2,096 dedicated employees.

In September 2015, we resumed marketing and business development activities in selected areas for the distribution of our simple, low-cost life insurance products and have sold approximately 215,500 new policies through October 30,

2016, in addition to the basic life insurance policy provided with every EPE account opened. We continue to recruit additional and often-times specialized staff to expand our insurance activities during fiscal 2017.

We experienced higher year-over-year growth in the demand for our loans. Tougher economic conditions in South Africa, aggravated by rising food prices as a result of widespread drought conditions and a weakening currency, has had an impact on the number of clients who qualify for our loan products.



The graph below presents the growth of the number of EPE cards and Smart Life policies:

### ***Strategic investment***

We have signed a subscription agreement with One MobiKwik Systems Private Limited, or MobiKwik, in India. MobiKwik is India's largest independent mobile payments network, with over 35 million users and 100,000 retailers. MobiKwik's current shareholders include Sequoia Capital, Tree Line Asia, American Express, Cisco Investments, GMO Payment Gateway and MediaTek, as well as Bipin Preet Singh and Upasana Taku, the founders and executive officers. Pursuant to the subscription agreement, we have agreed to make an equity investment of up to \$40.0 million in MobiKwik over the next 24 months. We made an agreed initial \$15.0 million investment under this subscription agreement in August 2016. In addition, through a technology agreement, our Virtual Card technology will be integrated across all MobiKwik wallets in order to provide ubiquity across all merchants in India.

### ***Acquisition of a strategic stake in Blue Label Telecoms***

On October 5, 2016 we entered into a share subscription agreement with Blue Label Telecoms Limited, or Blue Label, to subscribe for approximately 117.9 million shares in Blue Label, at a subscription price of ZAR 16.96 per share, representing a 10% discount to ZAR 18.84, being the 30-day volume weighted average price of a Blue Label share traded on the Johannesburg Stock Exchange to September 29, 2016. The aggregate subscription consideration payable is ZAR 2.0 billion (\$144.3 million, translated at exchange rates applicable as of September 30, 2016). Following implementation of the subscription, we will own approximately 15% of the issued ordinary shares in Blue Label. We will settle the subscription consideration through a combination of cash resources, debt instruments and an equity issuance of five million shares of common stock, at an issue price of \$9.00 per share. Following implementation of the subscription, which is subject to the approval of Blue Label shareholders, we will be entitled to nominate a director to Blue Label's board.

Blue Label, which operates in South Africa, Mexico and India, is listed in the Telcoms – Mobile Telcoms sector of the Main Board of the JSE, and is a market leading virtual and physical distributor of secure electronic tokens of value as

well as a provider of transactional and value added services. Blue Label is in the process of acquiring a 45% interest in Cell C, one of South Africa's three major licensed mobile network operators. For the fiscal year ended May 31, 2016, Blue Label reported revenue of ZAR 26.2 billion (\$1.9 billion), EBITDA of ZAR 1.24 billion (\$90.0 million) and earnings per share of ZAR 1.04 (\$0.08), all amounts translated at exchange rates applicable as of September 30, 2016.

We expect that this strategic investment will assist us, Blue Label and Cell C to accelerate the growth of our combined customer bases, and facilitate cross selling opportunities between ourselves. The combination of our and Blue Label's infrastructures is expected to envelop all areas of South Africa through our combined physical and mobile branches, associations with merchant stores and virtual distribution services via USSD, voice, internet and social media linked with traditional payment systems including EFTs, debit and credit cards and our Virtual Card solution.

In India, we are a shareholder in MobiKwik and Blue Label is a shareholder in Oxigen, and we believe that there are compelling opportunities for us to extend our collaboration through the provision of innovative payment solutions, enabling universal acceptance and value to customers of two of India's leading digital wallet providers who also have highly developed online and offline infrastructure and capabilities. Our alliance with Blue Label is expected to further enhance the marketing of our international remittances, virtual cards and merchant financing strategies. In addition, the POS infrastructure that Blue Label has deployed in Mexico opens up new and real potential to participate in, acquiring, bill payments and remittances when combined with our technology and relationships in North America.

#### ***User access security enhancements to prepaid products***

User security remains of paramount importance to us and, as we continue to evaluate and introduce non-PIN based security enhancements to our product offerings, this can, in certain cases, result in an initial drop off while the technology is rolled out, understood and adopted. We introduced our new biometric-linking feature during the first quarter of fiscal 2017, which has reduced the number of transacting users as the adoption rate scales. This in turn therefore impacted volume in prepaid sales vouchers on Umoja Manje during the quarter.

We believe that the adverse impact of the new security on sales volumes will rectify itself over time as we further entrench ourselves as the most secure, convenient and cost effective service provider in the market. Our biometric security enhancements provide the leadership in solving an industry-wide endemic of unauthorized transactions by providing non-repudiable transaction authorizations. Our mobile vending channel now incorporates biometry - which makes it the first of its kind, and will facilitate the launch of further digital services that incorporate dual authorization-and-identification factors.

#### **Critical Accounting Policies**

Our unaudited condensed consolidated financial statements have been prepared in accordance with U.S. GAAP, which requires management to make estimates and assumptions about future events that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities. As future events and their effects cannot be determined with absolute certainty, the determination of estimates requires management's judgment based on a variety of assumptions and other determinants such as historical experience, current and expected market conditions and certain scientific evaluation techniques.

Critical accounting policies are those that reflect significant judgments or uncertainties, and potentially may result in materially different results under different assumptions and conditions. Management has identified the following critical accounting policies that are described in more detail in our Annual Report on Form 10-K for the year ended June 30, 2016:

- Business combinations and the recoverability of goodwill;
- Intangible assets acquired through acquisitions;
- Deferred taxation;
- Stock-based compensation and equity instrument issued pursuant to BEE transaction;
- Accounts receivable and allowance for doubtful accounts receivable; and
- Research and development.

#### **Recent accounting pronouncements adopted**

Refer to Note 1 to our unaudited condensed consolidated financial statements for a full description of recent accounting pronouncements adopted, including the dates of adoption and the effects on our condensed consolidated financial statements.

#### **Recent accounting pronouncements not yet adopted as of September 30, 2016**

Refer to Note 1 to our unaudited condensed consolidated financial statements for a full description of recent accounting pronouncements not yet adopted as of September 30, 2016, including the expected dates of adoption and effects on our financial condition, results of operations and cash flows.

**Currency Exchange Rate Information****Actual exchange rates**

The actual exchange rates for and at the end of the periods presented were as follows:

| <b>Table 1</b>                      | <b>Three months ended</b> |             | <b>Year ended</b> |
|-------------------------------------|---------------------------|-------------|-------------------|
|                                     | <b>September 30,</b>      |             | <b>June 30,</b>   |
|                                     | <b>2016</b>               | <b>2015</b> | <b>2016</b>       |
| ZAR : \$ average exchange rate      | 14.0890                   | 12.9702     | 14.5062           |
| Highest ZAR : \$ rate during period | 14.8114                   | 14.0282     | 16.8231           |
| Lowest ZAR : \$ rate during period  | 13.3000                   | 12.1965     | 12.1965           |
| Rate at end of period               | 13.8630                   | 14.0282     | 14.7838           |
| KRW : \$ average exchange rate      | 1,121                     | 1,169       | 1,173             |
| Highest KRW : \$ rate during period | 1,163                     | 1,203       | 1,245             |
| Lowest KRW : \$ rate during period  | 1,092                     | 1,118       | 1,122             |
| Rate at end of period               | 1,102                     | 1,196       | 1,153             |

**ZAR: US \$ Exchange Rates**

**KRW: US \$ Exchange Rates****Translation exchange rates for financial reporting purposes**

We are required to translate our results of operations from ZAR and KRW to U.S. dollars on a monthly basis. Thus, the average rates used to translate this data for the three months ended September 30, 2016 and 2015, vary slightly from the averages shown in the table above. The translation rates we use in presenting our results of operations are the rates shown in the following table:

| <b>Table 2</b>                        | <b>Three months ended</b> |             | <b>Year ended</b> |
|---------------------------------------|---------------------------|-------------|-------------------|
|                                       | <b>September 30</b>       |             | <b>June 30,</b>   |
|                                       | <b>2016</b>               | <b>2015</b> | <b>2016</b>       |
| Income and expense items: \$1 = ZAR . | 14.1048                   | 12.9583     | 14.3842           |
| Income and expense items: \$1 = KRW   | 1,127                     | 1,167       | 1,172             |
| Balance sheet items: \$1 = ZAR        | 13.8630                   | 14.0282     | 14.7838           |
| Balance sheet items: \$1 = KRW        | 1,102                     | 1,196       | 1,153             |

**Results of operations**

The discussion of our consolidated overall results of operations is based on amounts as reflected in our unaudited condensed consolidated financial statements which are prepared in accordance with U.S. GAAP. We analyze our results of operations both in U.S. dollars, as presented in the consolidated financial statements, and supplementally in ZAR, because ZAR is the functional currency of the entities which contribute the majority of our profits and is the currency in which the majority of our transactions are initially incurred and measured. Due to the significant impact of currency fluctuations between the U.S. dollar and ZAR on our reported results and because we use the U.S. dollar as our reporting currency, we believe that the supplemental presentation of our results of operations in ZAR is useful to investors to understand the changes in the underlying trends of our business.

The first quarter of fiscal 2017 includes the results of Masterpayment and T24 for the entire quarter. The first quarter of fiscal 2016 does not include Masterpayment or T24.

Our operating segment revenue presented in Results of operations by operating segment represents total revenue per operating segment before inter-segment eliminations. Reconciliation between total operating segment revenue and revenue presented in our unaudited condensed consolidated financial statements is included in Note 15 to those statements.

We analyze our business and operations in terms of three inter-related but independent operating segments: (1) South African transaction processing, (2) International transaction processing and (3) Financial inclusion and applied technologies. In addition, corporate and corporate office activities that are impracticable to ascribe directly to any of the other operating segments, as well as any inter-segment eliminations, are included in corporate/eliminations.

### **First quarter of fiscal 2017 compared to first quarter of fiscal 2016**

The following factors had a significant influence on our results of operations during the first quarter of fiscal 2017 as compared with the same period in the prior year:

***Unfavorable impact from the strengthening of the U.S. dollar against ZAR:*** The U.S. dollar appreciated by 9% against the ZAR during the first quarter of fiscal 2017, which negatively impacted our reported results;

***Growth in lending and insurance businesses:*** We continued to experience volume growth and operating efficiencies in our lending and insurance businesses during the first quarter of fiscal 2017, which has resulted in an improved contribution to our financial inclusion revenue and operating income;

***Impact of changes in specific regulations in South Korea governing fees charged on card transactions:*** Recently introduced regulations governing the fees that may be charged on card transactions have adversely impacted our revenues and operating income in South Korea;

***Reversal of stock-based compensation charge of \$1.8 million:*** We have determined that awards of restricted stock subject to performance conditions granted in fiscal 2016 are not likely to vest due to an increase in the weighted average number of shares outstanding resulting from the issuance of approximately 10 million shares of our common stock to the IFC Investors;

***Lower prepaid sales resulting from improved security features to our Manje products:*** The introduction of our new biometric-linking feature was implemented this quarter and adversely impacted the number of transacting users purchasing prepaid products through our mobile channel; and

***Ongoing contributions from EPE offering:*** Our EPE offering contributed to an increase in revenue and operating income as we further expanded our customer base utilizing our ATM infrastructure.



**Consolidated overall results of operations**

This discussion is based on the amounts which were prepared in accordance with U.S. GAAP.

The following tables show the changes in the items comprising our statements of operations, both in U.S. dollars and in ZAR:

|  | <b>In U.S. Dollars</b>                  |               |               |
|--|---|---------------|---------------|
|  | <b>(U.S. GAAP)</b>                      |               |               |
|  | <b>Three months ended September 30,</b> |               |               |
|  | <b>2016</b>                             | <b>2015</b>   | <b>\$ %</b>   |
|  | <b>\$ 000</b>                           | <b>\$ 000</b> | <b>change</b> |
| Revenue  | 155,633                                 | 154,473       | 1%            |
| Cost of goods sold, IT processing, servicing and support     | 74,780                                  | 77,382        | (3%)          |
| Selling, general and administration                          | 38,468                                  | 35,761        | 8%            |
| Depreciation and amortization                                | 10,204                                  | 10,115        | 1%            |
| Operating income   | 32,181                                  | 31,215        | 3%            |
| Interest income  | 4,304                                   | 4,275         | 1%            |
| Interest expense   | 796                                     | 974           | (18%)         |
| Income before income tax expense                             | 35,689                                  | 34,516        | 3%            |
| Income tax expense   | 11,103                                  | 10,897        | 2%            |
| Net income before earnings from equity-accounted investments | 24,586                                  | 23,619        | 4%            |
| Earnings from equity-accounted investments                   | 659                                     | 188           | 251%          |
| Net income   | 25,245                                  | 23,807        | 6%            |
| Less net income attributable to non-controlling interest     | 613                                     | 787           | (22%)         |
| Net income attributable to us                                | 24,632                                  | 23,020        | 7%            |

|  | <b>In South African Rand</b>            |             |               |
|--|---|-------------|---------------|
|  | <b>(U.S. GAAP)</b>                      |             |               |
|  | <b>Three months ended September 30,</b> |             |               |
|  | <b>2016</b>                             | <b>2015</b> | <b>ZAR %</b>  |
|  | <b>ZAR</b>                              | <b>ZAR</b>  | <b>change</b> |
|  | <b>000</b>                              | <b>000</b>  | <b>change</b> |
| Revenue  | 2,195,171                               | 2,001,708   | 10%           |
| Cost of goods sold, IT processing, servicing and support     | 1,054,755                               | 1,002,739   | 5%            |
| Selling, general and administration                          | 542,583                                 | 463,402     | 17%           |
| Depreciation and amortization                                | 143,926                                 | 131,073     | 10%           |
| Operating income   | 453,907                                 | 404,494     | 12%           |
| Interest income  | 60,707                                  | 55,397      | 10%           |
| Interest expense   | 11,227                                  | 12,621      | (11%)         |
| Income before income tax expense                             | 503,387                                 | 447,270     | 13%           |
| Income tax expense   | 156,606                                 | 141,207     | 11%           |
| Net income before earnings from equity-accounted investments | 346,781                                 | 306,063     | 13%           |
| Earnings from equity-accounted investments                   | 9,295                                   | 2,436       | 282%          |
| Net income   | 356,076                                 | 308,499     | 15%           |
| Less net income attributable to non-controlling interest     | 8,646                                   | 10,198      | (15%)         |
| Net income attributable to us                                | 347,430                                 | 298,301     | 16%           |

In ZAR, the increase in revenue was primarily due to more fees generated from our EPE and ATM offerings, improved lending and insurance activities, higher ad hoc terminal sales, the inclusion of T24 and Masterpayment s businesses, more low-margin transaction fees generated from cardholders using the South African National Payment System, and an increase in the number of SASSA UEPS/EMV beneficiaries paid, which was partially offset by lower prepaid airtime sales and a lower contribution from KSNET due to regulatory changes in South Korea.

In ZAR, the increase in cost of goods sold, IT processing, servicing and support was primarily due to higher expenses incurred from increased usage of the South African National Payment System by beneficiaries, expenses incurred to operate our EPE and ATM offerings and expanding our branch network, and the inclusion of T24 and Masterpayment s businesses, which was partially offset by fewer prepaid airtime sales.

In ZAR, our selling, general and administration expense increased primarily due to a higher staff complement resulting from our EPE roll-out in fiscal 2016, the impact of October 2015 annual salary increases for our South African and UK-based employees, as well as increases in goods and services purchased from third parties, which was partially offset by the reversal of stock-based compensation charges related to awards of restricted stock with performance conditions which we believe will not be achieved.

Our operating income margin for first quarter of fiscal 2017 and 2016 was 21% and 20% respectively. We discuss the components of operating income margin under Results of operations by operating segment. The increase was primarily attributable the reversal of stock-based compensation charges, which was partially offset by the higher cost of goods sold, IT processing, servicing and support referred to above and an increase in depreciation expense.

Depreciation and amortization increased primarily due to an increase in depreciation related to more ATMs in South Africa and terminals used to provide transaction processing in Korea as well as an increase in acquisition-related intangible asset amortization resulting from the T24 and Masterpayment transactions. These increases were partially offset by lower overall amortization of intangible assets that are fully amortized and tangible assets that are fully depreciated.

In ZAR, interest on surplus cash increased to \$4.3 million (ZAR 60.7 million) from \$4.3 million (ZAR 55.4 million), due primarily to higher average daily ZAR cash balances and ZAR interest rates, partially offset by the lower interest earned on the U.S. dollar cash reserves that we converted from ZAR through distributions from our South African subsidiary.

Interest expense decreased to \$0.8 million (ZAR 11.2 million) from \$1.0 million (ZAR 12.6 million) due to a lower average long-term debt balance on our South Korean debt and a lower interest rate.

Fiscal 2017 tax expense was \$11.1 million (ZAR 156.6 million) compared to \$10.9 million (ZAR 141.2 million) in fiscal 2016. Our effective tax rate for fiscal 2017, was 31.1% and was higher than the South African statutory rate as a result of non-deductible expenses and the tax impact attributable to distributions from our South African subsidiary. Our effective tax rate for fiscal 2016, was 31.6% and was higher than the South African statutory rate as a result of a valuation allowance for foreign tax credits and non-deductible expenses (including consulting and legal fees).

Earnings from equity-accounted investments for the first quarter of fiscal 2017, has increased primarily due to the inclusion of our portion of Finbond's net income. Finbond is listed on the Johannesburg Stock Exchange and reports its six month results during our first quarter and its annual results during our fourth quarter. We have included our portion of its interim net income in our first quarter 2017 results and expect to record the last six months of its fiscal year ended February 2017 net income in our third quarter of fiscal 2017 results.

### Results of operations by operating segment

The composition of revenue and the contributions of our business activities to operating income are illustrated below:

| <b>Operating Segment</b>             | <b><i>In U.S. Dollars (U.S. GAAP)</i></b> |              |               |              |               |
|--------------------------------------|---|--------------|---------------|--------------|---------------|
|                                      | <b>Three months ended September 30,</b>   |              |               |              |               |
|                                      | <b>2016</b>                               | <b>% of</b>  | <b>2015</b>   | <b>% of</b>  | <b>%</b>      |
|                                      | <b>\$ 000</b>                             | <b>total</b> | <b>\$ 000</b> | <b>total</b> | <b>change</b> |
| Revenue:                             |   |              |               |              |               |
| South African transaction processing | 57,568                                    | 37%          | 55,639        | 36%          | 3%            |
| International transaction processing | 46,190                                    | 30%          | 41,229        | 27%          | 12%           |
|                                      | 63,542                                    | 41%          | 67,360        | 44%          | (6%)          |

## Financial inclusion and applied technologies

|  |          |      |         |       |       |
|--|----------|------|---------|-------|-------|
| Subtotal: Operating segments                 | 167,300  | 108% | 164,228 | 107%  | 2%    |
| Intersegment eliminations                    | (11,667) | (8%) | (9,755) | (7%)  | 20%   |
| <b>Consolidated revenue</b>                  | 155,633  | 100% | 154,473 | 100%  | 1%    |
| Operating income (loss):                     |          |      |         |       |       |
| South African transaction processing         | 13,548   | 42%  | 13,511  | 43%   | -     |
| International transaction processing         | 5,817    | 18%  | 6,543   | 21%   | (11%) |
| Financial inclusion and applied technologies | 15,183   | 47%  | 16,554  | 53%   | (8%)  |
| Subtotal: Operating segments                 | 34,548   | 107% | 36,608  | 117%  | (6%)  |
| Corporate/Eliminations                       | (2,367)  | (7%) | (5,393) | (17%) | (56%) |
| <b>Consolidated operating income</b>         | 32,181   | 100% | 31,215  | 100%  | 3%    |

32

**Table 6**

*In South African Rand (U.S. GAAP)*  
**Three months ended September 30,**

| <b>Operating Segment</b>                     | <b>2016<br/>ZAR<br/>000</b> | <b>% of<br/>total</b> | <b>2015<br/>ZAR<br/>000</b> | <b>% of<br/>total</b> | <b>%<br/>change</b> |
|--|-----------------------------|-----------------------|-----------------------------|-----------------------|---------------------|
| <b>Revenue:</b>                              |                             |                       |                             |                       |                     |
| South African transaction processing         | 811,985                     | 37%                   | 720,987                     | 36%                   | 13%                 |
| International transaction processing         | 651,501                     | 30%                   | 534,258                     | 27%                   | 22%                 |
| Financial inclusion and applied technologies | 896,247                     | 41%                   | 872,871                     | 44%                   | 3%                  |
| Subtotal: Operating segments                 | 2,359,733                   | 108%                  | 2,128,116                   | 107%                  | 11%                 |
| Intersegment eliminations                    | (164,562)                   | (8%)                  | (126,408)                   | (7%)                  | 30%                 |
| <b>Consolidated revenue</b>                  | <b>2,195,171</b>            | <b>100%</b>           | <b>2,001,708</b>            | <b>100%</b>           | <b>10%</b>          |
| <b>Operating income (loss):</b>              |                             |                       |                             |                       |                     |
| South African transaction processing         | 191,092                     | 42%                   | 175,080                     | 43%                   | 9%                  |
| International transaction processing         | 82,048                      | 18%                   | 84,786                      | 21%                   | (3%)                |
| Financial inclusion and applied technologies | 214,153                     | 47%                   | 214,512                     | 53%                   | -                   |
| Subtotal: Operating segments                 | 487,293                     | 107%                  | 474,378                     | 117%                  | 3%                  |
| Corporate/Eliminations                       | (33,386)                    | (7%)                  | (69,884)                    | (17%)                 | (52%)               |
| <b>Consolidated operating income</b>         | <b>453,907</b>              | <b>100%</b>           | <b>404,494</b>              | <b>100%</b>           | <b>12%</b>          |
| <b>South African transaction processing</b>  |                             |                       |                             |                       |                     |

In ZAR, the increase in segment revenue and operating income was primarily due to higher EPE transaction revenue as a result of increased usage of our ATMs, more low-margin transaction fees generated from card holders using the South African National Payment System, increased inter-segment transaction processing activities, and a modest increase in the number of social welfare grants distributed.

Our operating income margin for each of the first quarter of fiscal 2017 and 2016 was 24%. Our fiscal 2017 margin includes higher EPE revenue as a result of increased ATM transactions, an increase in inter-segment transaction processing activities, an increase in the number of beneficiaries paid in the first quarter of fiscal 2017 and a modest increase in the margin of transaction fees generated from cardholders using the South African National Payment System, which was partially offset by annual salary increases granted to our South African employees.

#### **International transaction-based activities**

South Korean regulators have recently introduced specific regulations governing the fees that may be charged on card transactions, as is the case in most other developed economies. These regulations have a direct impact on card issuers in South Korea and consistent with global practices, card issuers have renegotiated their fees with South Korean VAN companies, including KSNET, which has had an adverse impact on KSNET's financial performance.

Segment revenue increased during the first quarter of fiscal 2017, primarily due to the inclusion of T24 and Masterpayment; however, this growth was partially offset by a lower contribution from KSNET due to the regulatory changes described above. Operating income during the first quarter of fiscal 2017 was lower due a decrease in revenue and an increase in depreciation expenses at KSNET and ongoing ZAZOO start-up costs in the UK and India, which was partially offset by a positive contribution by T24 and XeoHealth.

Operating income margin for the first quarter of fiscal 2017 and 2016 was 13% and 16%, respectively.

Masterpayment has commenced implementing its expansion plan and we expect to incur additional expenses in the second quarter of fiscal 2017 as it enters new markets.

### **Financial inclusion and applied technologies**

In ZAR, Financial inclusion and applied technologies revenue and operating income increased primarily due to from increased volumes and improved operating efficiencies in our lending and insurance businesses, and, in ZAR, an increase in inter-segment revenues, more ad hoc terminal and card sales, which was offset by fewer prepaid airtime and other value-added services sales. These sales were specifically impacted this quarter by the introduction of our new biometric-linking feature which adversely impacted the number of transacting users purchasing prepaid products through our mobile channel.

Operating income margin for the Financial inclusion and applied technologies segment was 24% and 25% during the first quarter of fiscal 2017 and 2016, respectively, and has decreased primarily due to the increase in branch infrastructure and staff compliment, which was partially offset by improved revenues from our lending and insurance businesses and an increase in inter-segment revenues.

## Corporate/Eliminations

Our corporate expenses generally include acquisition-related intangible asset amortization; expenditure related to compliance with the Sarbanes-Oxley Act of 2002; non-employee directors' fees; employee and executive bonuses; stock-based compensation; legal fees; audit fees; directors and officers insurance premiums; telecommunications expenses; property-related expenditures including utilities, rental, security and maintenance; and elimination entries.

Our corporate expenses have decreased primarily due to reversal of stock-based compensation charges, the impact of the stronger U.S. dollar on goods and services procured in other currencies, primarily the ZAR, and lower amortization costs, partially offset by modest increases in U.S. dollar denominated goods and services purchased from third parties and directors' fees.

## Liquidity and Capital Resources

At September 30, 2016, our cash balances were \$205.3 million, which comprised mainly ZAR-denominated balances of ZAR 1.2 billion (\$87.1 million), U.S. dollar-denominated balances of \$73.2 million, KRW-denominated balances of KRW 35.8 billion (\$32.5 million) and other currency deposits, primarily euros, of \$12.5 million. The decrease in our cash balances from June 30, 2016, was primarily due to repurchase of shares of our common stock, unscheduled repayments of our Korean debt, the investment in MobiKwik and capital expenditures, which was partially offset by the expansion of most of our core businesses, and the weakening of the U.S. dollar against our primary functional currencies.

We currently believe that our cash and credit facilities are sufficient to fund our future operations for at least the next four quarters.

We generally invest the surplus cash held by our South African operations in overnight call accounts that we maintain at South African banking institutions, and surplus cash held by our non-South African companies in the U.S. dollar denominated money market accounts. We have invested surplus cash in Korea in short-term investment accounts at Korean banking institutions.

Historically, we have financed most of our operations, research and development, working capital, capital expenditures and acquisitions through our internally generated cash. When considering whether to borrow under our financing facilities, we consider the cost of capital, cost of financing, opportunity cost of utilizing surplus cash and availability of tax efficient structures to moderate financing costs. For instance, in October 2016, we obtained loan facilities from RMB to fund a portion of our working capital requirements and a portion of the Blue Label investment. Refer to Note 18 to our unaudited condensed consolidated financial statements for the three months ended September 30, 2016 for additional information related to these loan facilities.

We have a short-term South African credit facility with Nedbank Limited of ZAR 400 million (\$28.8 million), which consists of (i) a primary amount of up to ZAR 200 million, which is immediately available, and (ii) a secondary amount of up to ZAR 200 million, which is not immediately available. The primary amounts comprise an overdraft facility of up to ZAR 50 million and indirect and derivative facilities of up to ZAR 150 million, which includes letters of guarantee, letters of credit and forward exchange contracts. As of September 30, 2016, we have used none of the overdraft and ZAR 131.1 million (\$9.5 million) of the indirect and derivative facilities to obtain foreign exchange contracts and to support guarantees issued by Nedbank to various third parties on our behalf. Refer to Note 12 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended June 30, 2016, for additional information related to our short-term facilities.

As of September 30, 2016, we had outstanding long-term debt of KRW 30.0 billion (approximately \$27.2 million translated at exchange rates applicable as of September 30, 2016) under credit facilities with a group of South Korean banks. The loans bear interest at the South Korean CD rate in effect from time to time (1.36% as of September 30,

2016) plus a margin of 3.10% for one of the term loan facilities and the revolver. Scheduled remaining repayments of the term loans and loan under the revolving credit facility are as follows: April 2017 and 2018 (KRW 10 billion each) and October 2018 (KRW 10 billion plus all outstanding loans under our revolving credit facility). Refer to Note 13 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended June 30, 2016 and Note 9 to our unaudited condensed consolidated financial statements for the three months ended September 30, 2016, for additional information related to our long-term borrowings.



**Cash flows from operating activities****First quarter**

Net cash provided by operating activities for the first quarter of fiscal 2017 was \$53.5 million (ZAR 755.2 million) compared to \$28.1 million (ZAR 364.2 million) for the first quarter of fiscal 2016. Excluding the impact of interest received, interest paid under our Korean debt and taxes presented in the table below, in ZAR, the increase in cash from operating activities resulted from improved trading activity during fiscal 2017.

During the first quarter of fiscal 2017, we made an additional tax payment of \$1.2 million (ZAR 16.7 million) related to our 2016 tax year in South Africa and received a refund of approximately \$1.2 million (ZAR 16.6 million) related to taxes overpaid in previous tax years in South Africa. We paid dividend withholding taxes of \$1.5 million (ZAR 21.3 million) during the first quarter of fiscal 2017. During the first quarter of fiscal 2016, we made an additional tax payment of \$3.4 million (ZAR 46.8 million) related to our 2015 tax year in South Africa. We paid dividend withholding taxes of \$0.8million (ZAR 10 million) during the first quarter of fiscal 2016.

Taxes paid during the first quarter of fiscal 2017 and 2016 were as follows:

**Table 7**

|                                      | <b>Three months ended September 30,</b> |              |               |               |
|--------------------------------------|---|--------------|---------------|---------------|
|                                      | <b>2016</b>                             | <b>2015</b>  | <b>2016</b>   | <b>2015</b>   |
|                                      | <b>\$</b>                               | <b>\$</b>    | <b>ZAR</b>    | <b>ZAR</b>    |
|                                      | <b>000</b>                              | <b>000</b>   | <b>000</b>    | <b>000</b>    |
| Taxation paid related to prior years | 1,186                                   | 3,436        | 16,708        | 46,840        |
| Taxation refunds received            | (1,203)                                 | (176)        | (16,563)      | (2,402)       |
| Dividend withholding taxation        | 1,471                                   | 789          | 21,300        | 10,000        |
| Total South African taxes paid       | 1,454                                   | 4,049        | 21,445        | 54,438        |
| Foreign taxes paid                   | 49                                      | 17           | 691           | 232           |
| <b>Total tax paid</b>                | <b>1,503</b>                            | <b>4,066</b> | <b>22,136</b> | <b>54,670</b> |

**Cash flows from investing activities****First quarter**

Cash used in investing activities for the first quarter of fiscal 2017 includes capital expenditure of \$3.4 million (ZAR 48.3 million), primarily for the acquisition of payment processing terminals in Korea. Our Korean capital expenditures have declined due to regulatory changes in South Korea which now prohibit the provision of payment equipment to the majority of merchants. We also paid approximately \$15.3 million for a 7.5% interest in MobiKwik.

Cash used in investing activities for the first quarter of fiscal 2016 includes capital expenditure of \$10.7 million (ZAR 138.8 million), primarily for the acquisition of payment processing terminals in Korea and the rollout of ATMs in South Africa.

**Cash flows from financing activities****First quarter**

During the first quarter of fiscal 2017, we paid approximately \$31.6 million to repurchase 3,137,609 shares of our common stock and also paid \$0.5 million, on July 1, 2016, related to settlement of amounts outstanding related to the repurchases at the end of June 2016. We also made a \$26.7 million unscheduled repayment of our Korean debt and utilized approximately \$0.5 million of our Korean facility to pay a portion of our quarterly interest due. In addition,

we paid a dividend of approximately \$0.6 million to certain of our non-controlling interests.

During the first quarter of fiscal 2016, we received approximately \$3.8 million from the exercise of stock options and utilized approximately \$0.7 million of our Korean borrowings to pay quarterly interest due.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

## Capital Expenditures

We expect capital spending for the second quarter of fiscal 2017 to primarily include the acquisition of payment terminals for the expansion of our operations in Korea and expansion of our ATM infrastructure and branch network in South Africa.

Our historical capital expenditures for the first quarter of fiscal 2017 and 2016 are discussed under **Liquidity and Capital Resources** Cash flows from investing activities. All of our capital expenditures for the past three fiscal years were funded through internally-generated funds. We had outstanding capital commitments as of September 30, 2016, of \$0.9 million related mainly to the procurement of ATMs. We expect to fund these expenditures through internally-generated funds.

## Contingent Liabilities, Commitments and Contractual Obligations

The following table sets forth our contractual obligations as of September 30, 2016:

|                                    | <b>Total</b>  | <b>Less than 1 year</b> | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than 5 years</b> |
|------------------------------------|---------------|-------------------------|------------------|------------------|--------------------------|
| Long-term debt obligations (A)     | 29,264        | 10,396                  | 18,868           | -                | -                        |
| Operating lease obligations        | 9,671         | 5,641                   | 3,657            | 373              | -                        |
| Purchase obligations               | 2,569         | 2,569                   | -                | -                | -                        |
| Capital commitments                | 931           | 931                     | -                | -                | -                        |
| Other long-term obligations (B)(C) | 2,793         | -                       | -                | -                | 2,793                    |
| <b>Total</b>                       | <b>45,228</b> | <b>19,537</b>           | <b>22,525</b>    | <b>373</b>       | <b>2,793</b>             |

(A) Includes \$27.2 million of long-term debt and interest payable at the rate applicable on September 30, 2016, under our Korean debt facility.

(B) Includes policy holder liabilities of \$1.8 million related to our insurance business.

(C) We have excluded cross-guarantees in the aggregate amount of \$9.2 million issued as of September 30, 2016, to Nedbank to secure guarantees it has issued to third parties on our behalf as the amounts that will be settled in cash are not known and the timing of any payments is uncertain. We have also excluded contractual commitments to investment approximately \$25 million in MobiKwik, subject to the achievement of certain contractual conditions.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

In addition to the tables below, see Note 5 to the unaudited condensed consolidated financial statements for a discussion of market risk.

The following table illustrates the effect on our annual expected interest charge, translated at exchange rates applicable as of September 30, 2016, as a result of changes in the Korean CD rate. The effect of a hypothetical 1% (i.e. 100 basis points) increase and a 1% decrease in each of the Korean CD rate as of September 30, 2016, are shown. The selected 1% hypothetical change does not reflect what could be considered the best or worst case scenarios.

**As of September 30, 2016**

**Table 9**

**Estimated annual**

|                                   | <b>Annual<br/>expected<br/>interest<br/>charge<br/>(\$ 000)</b> | <b>Hypothetical<br/>change in<br/>Korean CD<br/>rate, as<br/>appropriate</b> | <b>expected interest<br/>charge after<br/>hypothetical change in<br/>Korean CD rate, as<br/>appropriate<br/>(\$ 000)</b> |
|-----------------------------------|---|--|--|
| Interest on Korean long-term debt | 1,215   | 1%   | 1,487  |
|                                   |   | (1%)   | 942  |

36

#### **Item 4. Controls and Procedures**

##### **Evaluation of disclosure controls and procedures**

Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of September 30, 2016. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, the chief executive officer and the chief financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2016.

##### **Changes in Internal Control over Financial Reporting**

There have not been any changes in our internal control over financial reporting during the fiscal quarter ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Part II. Other Information

### Item 1. Legal Proceedings

#### *Litigation Regarding Legality of Debit Orders under Social Assistance Act Regulations*

On June 3, 2016, we filed for a declaratory order with the High Court of the Republic of South Africa Gauteng Division, Pretoria, to provide certainty to us, as well as other industry stakeholders, on the interpretation of the Assistance Act and recent Regulations promulgated in terms thereof (the Regulations). The Regulations limit direct deductions from social grants paid to beneficiaries. We interpret the meaning of the word deductions to be specific to the practice of deducting amounts, historically limited to life insurance premiums from grants, before the grants are paid to social welfare beneficiaries bank accounts, and are of the opinion that the legislature did not intend to curtail the right of beneficiaries to transact freely once the money is deposited into their bank accounts. The matter was heard by the Court on October 17 and 18, 2016, and it has reserved judgment. We cannot predict how or when the Court will rule on our declaratory order application.

### Item 1A. Risk Factors

See Item 1A RISK FACTORS in Part I of our Annual Report on Form 10-K for the fiscal year ended June 30, 2016, for a discussion of risk factors relating to (i) our business, (ii) operating in South Africa and other foreign markets, (iii) government regulation, and (iv) our common stock. Except as set forth below, there have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2016.

#### **We may not achieve the expected benefits from our strategic investment in Blue Label Telecoms.**

As more fully described in Part I of this Quarterly Report under Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Recent Developments, we recently announced our intention to acquire approximately 15% of the outstanding shares of Blue Label for a purchase price of ZAR 2.0 billion (\$144.3 million, translated at exchange rates applicable as of September 30, 2016). Closing of the transaction is subject to approval by Blue Label's shareholders. We expect that Blue Label will use the proceeds from our investment to help fund its acquisition of a 45% interest in Cell C Proprietary Limited, a leading mobile network operator in South Africa. Blue Label's investment in Cell C is subject to a number of closing conditions. We believe that our investment in Blue Label and Blue Label's investment in Cell C together should create business opportunities and synergies for us, both in South Africa and elsewhere.

We may not achieve some or all or the benefits that we expect to achieve from our investment in Blue Label. First, our investment in Blue Label is not conditioned on Blue Label's investment in Cell C and, if the Blue Label/Cell C transaction is not completed, Blue Label's share price may decline. Even if the Blue Label/Cell C transaction is completed, it is possible that Blue Label may not successfully execute its strategy with respect to its investment in Cell C. Furthermore, we may not be successful in cross-selling our products and services to Blue Label's and Cell C's customers (and vice versa). Also, although we will be entitled to appoint one member of Blue Label's board of directors, as a minority shareholder, our influence on Blue Label will be limited, and it is possible that Blue Label may take actions that are not in our interest. Finally, we expect to utilize the bulk of our South African cash reserves and a portion of the proceeds from new loan facilities to fund the Blue Label investment. These lending facilities include customary financial covenants and undertakings that restrict us from freely operating our business, particularly in South Africa. To the extent that we do not achieve the expected benefits from our investment, our business, financial condition and results of operations may be materially and adversely affected.



**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The table below presents information relating to purchases of shares of our common stock during the first quarter of fiscal 2017:

| <b>Table 10</b> |                  | (b)             | (c)             | (d)        |
|-----------------|------------------|-----------------|-----------------|------------|
|                 | (a)              | Average         | Total           | Maximum    |
|                 | Total            | price           | number          | dollar     |
|                 | number           | paid per        | of shares       | value      |
|                 | of shares        | share           | purchased       | of shares  |
|                 | purchased        | (US             | as              | that       |
|                 |                  | dollars)        | part of         | may yet be |
|                 |                  |                 | publicly        | purchased  |
|                 |                  |                 | announced       | under the  |
|                 |                  |                 | plans or        | plans or   |
|                 |                  |                 | programs        | programs   |
|                 |                  |                 |                 | (1)        |
| <b>Period</b>   | <b>purchased</b> | <b>dollars)</b> | <b>programs</b> |            |
| July 2016       | 853,464          | 10.04           | 853,464         | 75,508,538 |
| August 2016     | 2,026,638        | 10.14           | 2,026,638       | 54,952,474 |
| September 2016  | 257,507          | 9.65            | 257,507         | 52,468,000 |
| Total           | 3,137,609        |                 | 3,137,609       |            |

(1) On February 3, 2016, our Board of Directors approved the replenishment of our authorization to repurchase back up to an aggregate of \$100 million of common stock. The authorization has no expiration date.

**Item 6. Exhibits**

The following exhibits are filed as part of this Form 10-Q:

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   | <b>Included Herewith</b> | <b>Incorporated by Reference Herein</b> |                |                    |
|--------------------|---|--------------------------|---|----------------|--------------------|
|                    |   |                          | <b>Form</b>                             | <b>Exhibit</b> | <b>Filing Date</b> |
| <u>31.1</u>        | <u>Certification of Principal Executive Officer pursuant to Rule 13a-14(a) under the Exchange Act</u> | X                        |   |                |                    |
| <u>31.2</u>        | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) under the Exchange Act</u> | X                        |   |                |                    |
| <u>32</u>          | <u>Certification pursuant to 18 USC Section 1350</u>  | X                        |   |                |                    |
| 101.INS            | XBRL Instance Document  | X                        |   |                |                    |
| 101.SCH            | XBRL Taxonomy Extension Schema  | X                        |   |                |                    |
| 101.CAL            | XBRL Taxonomy Extension Calculation Linkbase  | X                        |   |                |                    |
| 101.DEF            | XBRL Taxonomy Extension Definition Linkbase   | X                        |   |                |                    |
| 101.LAB            | XBRL Taxonomy Extension Label Linkbase  | X                        |   |                |                    |
| 101.PRE            |   | X                        |   |                |                    |



XBRL Taxonomy Extension Presentation  
Linkbase

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 3, 2016.

NET 1 UEPS TECHNOLOGIES, INC.

By: /s/ Serge C.P. Belamant

Serge C.P. Belamant

Chief Executive Officer, Chairman of the Board and Director

By: /s/ Herman G. Kotzé

Herman G. Kotzé

Chief Financial Officer, Treasurer and Secretary, Director