Pepper Group Limited

ABN 55 094 317 665

Consolidated financial statements for the year ended 31 December 2018

Table of contents

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Directors' report

The directors of Pepper Group Limited (the Company) submit the annual report of the Company and the entities it controlled at the end of, or during, the year ended 31 December 2018.

Information about the directors

The name and particulars of the directors of the company during or since the end of the financial year are:

Michael Culhane
Cameron Small
Stuart Bleischke
Mario Rehayem (Appointed 2 May 2018)
Seumas Dawes (Resigned 2 May 2018)
Des O'Shea (Resigned 2 May 2018)
Matthew Burlage (Resigned 2 May 2018)
Jamie Weinstein (Resigned 2 May 2018)
Dan Pietrzak (Resigned 2 May 2018)
John Howard (Resigned 2 May 2018)
Varun Khanna (Resigned 2 May 2018)

Indemnification of officers and auditors

During the period, the Group paid an insurance premium in respect of the Directors of the Group as named above, the company secretary and all executive officers of the company against a liability incurred as such a director, secretary or executive officer to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

The Group has not otherwise, during or since the financial year, except to the extent permitted by law, indemnified or agreed to indemnify an officer or auditor of the Group against a liability incurred as such an officer or auditor.

Operating and financial review

The Board presents its 2018 operating and financial Review. The review complements the financial report.

Principal activities and review of operations

Pepper is a specialist residential mortgage and consumer lender and loan servicer, operating in targeted market segments and asset classes in Australia and internationally, many of which are underserved by traditional banks and other lenders.

Pepper has developed a strong specialist lending and loan servicing group through a combination of organic growth and targeted acquisitions across Australia, New Zealand, Ireland, the United Kingdom, Spain, Greece, Cyprus, South Korea, Hong Kong and China.

Pepper offers a broad range of lending products across residential mortgages, auto and equipment finance, point of sale finance and personal loans, underpinned by a comprehensive risk based pricing methodology. Pepper also provides loan servicing for its own originated loans as well as for third party originated loans, including residential mortgages, consumer unsecured loans, consumer secured loans and commercial real estate loans.

Through Pepper Property Group, Pepper is also an independent real estate investment adviser that provides integrated property and capital solutions for corporations, investors and developers.

Pepper’s business model provides a diversified base of revenue generated at multiple points across the customer relationship and includes loan origination, lending, servicing and loan administration, performance fees and advisory revenue.

Pepper’s unique operating model combines credit risk based underwriting expertise with highly developed specialist loan servicing and collection management capabilities which together deliver enhanced performance in both its lending and servicing businesses across multiple asset classes including: residential mortgages, auto loans, equipment finance, small balance commercial mortgages, small and medium sized enterprise loans and personal loans.

Operating and financial review (continued)

Pepper's core capabilities include

- Product manufacturing: Deep manufacturing expertise in residential mortgage and auto loans gives Pepper flexibility in providing a range of products with attractive risk-return profiles in Australia. Internationally, Pepper's management team has experience in specialist mortgage lending in the United Kingdom, Ireland and South Korea and consumer finance in Spain, South Korea, Hong Kong and China. Pepper is able to apply its detailed knowledge of borrowers to develop new products that address unmet demand;
- Distribution: Pepper distributes loans in Australia through its relationships with accredited brokers and white-label partners, in addition to its direct-to-customer consumer channel. Strong long-term relationships with global loan portfolio acquirers help Pepper win and maintain servicing contracts across multiple jurisdictions. Overseas, Pepper distributes via intermediaries and direct to the public depending on the product type and location;
- Treasury and funding expertise: Pepper has strong long-term relationships with global funding partners and is a trusted issuer in the term securitisation markets;
- Risk management: Pepper operates with a holistic risk management and governance framework; and
- Collections management: Pepper's specialised collections processes are based on deep experience, expertise, analytical capabilities and a solution based approach to customer management.

Funding

Across each of its lending markets, Pepper maintains access to a diversified funding platform supported by established funding relationships and a Board approved funding policy.

The following funding channels are used to support Pepper's lending activities:

- Corporate debt facilities: Utilised for working capital and business operations (which includes a revolving credit facility issued in Australia and a related party loan from Red Hot Australia Bidco Pty Limited (Bidco)). On 15 May 2018 Red Hot Australia Holdco Pty Ltd (ultimate parent entity - Holdco) issued a €230m, 4 year, fixed rate, subordinated bond (high yield bond). When Holdco received the funds, it invested the full amount into Bidco in exchange for ordinary shares. Bidco then entered an agreement to loan Pepper Group Limited €230m on economically similar terms to the high yield bond, reported as a related party loan within corporate debt facilities.
- Warehouse facilities: Third-party funders provide limited-recourse financing to special purpose vehicles established by Pepper to originate or acquire loans;
- Term securitisations: Loans that are initially funded via a warehouse facility can be pooled together and refinanced by being sold to a new funding vehicle that issues limited-recourse asset-backed securities to public market investors;
- Whole loan sales: Pepper is able to create additional liquidity by selling specific pools of loans to release and recycle capital; and
- South Korea deposits: Pepper's lending business in South Korea holds a banking licence and the lending book is primarily funded by customer deposits.

Principal risks

The Group's key risks include, but are not limited to:

- Funding risk: Pepper's funding platform currently comprises a mix of warehouse facilities, term securitisations, corporate debt facilities, whole loan sales and customer deposits. Pepper depends on these sources to fund mortgage and consumer loan originations and therefore faces funding risks which could lead to the inability to access funding or less favourable terms;
- Capital and liquidity requirements: there is a risk that Pepper could be required to contribute additional "first loss" equity capital to support the credit position of senior ranking noteholders in Pepper warehouse facilities and term securitisations and could be required to contribute additional capital to support the regulatory capital requirements or business needs of Pepper South Korea, which could impact Pepper's profitability, ability to grow and/or could force it to raise additional capital;
- Regulatory and licence compliance: Pepper is subject to extensive regulation in each of the jurisdictions in which it conducts its business. Changes in law or regulation in a market in which Pepper operates could materially impact the business. Pepper is licensed and/or registered to operate a number of its services across a range of jurisdictions. Changes to these licensing regimes, the revocation of existing licences, an inability to renew or receive necessary licences or the imposition of capital requirements could materially adversely affect Pepper's business, operating and financial performance; and
- Downturn in the global economy: Pepper is a global business operating in multiple jurisdictions. A material downturn in the economies in which Pepper operates, a sustained outbreak of higher inflation or shocks to the financial system could result in a material increase in unemployment, decreases in house prices, higher interest rates, general reduction in demand for credit and/or a reduction in a borrower's ability to service their debt (credit risk).

Operating and financial review (continued)

Financial performance review

Consolidated Income Statement (extract)

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Total revenue	**653,751**	514,252
Profit from share of results of associates	**10,741**	10,457
Expenses	**(639,930)**	(467,097)
Profit before tax	**24,562**	57,612

The Group recorded a statutory profit before tax for the year of $24.6m, a decrease of 57% year on year (2017: $57.6m) primarily reflecting the impact of AASB 9 on the Group's growing loan portfolios and transaction costs incurred by the business for acquisitions, disposals or restructures during the year that are considered to be outside of underlying performance.

Total revenue increased by $139.5m (27%) to $653.8m, driven by an increase in net interest revenue in the Australian Mortgage and Asset Finance businesses and internationally in the South Korean lending business, reflecting the organic growth of the underlying businesses.

Total statutory expenses increased by $172.8m (37%) to $639.9m, driven by a $68.5m increase in loan loss expenses, reflecting the growth of underlying portfolios in Australia, South Korea and Europe and the adoption of AASB 9, effective from 1 January 2018. The Group's global expansion was the main driver for the increase in employee benefits expenses ($64.1m), and transaction costs from acquisitions, disposals and restructures.

Consolidated Balance sheet (extract)

Assets	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Cash and cash equivalents	**1,200,367**	854,189
Investment in associates	**109,079**	98,516
Receivables	**118,884**	87,338
Loans and advances	**15,366,495**	9,628,278
Intangible assets (including Goodwill)	**128,550**	71,457
Other asset categories	**293,388**	139,004
Total assets	**17,216,763**	10,878,782

The Group’s loans and advances grew by $5,738.2m, reflecting 60% net portfolio growth. The portfolio growth demonstrates Pepper’s global expansion, underpinning its core profitability.

This increase was driven by prime, near-prime and non-conforming mortgages and asset and equipment finance in the ANZ Division.

The Asia Division also demonstrated strong growth throughout the year driven by increases in personal loans and residential mortgages in South Korea.

The loan portfolio in the Europe Division continued to grow in line with forecast driven by increases in personal loans in Spain and residential mortgages in the UK supplemented by the acquisition of Optimum Credit that added $950.7m of second charge mortgages and $40.0m of goodwill.

Operating and financial review (continued)

Financial performance review (continued)

Consolidated Balance sheet (extract) (continued)

Liabilities	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Deposits - South Korea	**2,826,343**	1,919,289
Borrowings	**13,452,986**	8,192,057
Other liability categories	**392,993**	265,963
Total liabilities	**16,672,322**	10,377,309

The asset growth was largely supported by funding facilities in the respective businesses where the loan growth resided including customer deposits.

Significant changes in affairs

On 13 December 2018 Pepper Money (Pepper) acquired 100% of the shares of Optimum Credit Ltd, a second charge mortgage business in the UK. Pepper acquired Optimum Credit's entire business, which includes a UK second charge loan portfolio of more than $950.7m residing in securitised term funding and warehouse funding vehicles.

On 20 July 2017 Pepper signed a share purchase agreement to acquire 100% of Portuguese consumer finance bank, Banco Primus S.A Lisbon (“Primus”) from parent company Credit Foncier de France (“CFF”). The transaction remains subject to a standard change of control approval from Bank of Portugal and the European Central Bank and is expected to complete during the first half of 2019. Upon completion, Pepper will pay €83m in cash for 100% of the Primus shares.

Events since the end of the financial year

There has not been any matter or circumstance occurring subsequent to the end of the financial year that has significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.

Dividends

During the year the Company paid a fully franked dividend of $Nil to shareholders (2017: $25m).

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 7.

Rounding of amounts

The Company is of a kind referred to in ASIC Legislative Instrument 2016/191, relating to the 'rounding off' of amounts in the directors' report. Amounts in the directors' report have been rounded off in accordance with the instrument to the nearest thousand dollars, or in certain cases, to the nearest dollar.

This report is made in accordance with a resolution of directors.

Michael Culhane
Group Chief Executive Officer and Director
Wednesday 10 April 2019

Cameron Small
Group Chief Financial Officer and Director
Wednesday 10 April 2019

Directors' declaration

The directors of Pepper Group Limited declare that, in the directors' opinion:

(a) the financial statements and notes set out on pages 11 to 61 are in accordance with the *Corporations Act 2001*, including:

  (i) compliance with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements, and

  (ii) giving a true and fair view of the consolidated entity's financial position as at 31 December 2018 and of its performance for the financial year ended on that date, and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

The attached financial statements are in accordance with the International Financial Reporting Standards as issues by the International Accounting Standards Board.

This declaration is made in accordance with a resolution of directors.

Michael Culhane
Director
Wednesday 10 April 2019

Cameron Small
Director
Wednesday 10 April 2019

Deloitte.

Deloitte Touche Tohmatsu
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The Board of Directors
Pepper Group Limited
Level 27, 177 Pacific Highway
North Sydney, NSW 2060

10 April 2019

Dear Board Members

Pepper Group Limited

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Pepper Group Limited.

As lead audit partner for the audit of the financial statements of Pepper Group Limited for the financial year ended 31 December 2018. I declare that to the best of my knowledge and belief, there have been no contraventions of:

(i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

(ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

Heather Baister
Partner
Chartered Accountants

Deloitte Touche Tohmatsu
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Independent Auditor's Report to the Members of Pepper Group Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Pepper Group Limited (the Company) and its controlled entities (the Group) which comprises the consolidated balance sheet as at 31 December 2018, consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion, the accompanying financial report of the Group is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Group's financial position as at 31 December 2018 and of its financial performance for the year then ended; and

(ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of the Company, would be in the same terms if given to the directors as at the time of this auditor's report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

The directors are responsible for the other information. The other information comprises the Directors' report for the year ended 31 December 2018, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the Financial Report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial report. We are responsible for the direction, supervision and performance of the Group's audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

Heather Baister
Partner
Chartered Accountants
Sydney, 10 April 2019

Consolidated income statement

	Notes	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Interest revenue	4	**826,633**	571,512
Interest expense	4	**(426,488)**	(280,010)
Net interest revenue		**400,145**	291,502
Fee revenue	4	**199,103**	173,638
Other revenue	4	**54,503**	49,112
Total revenue		**653,751**	514,252
Employee benefits expense	4	**(278,528)**	(214,381)
Depreciation and amortisation expenses	4	**(16,927)**	(14,901)
Corporate debt facilities - borrowing costs	4	**(30,787)**	(11,471)
Loan loss expenses	4	**(161,256)**	(92,742)
Other expenses from operations	4	**(152,432)**	(133,602)
Total expenses		**(639,930)**	(467,097)
Share of net profit of results of associates	10	**10,741**	10,457
Profit before tax		**24,562**	57,612
Income tax expense	5	**(3,613)**	(16,182)
Profit after tax		**20,949**	41,430
Profit is attributable to:			
Owners of Pepper Group Limited		**20,513**	41,431
Non-controlling interests		**436**	(1)
		20,949	41,430

The above consolidated income statement should be read in conjunction with the accompanying notes.

Consolidated statement of comprehensive income

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Profit after tax	**20,949**	41,430
Other comprehensive income / (expense) that may be recycled to profit or loss		
Currency translation reserve:		
Currency translation differences within associates	**604**	915
Currency translation differences relating to other Group entities	**16,325**	3,632
Tax	**(517)**	(2,199)
Cash flow hedge reserve:		
Gain / (loss) from changes in fair value	**(6,975)**	4,391
Amounts transferred to the income statement	**(613)**	(25)
Tax	**2,141**	(1,326)
Total other comprehensive income that may be recycled to profit or loss	**10,965**	5,388
Other comprehensive income not recycled to profit or loss (net of tax):		
Retirement benefit remeasurements	**(275)**	(145)
Tax	**61**	31
Other comprehensive income for the period	**10,751**	5,274
Total comprehensive income for the period	**31,700**	46,704
Total comprehensive income for the period		
Owners of the company	**31,264**	46,705
Non-controlling interests	**436**	(1)
	31,700	46,704

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Consolidated balance sheet

	Notes	**As at 31 December 2018 $'000**	As at 31 December 2017 $'000
Assets			
Cash and cash equivalents	22	**1,200,367**	854,189
Investment securities	6	**80,774**	40,125
Derivative financial assets	25	**84,660**	1,104
Receivables	7	**118,884**	87,338
Current tax assets	5	**9,813**	-
Other assets		**34,356**	37,000
Loans and advances	8	**15,366,495**	9,628,278
Deferred tax assets	5	**34,750**	13,273
Other investments	9	**27,383**	23,826
Investment in associates	10	**109,079**	98,516
Property, plant and equipment		**21,652**	23,676
Intangible assets	11	**67,726**	49,042
Goodwill	11	**60,824**	22,415
Total assets		**17,216,763**	10,878,782
Liabilities			
Deposits	13	**2,826,343**	1,919,289
Derivative liabilities	25	**14,011**	16,929
Trade and other payables		**61,083**	41,870
Current tax liabilities	5	**4,977**	1,110
Borrowings	14	**13,452,986**	8,192,057
Other liabilities	15	**256,049**	164,002
Provisions	17	**55,671**	40,214
Deferred tax liabilities	5	**1,202**	1,838
Total liabilities		**16,672,322**	10,377,309
Total net assets		**544,441**	501,473
Equity			
Issued capital	18	**356,101**	306,101
Other equity	19	**(19,176)**	(9,029)
Other reserves	19	**24,836**	13,820
Retained earnings		**181,698**	191,017
Total equity attributable to owners of Pepper Group Limited		**543,459**	501,909
Non-controlling interests		**982**	(436)
Total equity		**544,441**	501,473

The above consolidated balance sheet should be read in conjunction with the accompanying notes.

Consolidated statement of changes in equity

	Issued capital $'000	Other equity $'000	Other reserves $'000	Retained earnings $'000	Attributable to owners of the parent $'000	Non-controlling interests $'000	Total equity $'000
Balance at 1 January 2017	298,080	(24,344)	8,432	172,039	454,207	(436)	453,771
Profit for the period	-	-	-	41,431	41,431	(1)	41,430
Currency translation movements	-	-	2,348	-	2,348	-	2,348
Cash flow hedge movements	-	-	3,040	-	3,040	-	3,040
Retirement benefit remeasurements	-	(114)	-	-	(114)	-	(114)
Total comprehensive income for the period	-	(114)	5,388	41,431	46,705	(1)	46,704
Contributions of equity	8,021	(8,021)	-	-	-	-	-
Dividends paid	-	-	-	(25,094)	(25,094)	-	(25,094)
Capital contribution	-	16,302	-	3,270	19,572	-	19,572
Transfer of settled equity share schemes	-	(1,520)	-	(693)	(2,213)	-	(2,213)
Recognition of share based payments	-	8,669	-	-	8,669	-	8,669
Other movements	-	(1)	-	64	63	1	64
Balance at 31 December 2017	**306,101**	**(9,029)**	**13,820**	**191,017**	**501,909**	**(436)**	**501,473**
Impact of AASB 9 adoption	**-**	**1**	**-**	**(51,801)**	**(51,800)**	**-**	**(51,800)**
Impact of AASB 15 adoption	**-**	**-**	**-**	**(2,501)**	**(2,501)**	**-**	**(2,501)**
Profit for the period	**-**	**-**	**-**	**20,513**	**20,513**	**436**	**20,949**
Currency translation movements	**-**	**-**	**16,412**	**-**	**16,412**	**-**	**16,412**
Cash flow hedge movements	**-**	**-**	**(5,447)**	**-**	**(5,447)**	**-**	**(5,447)**
Retirement benefit remeasurements	**-**	**(214)**	**-**	**-**	**(214)**	**-**	**(214)**
Total comprehensive income for the period	**-**	**(214)**	**10,965**	**20,513**	**31,264**	**436**	**31,700**
Contributions of equity	**50,000**	**-**	**-**	**-**	**50,000**	**982**	**50,982**
Dividends paid	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Capital contribution	**-**	**-**	**-**	**14,535**	**14,535**	**-**	**14,535**
Transfer of settled equity share schemes	**-**	**(9,935)**	**-**	**9,935**	**-**	**-**	**-**
Recognition of share based payments	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Other movements	**-**	**1**	**51**	**-**	**52**	**-**	**52**
Balance at 31 December 2018	**356,101**	**(19,176)**	**24,836**	**181,698**	**543,459**	**982**	**544,441**

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

Consolidated statement of cash flows

	Notes	**Year ended 31 December 2018 $'000**	Year ended 31 December 2017 $'000
Cash flows from operating activities			
Receipts from customers		**326,008**	235,651
Payments to suppliers and employees		**(516,408)**	(446,617)
Interest received		**971,308**	658,071
Interest and other finance costs paid		**(479,747)**	(327,001)
Income taxes paid		**(7,976)**	(18,244)
Net cash inflow from operating activities		**293,185**	101,860
Cash flows from investing activities			
Net payments for property, plant and equipment		**(9,443)**	(8,885)
Payments for intangibles		**(25,804)**	(12,210)
Cash flows relating to investments		**6,655**	12,742
Amounts (paid to)/ received from related parties		**(5,555)**	842
Payments for arrangement fees		**(18,750)**	(10,918)
Repayment of / (investment in) debt securities		**(40,311)**	42,402
Net increase in loans and advances		**(6,285,505)**	(3,729,599)
Net cash outflow from acquisition and disposal of businesses		**(12,248)**	(892)
Payments received from investment in associate		**5,758**	4,707
Receipts from sale of loan portfolios		**1,073,558**	1,256,107
Net cash (outflow) from investing activities		**(5,311,645)**	(2,445,704)
Cash flows from financing activities			
Net proceeds from issuance of capital		**50,000**	2,595
Net increase in borrowings		**4,540,019**	1,968,461
Net increase in deposits		**748,836**	455,991
Dividend paid		**-**	(25,094)
Net cash inflow from financing activities		**5,338,855**	2,401,953
Effects of exchange rate changes on cash and cash equivalents		**25,783**	14,004
Net increase in cash and cash equivalents		**346,178**	72,113
Cash and cash equivalents at the beginning of the financial year		**854,189**	782,076
Cash and cash equivalents at end of year	22	**1,200,367**	854,189

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

1 About this report

The information presented in note 1 is considered relevant to an understanding of the financial statements.

(a) General information

These consolidated financial statements are for the Consolidated Group (the Group), consisting of Pepper Group Limited (the Company) and its controlled entities for the year ended 31 December 2018. These financial statements were approved and authorised for issue by the Board of Directors on Wednesday 10 April 2019.

(b) Basis of preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards and interpretations issued by the Australian Accounting Standards Board and the *Corporations Act 2001*. The Company is a for-profit entity for the purpose of preparing the financial statements.

(i) Historical cost convention

These financial statements have been prepared under the historical cost basis, except for the following:

- derivative financial instruments - measured at fair value.
- investment securities - measured at fair value.
- other investments - measured at fair value.

(ii) Compliance with IFRS

The consolidated financial statements of the Group also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(iii) Rounding of amounts

The amounts contained in this financial report are presented in Australian dollars (the Group's functional currency) and rounded to the nearest thousand dollar unless otherwise stated, under the option available under ASIC Legislative Instrument 2016/191.

(iv) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and all entities controlled by the Company. Control is achieved when the Company:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate there are changes to one or more of the three elements of control listed above.

When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- the size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders.
- potential voting rights held by the Company, other vote holders or other parties.
- rights arising from other contractual arrangements.
- any additional facts and circumstances that indicate the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated income statement and statement of other comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary.

Each component of comprehensive income is attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

(b) Basis of preparation (continued)

(iv) Basis of consolidation (continued)

All intragroup assets and liabilities, equity, income, expenses, changes in ownership interests and cash flows relating to transactions between members of the Group are eliminated in full on consolidation. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

(c) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Australian dollar ($), which is Pepper Group Limited's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the relevant functional currency at the rates of exchange prevailing at the dates of the transactions. Exchange differences on monetary items are recognised in the income statement in the period in which they arise except for exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), or exchange differences on transactions entered into in order to hedge certain foreign currency risks.

At the end of each reporting period, balances are translated as follows:

- monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.
- non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was measured.
- non-momentary items that are measured in terms of historical cost in the foreign currency are translated using the exchange rate at the date of the transaction.

(iii) Group companies

The results and financial position of foreign operations (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet
- income and expenses for each statement of profit or loss and statement of comprehensive income are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions), and
- all resulting exchange differences are recognised in other comprehensive income.

Goodwill and fair value adjustments, on identifiable assets and liabilities acquired. arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the rate prevailing at the end of each reporting period. Exchange differences arising are recognised in other comprehensive income and accumulated in equity.

2 Application of new and revised accounting standards

(a) New and amended standards adopted by the Group

The Group has applied the following standards and amendments for the first time for their annual reporting period commencing 1 January 2018:

- AASB 9 *Financial Instruments*
- AASB 7 *Financial Instruments: Disclosures*
- AASB 15 *Revenue from Contracts with Customers*

(i) AASB 9 Financial instruments: effective for annual reporting periods beginnings on or after 1 January 2018

AASB 9 replaces the existing guidance in AASB 139 Financial Instruments: Recognition and Measurement. AASB 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and de-recognition of financials instruments from AASB 139.

Financial assets

AASB 9 replaces the classification and measurement model in AASB 139 with a new model that categorises financial assets based on:
(i) the business model within which the assets are managed; and
(ii) whether the contractual cash flows under the instrument solely represent the payment of principal and interest (SPPI).

The three classification categories for financial assets are; amortised cost, fair value through other comprehensive income (FVOCI) and far value through profit or loss (FVTPL).

Amortised cost

AASB 9 identifies a financial asset is measured at amortised cost if both the following conditions are met:
(i) The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows: and
(ii) The contractual terms of the financial asset give rise on specified dates to cash flows that meet the SPPI requirements.

Financial value through other comprehensive income (FVOCI)

AASB 9 identifies a financial asset is measured at FVOCI if the following conditions are met:
(i) The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling assets: and
(ii) The contractual terms of the financial asset give rise on specified dates to cash flow that meet the SPPI requirements.

Changes in the fair value of financial assets that are classified as FVOCI are recognised in OCI, except for the recognition of expected credit losses, interest revenue and foreign exchange gains and losses which are recognised in the income statement.

Expected credit losses are recognised both in the income statement and in OCI. When debt financial assets at FVOCI are derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from OCI to the income statement. Interest income from these financial assets is included using the effective interest rate (EIR) method.

In the current and prior reporting period the Group has applied the fair value option and so has designated debt instruments that meet the amortised cost or FVOCI criteria as measured at FVTPL. See note 25.

Fair value through profit or loss

Financial assets that are not measured at amortised cost or at FVOCI are measured at FVTPL.

Compared to AASB 139, the FVOCI category has been added and the held-to-maturity, loans and receivables and available for sale categories have been removed.

Under AASB 9, financial assets with embedded derivatives are classified in their entirety, without separating any embedded derivative element.

(a) New and amended standards adopted by the Group (continued)

(i) AASB 9 Financial instruments: effective for annual reporting periods beginnings on or after 1 January 2018 (continued)

Financial liabilities

AASB 9 largely retains the existing requirements of AASB 139 for the classification and measurement of financial liabilities.

Financial liabilities are measured at amortised cost except for financial liabilities designated at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, are subsequently measured at fair value.

Impairment

AASB 9 replaces AASB 139's incurred loss model with an expected loss model. Whilst the ultimate credit loss under both AASB 9 and AASB 139 is the same over the lifetime of the asset, AASB 9's expected credit loss (ECL) requirements requires earlier recognition of credit impairments. Under the old model losses are recognised when incurred. Under the new model, affected assets have recorded an estimate of losses currently incurred and those expected to be incurred. Additionally for the majority of financial assets which have experienced a significant increase in credit risk since initial recognition, a lifetime expected loss will be recognised.

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables, amounts receivable from contracts with customers as defined in AASB 15, loan commitments, certain letters of credit and financial guarantee contracts.

The ECL values are derived from internally developed statistical models and are adjusted to reflect probability-weighted forward-looking information. The Group's loan portfolios are segmented (at a minimum) by: product, region, and credit quality (arrears), to calculate ECL provisions.

The key inputs used for measuring ECL are:

• probability of default (PD);
• loss given default (LGD); and
• exposure at default (EAD).

PD is an estimate of the likelihood of default over a given time horizon. The Group's PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates. The estimation is based on current conditions, adjusted to consider estimates of future conditions that will impact PD.

LGD is an estimate of the loss arising on default. The LGD models for secured assets consider forecasts of future collateral valuation considering sale discounts, time to realisation of collateral, cost of realisation of collateral and cure rates. LGD models for unsecured assets consider time of recovery, and recovery rates. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the interest rate of the loan.

EAD is an estimate of the exposure at a future default date, considering expected changes in the exposure after the reporting date, including repayments of principal and interest. The Group's modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, including: amortisation profiles, early repayment or overpayment, changes in utilisation of undrawn commitments and credit mitigation actions taken before default. The Group uses EAD models that reflect the characteristics of the portfolios.

The Group uses forward-looking information that is available without undue cost or effort in its assessment of significant increase of credit risk as well as in its measurement of ECL. The Group uses external and internal information to generate a 'base case' scenario of future forecast of relevant economic variables along with a representative range of other possible forecast scenarios. The external information used includes economic data and forecasts published by governmental bodies and monetary authorities.

The Group has identified and documented key drivers of credit risk and credit losses for each loan portfolio and, using a statistical analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The principal macro-economic indicators included in the economic scenarios used at 31 December 2018 for the purposes of preparing ECL provisions include: unemployment rates, interest rates and house prices (HPI).

(a) New and amended standards adopted by the Group (continued)

(i) AASB 9 Financial instruments: effective for annual reporting periods beginnings on or after 1 January 2018 (continued)

The Group has applied probabilities to the forecast scenarios identified in its measurement of ECL.

The Group's ECL is determined with reference to the following stages:

Stage 1: Performing loans (credit risk has not increased significantly since initial recognition): Predominantly loans less than 30 days past due - requires a loss provision equal to the expected loss over the next 12 months.

Stage 2: Significant increase in credit risk has occurred: All the Group's loans and advances not in stage 3 and 30+ days in arrears are within stage 2 - require a loss provision equal to the expected loss over the expected lifetime of the asset.

Stage 3: Impaired: As a minimum, all the Group's loans and advances 90+ days in arrears are within stage 3. Loans in stage 3 require a lifetime expected credit loss provision incorporating a 100% probability of default.

Hedging

The new general hedge accounting requirements retain the three types of hedge accounting. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about the Group's risk management activities have been introduced.

In accordance with AASB 9's transition provisions for hedge accounting, the Group has applied the AASB 9 hedge accounting requirements prospectively from the date of initial application on 1 January 2018. The Group's qualifying hedging relationships in place as at 1 January 2018 also qualified for hedge accounting in accordance with AASB 9 and were therefore regarded as continuing hedging relationships. No rebalancing of any of the hedging relationships was necessary on 1 January 2018. As the critical terms of the hedging instruments match those of their corresponding hedged items, all hedging relationships continue to be effective under AASB 9's effectiveness assessment requirements. The Group has also not designated any hedging relationships under AASB 9 that would not have met the qualifying hedge accounting criteria under AASB 139.

In addition, the Group does not use the exemption to continue using AASB 139 hedge accounting rules, i.e. the Group applies AASB 9 hedge accounting rules in full, prospectively from the date of adoption on 1 January 2018.

See note 26 for the Group's detailed accounting policy.

Modified financial asset and financial liabilities at amortised cost

A financial instrument is modified when its original contractual cash flows are renegotiated or modified. A financial instrument that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the existing terms are modified such that the renegotiated loan is substantially different from the existing financial instrument. When the modification does not result in derecognition, a gain or loss is recognised in the income statement as the difference between the financial instrument's original contractual cash flows and the modified cash flows discounted at the original EIR.

Derecognition

AASB 9 largely retains the existing requirements of AASB 139 for the derecognition of financial instruments.

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in the income statement.

(a) New and amended standards adopted by the Group (continued)

(i) AASB 9 Financial instruments: effective for annual reporting periods beginnings on or after 1 January 2018 (continued)

On derecognition of a financial asset other than in its entirety the Group allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain or loss allocated to it that had been recognised in other comprehensive income is recognised in the income statement. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts.

Transition

As at 1 January 2018, the Group's management has reviewed the classification and measurement of existing financial instruments and determined that the classification has remained consistent except for other investments which changed from amortised cost to FVTPL and investment securities which changed from available for sale to FVTPL. The Group also assessed the existing financial assets classified at amortised cost and FVTOCI for impairment using reasonable and supportable information available without undue costs or effort in accordance with the requirements of AASB 9 to determine the credit risk of the respective items.

In relation to the impairment of financial assets, AASB 9 requires an Expected Credit Loss (ECL) model as opposed to an incurred credit loss model under AASB 139. The ECL model requires the Group to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial asset.

Specifically, AASB 9 requires the Group to recognise a loss allowance for expected losses on financial assets which are held at amortised cost.

The credit risk attributes of assets assessed as at amortised cost are:

Cash and cash equivalents - cash is held with recognised global institutions and has been assessed as having a low credit risk. The 12 month ECL has been assessed as immaterial and no provision has been recognised.

Receivables are comprised primarily of servicing receivables earned in the ordinary course of business across the Group and the simplified approach as allowable under AASB 9 has been applied. As such a lifetime ECL has been assessed for these assets. Due to the short term nature and credit risk of the counterparties, the ECL has been assessed as immaterial and no provision has been recognised.

Loans and advances - Management have developed a model to assess the credit risk of each loan. A lifetime credit risk is recognised on loans considered to have experienced a significant increase in credit risk. A 12-month ECL is recognised on those loans on which credit risk has not increased since initial recognition.

Undrawn customer commitments and redraw balances not recognised on the balance sheet are considered as classified at amortised cost and subsequently assessed for credit risk as required under AASB 9.

No assets have been assessed as classified or measured at FVTOCI.

As permitted by AASB 9, the Group has not restated its comparative financial statements and has recorded a transition adjustment to its opening balance sheet, retained earnings and OCI at 1 January 2018 for the impact of the adoption of AASB 9's classification and measurement, impairment and hedge accounting requirements.

(a) New and amended standards adopted by the Group (continued)

(i) AASB 9 Financial instruments: effective for annual reporting periods beginnings on or after 1 January 2018 (continued)

The table below summarises the impact from the adoption of AASB 9 on the Group's opening balance sheet excluding AASB 15's impact.

Balance sheet (extract)

	As as 1 January 2018 $'000	AASB 9* adoption Reclassification $'000	AASB 9+ adoption Remeasurement $'000	As at 31 December 2017 '$000
Assets				
Loans and advances	9,565,015	-	(63,263)	9,628,278
Deferred tax assets	28,603	454	14,876	13,273
Other investments	23,009	(817)	-	23,826
Investment in associates	94,165	-	(4,351)	98,516
Total assets impacted		**(363)**	**(52,738)**	
Liabilities				
Other liabilities	164,155	-	153	164,002
Deferred tax liabilities	384	-	(1,454)	1,838
Total liabilities impacted		**-**	**(1,301)**	
Equity				
Other reserves	13,821	-	1	13,820
Retained earnings	139,216	(363)	(51,438)	191,017
Total equity impacted		**(363)**	**(51,437)**	

*Other investments: Impact from changes in the classification and measurement from amortised cost to FVTPL.

+Loans and advances: Impact predominantly from transition from the incurred loss method to the ECL for impairment provisions.

+Investment in associates: Impact from transition from the incurred loss method to the ECL for impairment provisions.

*+Deferred tax assets/liabilities: Deferred tax impact from the adjustments noted above.

(a) New and amended standards adopted by the Group (continued)

(ii) AASB 15 Revenue from contracts with customers: effective for annual reporting periods beginning on or after 1 January 18

The Group has applied AASB 15 - Revenue from Contracts with Customers for the first time in the current period. AASB 15 introduces a 5-step approach to revenue recognition and more prescriptive guidance to deal with specific scenarios.

AASB 15 replaces all the previous guidance on revenue recognition from contracts with customers. It requires the identification of performance obligations within a customer contract and a transaction price allocated to these obligations. Revenue is recognised upon satisfying these performance obligations. The key judgements in applying AASB 15 include the timing and amount of variable consideration to be recognised in relation to servicing fees.

The Group adopted AASB 15 on 1 January 2018. Apart from providing more extensive disclosures for the Group's revenue transactions, the application of AASB 15 has not had a significant impact on the financial statements of the Group. The Group have applied the cumulative effect method allowable under AASB 15. This is shown as an adjustment to retained earnings at the date of adoption, 1 January 2018, with no adjustments being made to the comparative figures.

The Group's detailed accounting policies are outlined in Note 4. The amount of adjustment for each financial statement line item affected by the application of AASB 15 excluding AASB 9's impact is illustrated below:

Balance sheet (extract)

	As at 1 January 2018 $'000	AASB 15 adoption $'000	As at 31 December 2017 $'000
Assets			
Receivables	84,481	(2,857)	87,338
Total assets impacted		**(2,857)**	
Liabilities			
Deferred tax liabilities	1,482	(356)	1,838
Total liabilities impacted		**(356)**	
Equity			
Retained earnings	188,516	(2,501)	191,017
Total equity impacted		**(2,501)**	

The adjustment to receivables solely relates to one region, Ireland, due to a change in the recognition criteria for variable components of a contract. The impact on the deferred tax of this adjustment has also been recognised.

Following on from the opening balance adjustment, the impact of AASB 15 on year ended 31 December 2018 has not been significant. For more information refer to note 4.

(iii) AASB 7 Financial Instruments: Disclosures: effective for annual reporting periods beginning on or after 1 January 2018

AASB 7 has been amended to include more extensive qualitative and quantitative disclosure relating to AASB 9, such as new financial instrument classification categories which impacts disclosures related to the statement of financial position as well as introducing new qualitative and quantitative disclosure requirements for the three stage ECL impairment model. The amendment also includes new hedge accounting and transition disclosures related to the adoption of AASB 9.

(b) New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for the 31 December 2018 reporting period and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

(i) AASB 16 Leases: effective for annual reporting periods beginning on or after 1 January 2019.

AASB 16 introduces a new lease accounting model for lessees that requires lessees to recognise all leases on balance sheet (except for short-term leases and low value assets) and recognise the amortisation of lease assets and interest on lease liabilities in the income statement. It will be mandatorily effective for reporting periods beginning on or after 1 January 2019. The Group is in the process of finalising the impact of the application of AASB 16. The financial impact on the financial statements is not expected to be significant.

There have been no other new or amended accounting standards during the reporting period ended 31 December 2018 that have had or may have a significant impact on the financial results of the Group.

3 Critical estimates, judgements and errors

The preparation of financial statements requires the use of judgment, estimates and assumptions. Should different assumptions or estimates be applied, the resulting values may change, impacting the net assets and income of the Group. These estimates and assumptions are reviewed on an ongoing basis. The nature of significant estimates and judgements made are noted below.

(a) Determination of impairment losses on loans and advances

The Group assesses at each balance date whether there is any objective evidence of impairment. In determining whether objective evidence exists and whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a loan before the decrease can be identified within an individual loan. Such evidence may include payment defaults, increased historic loss rates and trends in the relevant industry or market.

As outlined in Note 2, AASB 9 replaced AASB 139 from 1 January 2018, resulting in the replacement of the incurred loss loan provisioning model with an expected loss (ECL) model. Whilst the ultimate credit loss under both AASB 9 and AASB 139 is the same over the lifetime of the asset, AASB 9's ECL model requires earlier recognition of credit impairments.

Significant increase in credit risk: As explained in note 2, ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL assets for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. AASB 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Group takes into account qualitative and quantitative reasonable and supportable forward-looking information.

Models and assumptions used: The Group uses various models and assumptions in measuring fair value of financial assets as well as in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk.

The following are key estimations that are expected to have the most significant effect on the amounts recognised in financial statements:

Probability of default: PD constitutes a key input in measuring ECL. PD is an estimate of the likelihood of default over a given time horizon, the calculation of which includes historical data, assumptions and expectations of future conditions.

Loss Given Default: LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, considering cash flows from collateral.

Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and determining the forward-looking information relevant to each scenario: When measuring ECL the Group uses reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

The carrying value of loans and advances, as well as further information on the impairment provisions, is set out in note 17. Additionally, for further information on how the Group manages its credit risk please see note 26.

(b) Goodwill and other intangible assets

Determining whether goodwill or other intangible assets are impaired requires an estimation of the value in use of the cash generating units to which the intangible has been allocated. The value in use calculation requires management to estimate both the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value. Where the actual future cash flows are less than expected, an impairment loss may arise. In addition, determining the estimated useful lives of definite life intangible assets requires the use of judgement. For further information please see note 11.

(c) Revenue recognition

Measurement of financial instruments at amortised cost using the effective interest rate method requires calculations based on reliably estimated cash flows through the expected life of financial instruments incorporating behavioural modelling of prepayments. Any fee income accounted for using the effective interest rate method is assessed by management who apply judgement to ensure recognition in the most appropriate period.

As outlined in note 2, AASB 15 replaces all the previous guidance on revenue recognition from contracts with customers. It requires the identification of performance obligations within a customer contract and a transaction price that is allocated to these obligations. Revenue is recognised upon satisfying these performance obligations. Key judgement is required to determine the timing and amount of variable consideration to be recognised in relation to performance fees, and the interrelated nature of obligations in the Group's servicing contracts.

(d) Share based payment valuation

The value of employee services received (compensation expenses) in exchange for awards of equity instruments is recognised based upon the grant date fair value of share options, share rights and loans granted to employees. The grant date fair value of share options and share rights issued prior to 2018 are estimated using a Black-Scholes valuation model, a discounted cash flow model for loans granted to employees, and probability-weighted expected returns model for long term incentive plans issued after 2017. All models require the use of various assumptions and estimates involving management judgement.

4 Revenue and expenses

Interest income

Loans and advances are measured on an amortised cost basis in the balance sheet. Revenue is generally recognised over the life of the loan, taking into account all income and expenditure directly attributable to the loan. The rate at which revenue is recognised is referred to as the effective interest rate and is equivalent to the rate that effectively discounts estimated future cash flows throughout the estimated life to the net carrying value of the loan. The revenue stream includes interest revenue, mortgage risk fees received at loan settlement, loan premium revenue and early termination interest adjustments payable upon early redemption of a loan. Acquisition costs such as upfront broker commissions paid are also spread across the expected life of the loan. When a financial asset is classified in Stage 3 for impairment, subsequent interest income is recognised in profit or loss by applying the effective interest rate to the net carrying amount of the financial asset.

Interest expenses include: interest on customer deposits in South Korea, interest on securitised term funding facilities and interest on warehouse facilities (collectively referred to as asset funding). Interest expenses are recognised using the effective interest rate method.

Fee revenue

The key judgements in applying AASB 15 include the timing and amount of variable consideration (at a point in time or over time) to be recognised in relation to performance fees earned and determining whether multiple services provided in a single servicing contract are distinct. The main key judgement changes made in applying AASB 15 are disclosed below.

Servicing revenue

Servicing fees are paid by portfolio owners to the Group for servicing portfolios of assets. Some contracts contain multiple performance obligations which are assessed separately for the nature and timing of their satisfaction. Except for performance fees, revenue is recognised over time as the servicing activities are performed and it earns the right to consideration as identified in the contractual pricing arrangements the Group has with its customers in the amount it has a right to invoice.

Performance fees are recognised at a point in time when the performance conditions are considered highly probable of being met. The amount is estimated using either the expected value or most likely amount and recognised if, and only if, the revenue is highly probable of not subsequently reversing. Judgement is required to assess the likelihood and the potential amount of a revenue reversal from uncertain future events.

Under the previous accounting policies revenue was recognised as the services were provided as set out in the relevant servicer fee letters whilst performance fees were recognised when reliably measurable and the economic benefits to the Group were probable. The implementation of AASB 15 has had no impact on the Group’s policy other than with respect to performance fees which are now recognised when it is highly probable that the performance conditions will be met, rather than when reliably measurable. This has resulted in the transition adjustment shown in Note 2.

Advisory fees

Advisory fees represent income earned by Pepper Property Group and due diligence fees earned across the Group.

Revenue is recognised upon completion of advisory services as the customer does not receive the benefits associated with the performance obligation until the services are complete. There was no material impact from the change in accounting policy (to AASB 15) on advisory fee revenue.

Other fee revenue

The material components of other fee revenue include those fees that do not meet the criteria for recognition as part of the effective interest rate. Fees that relate to a provision of a specific transactional service are recognised when the service has been completed. Prior to the adoption of AASB 15, revenue was recognised in the period in which it was earned. There was no material impact from the change in accounting policy (to AASB 15) on other fee revenue.

Other revenue

Other revenue includes gains on loan sales recognised upon de-recognition of loan portfolios by the Group.

Revenue and expenses

(a) Revenue recognition

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Interest revenue:		
Interest from customers	**816,787**	560,023
Interest from investments	**482**	3,643
Bank interest	**9,364**	7,846
Total interest revenue	**826,633**	571,512
Interest expense:		
Interest - deposits	**(59,797)**	(35,536)
Interest - other asset funding	**(366,691)**	(244,474)
Total interest expense	**(426,488)**	(280,010)
Total net interest revenue	**400,145**	291,502
Fee revenue:		
Servicing fees	**107,639**	104,028
Advisory fees	**21,790**	11,907
Other fee revenue	**69,674**	57,703
Total fee revenue	**199,103**	173,638
Other revenue:		
Loan sale gains	**34,401**	39,273
Other revenue	**20,102**	9,839
Total other revenue	**54,503**	49,112
Total revenue	**653,751**	514,252

The 2018 interest expenses includes $426m of asset funding interest expenses, previously disclosed as borrowing costs. Comparative periods have also been reclassified (2017: $280m).

(b) Expense recognition policy

Employee benefits expense

Employee benefits expenses are recorded for benefits to employees primarily in respect of wages and salaries, bonuses, share based payments, annual leave and long service leave and are recognised in respect of employees' services up to the end of the reporting period. See note 17 for further information on recognition and measurement of employee benefits.

Borrowing costs

Borrowing costs include interest paid on corporate debt facilities under the effective interest rate method.

Loan loss expenses

Loan loss expenses include certain specific and collective provision movements for loan impairment and other direct loan write-offs recorded during the year.

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
(b) Expenses		
Employee benefits expense	**278,528**	214,381
Depreciation and amortisation		
Amortisation of intangibles	**8,149**	6,815
Depreciation of property, plant and equipment	**8,778**	8,086
	16,927	14,901
Borrowing costs		
Interest - corporate debt facilities	**30,787**	11,471
Loan loss expenses	**161,256**	92,742
Other expenses from operations		
Legal, consulting, audit, and other professional fees	**28,986**	41,098
Publications and advertising	**13,475**	11,748
Travel	**10,302**	6,665
Rent and other premises related expenses	**18,987**	15,691
Computer, internet, communication and information services	**25,002**	18,477
Insurance	**13,088**	8,101
GST input tax losses	**8,006**	5,014
Printing, stationery and postage	**3,792**	3,340
Trustee expenses, loan servicer fees, and loan enforcement expenses	**10,098**	7,288
Other expenses	**20,696**	16,180
Total other expenses from operations	**152,432**	133,602

5 Taxation

Income tax expense comprises current and deferred tax. Income tax is recognised in the income statement, except when it relates to items that are recognised in other comprehensive income or directly in equity, in which case it follows the item to which it relates. Tax effects arising from the initial recognition of a business combination are included in the accounting for that business combination.

(i) Australian tax consolidated group

The Company and its wholly-owned Australian entities have formed a consolidated group for Australian income tax purposes. All entities within the tax consolidated group have entered into a tax sharing and funding agreement. The agreement is intended to limit joint and several liabilities for the applicable taxes.

The members of the tax consolidated group have agreed to pay to the Company an amount equal to the income tax that would otherwise be payable if the member was separately liable to pay income tax. Such amounts are reflected in amounts receivable from or payable to other entities in the tax consolidated group.

(ii) Current tax

Current tax payable is based on taxable profit for the year and is calculated at the income tax rates applicable to group entities that have been enacted or substantively enacted in each jurisdiction at balance date.

(iii) Deferred tax

Deferred tax is accounted for using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases. Deferred tax assets and liabilities are not recognised in respect of the following temporary differences:

- those arising from the initial recognition of goodwill.
- those arising from the initial recognition of other assets and liabilities (other than in a business combination) that affects neither the taxable income nor the accounting profit.
- those related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax is determined using the tax rates that are expected to apply in the period in which the liability will be settled or the asset realised, based on income tax rates (and tax laws) that have been enacted or substantively enacted at balance date.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and the Group intends to settle them on a net basis.

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
(a) Income tax recognised in profit or loss		
Current tax		
Current tax expense in respect to the current year	**7,667**	15,098
Adjustments recognised in the current year in relation to the current tax of prior years	**(838)**	757
Total current tax expense	**6,829**	15,855
Deferred tax		
Deferred tax (benefit)/expense recognised in the current year	**(2,344)**	(862)
Adjustments recognised in the current year in relation to the deferred tax of prior years	**(872)**	1,189
Total deferred tax (benefit) / expense	**(3,216)**	327
Total income tax expense recognised in the current year relating to continuing operations	**3,613**	16,182

(b) The income tax expense for the year can be reconciled to the accounting profit as follows:	**Year ended 31 December 2018 $'000**	Year ended 31 December 2017 $'000
Profit from continuing operations before income tax expense	**24,562**	57,612
Tax at the Australian tax rate of 30.0% (2017: 30.0%)	**7,368**	17,284
Difference in overseas tax rates	**(5,249)**	(6,642)
Effect of expenses that are not deductible in determining taxable profit	**8,487**	6,998
Effect of income that is exempt from taxation	**(4,451)**	(2,893)
Previously unrecognised tax losses used to reduce deferred tax expense	**(427)**	-
Other	**(405)**	(511)
	5,323	14,236
Adjustments recognised in the current year in relation to the income tax of prior years	**(1,710)**	1,946
Income tax expense	**3,613**	16,182

The tax rate used for the reconciliations above is the corporate tax rate of 30% payable by Australian corporate entities on the taxable profits under Australian tax law.

(c) Deferred tax recognition	**Year ended 31 December 2018 $'000**	Year ended 31 December 2017 $'000
Deferred tax	**1,685**	(3,494)
Total income tax recognised in other comprehensive income	**1,685**	(3,494)
Deferred tax	**17,140**	-
Total income tax recognised in equity	**17,140**	-

(d) Deferred tax balances	**Year ended 31 December 2018 $'000**	Year ended 31 December 2017 $'000
Opening balance	**11,435**	15,374
Impact from AASB 9 adoption	**16,784**	-
Impact from AASB 15 adoption	**356**	-
Adjusted opening balance	**28,575**	15,374
Recognised in the income statement	**3,216**	(327)
Recognised in other comprehensive income	**1,685**	(3,494)
Others	**72**	(260)
Foreign currency differences arising on consolidation	**-**	142
Closing balance	**33,548**	11,435

(d) Deferred tax balances	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Breakdown of closing balance as follows:		
Employee benefits	**6,955**	5,033
Provisions	**548**	526
Deferred expenses	**(13,449)**	(10,686)
Loan loss provisions and other doubtful debts	**23,002**	6,328
Other financial assets	**5,390**	4,247
Intangible assets	**(688)**	(678)
Reserves	**3,528**	309
Recognition of tax assets relating to tax losses	**7,029**	7,472
Other	**1,233**	(1,116)
	33,548	11,435
Deferred tax balances are presented in the balance sheet as follows:		
Deferred tax assets	**34,750**	13,273
Deferred tax liabilities	**(1,202)**	(1,838)
	33,548	11,435

(iv) Unrecognised temporary differences

There are unused tax losses in the Group, for which no deferred tax asset has been recognised as the measurement of any recognisable deferred tax asset is still highly uncertain and not reliably measurable.

6 Investment securities

Investment securities mainly comprise short term securities held at various times by the South Korean Mutual Savings Bank as part of its liquidity management program. These may and will, fluctuate in size depending on the needs of the bank at any given point in time.

Government bonds investment securities are held at FVTOCI and equity securities at FVTPL, these are covered by the Group's AASB 9 accounting policies outlined in note 2.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Investment securities		
Government bonds	**76,344**	35,924
Equity securities	**4,430**	4,201
Total investment securities	**80,774**	40,125

7 Receivables

(i) Trade receivables

Trade receivables are amounts comprised primarily of servicing receivables earned in the ordinary course of business across the Group.

(ii) Other debtors

This balance comprises various other sundry balances which management do not consider core to the Group's business.

(iii) Loans to related party

This balance predominantly represents loan assets held by Pepper Group Limited with Red Hot Australia Bidco Pty Limited.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Trade receivables	**65,104**	45,741
Other debtors	**42,128**	29,945
Loans to related party	**11,652**	11,652
Total receivables	**118,884**	87,338

8 Loans and advances

Loans and advances are measured at amortised cost using the effective interest rate method as they meet both the following conditions:

- are held within a business model whose objective is to hold financial assets in order to collect contractual cash flows: and
- the contractual terms of the financial asset give rise on specified dates to cash flows that meet the SPPI requirements.

Deferred transaction costs

Transaction costs include broker fees and commissions capitalised on the balance sheet as part of loans and advances. These costs are amortised to the income statement in line with the reduction in the underlying mortgage portfolio as part of the effective interest rate on the mortgage receivables.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Loans and advances by legal structure		
Loans and advances residing in securitised term trusts	**8,945,533**	4,799,118
Loans and advances residing in funding warehouses	**3,643,737**	2,939,044
Loans and advances residing in corporate entities	**2,777,225**	1,890,116
Total loans and advances	**15,366,495**	9,628,278
Loans and advances by product		
Residential mortgages	**10,920,450**	6,520,649
Auto and equipment finance	**1,938,239**	1,443,155
Point-of-sale finance	**307,232**	213,540
Personal loans	**1,555,725**	1,041,570
Commercial loans	**644,849**	409,364
Total loans and advances	**15,366,495**	9,628,278

	Loans and advances	
	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Impairment provisions ***(included in the balances above):***		
Opening balance	**71,112**	45,875
Impact from adoption of AASB 9	**62,689**	-
	133,801	45,875
Impairment provisions ***(included in the balances above):***		
Provided for during the year	**161,439**	92,398
Loan assets written-off, sold or reversed, previously provided for	**(52,598)**	(70,179)
Effect of currency translation differences	**8,745**	3,018
Total impairment provisions	**251,387**	71,112

9 Other investments

Investments at FVTPL

This balance is primarily comprised of a number of debt portfolio investments held by the Group at FVTPL.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Debt investments at FVTPL	**13,388**	17,001
Debt investment in related party at FVTPL	**6,761**	-
Collateral repossessed	**-**	424
Equity investments at FVTPL	**7,234**	6,401
Total other investments	**27,383**	23,826

10 Investment in associates

(i) General

Associates are those entities over which the Group has significant influence but not control or joint control. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

(ii) Equity method

Under the equity method of accounting, the investments are initially recognised at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses of the investee in the income statement and the Group's share of movements in other comprehensive income of the investee in other comprehensive income. Dividends received or receivable from associates and joint ventures are recognised as a reduction in the carrying amount of the investment.

The carrying amount of equity-accounted investments are reviewed for impairment indicators at each reporting period and are tested for impairment when indicators of impairment exist.

(iii) Prime Credit Holdings Limited

Prime Credit Holdings Limited is a consumer finance business in Hong Kong and China. This investment has been classified as an investment in an associate due to the Group's significant involvement in the financial and operating policy decisions, including Board representation of Prime Credit Holdings Limited.

(iii) Prime Credit Holdings Limited (continued)

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Investment in Prime Credit Holdings Ltd	**109,079**	98,516

Name of associate	Principal activity	Place of incorporation	Ownership % and voting power held by the Group 31 December 2018	31 December 2017
Prime Credit Holdings Ltd	Financing	Hong Kong	**12**	12

Summarised statement of comprehensive income	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Revenue	**351,527**	333,627
Profit after tax	**89,507**	87,142
Other comprehensive income	**(4,972)**	17,784
Total comprehensive income	**84,535**	104,926

Summarised balance sheet	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Balance sheet		
Current assets	**200,028**	187,946
Non-current assets	**2,184,719**	1,998,541
Total assets	**2,384,747**	2,186,487
Current liabilities	**(1,228,933)**	(1,075,394)
Non-current liabilities	**(266,772)**	(308,257)
Total liabilities	**(1,495,705)**	(1,383,651)
Net assets	**889,042**	802,836

Reconciliation to carrying amounts:		
Carry amount of Investment	**109,079**	98,516
Group's share of net assets (12% of Prime Credit Group's net assets)	**106,685**	96,340
Acquisition costs (denominated in HKD)	**2,394**	2,176
Total capitalised cost of Investment	**109,079**	98,516
Group's share of profit after tax for the period	**10,741**	10,457
Dividends paid	**5,758**	4,707

11 Intangible assets & Goodwill

(i) Nature of intangible assets

- Goodwill - recognised as the consideration over and above the identifiable net assets on acquisition of the Oakwood business and the Optimum Credit business in the UK and the Avent IKE business in Greece.
- Mortgage servicing rights - the servicing rights relate to contracts acquired in the Oakwood business in the UK.
- South Korean Mutual Banking Registration - the registration gives the South Korea Savings Bank the right to operate as a mutual savings bank in South Korea for an indefinite period of time.
- Licence fees and other information and technology costs recognised within the Group.

	Licence fees and software $'000	Mortgage servicing rights $'000	South Korean mutual savings bank registration $'000	Intangible assets (excluding Goodwill) $'000	Goodwill $'000	Total $'000
Net book value at 31 December 2016	12,782	3,205	24,553	40,540	22,195	62,735
Acquisitions through business combinations	-	-	-	-	150	150
Costs capitalised during the year	14,664	-	-	14,664	-	14,664
Disposal write offs	(626)	-	-	(626)	-	(626)
Amortisation expense	(6,349)	(466)	-	(6,815)	-	(6,815)
Effect of currency translation differences	197	16	1,066	1,279	70	1,349
Net book value at 31 December 2017	20,668	2,755	25,619	49,042	22,415	71,457
Made up of:						
Gross carrying amount	36,448	4,791	25,619	66,858	22,415	89,273
Accumulated amortisation	(15,780)	(2,036)	-	(17,816)	-	(17,816)
Net book value at 31 December 2017	20,668	2,755	25,619	49,042	22,415	71,457
Acquisitions through business combinations	**-**	**-**	**-**	**-**	**45,101**	**45,101**
Costs capitalised during the year	**26,419**	**-**	**-**	**26,419**	**-**	**26,419**
Impairment charge [1]	**-**	**-**	**-**	**-**	**(7,703)**	**(7,703)**
Disposal write offs	**(1,560)**	**-**	**-**	**(1,560)**	**-**	**(1,560)**
Amortisation expense	**(7,646)**	**(495)**	**-**	**(8,141)**	**-**	**(8,141)**
Effect of currency translation differences	**260**	**124**	**1,582**	**1,966**	**1,011**	**2,977**
Net book value at 31 December 2018	**38,141**	**2,384**	**27,201**	**67,726**	**60,824**	**128,550**
Made up of:						
Gross carrying amount	**62,878**	**5,020**	**27,201**	**95,099**	**60,824**	**155,923**
Accumulated amortisation	**(24,737)**	**(2,636)**	**-**	**(27,373)**	**-**	**(27,373)**
Net book value at 31 December 2018	**38,141**	**2,384**	**27,201**	**67,726**	**60,824**	**128,550**

Note

1 - During the year the Goodwill held in relation to PPG was written off as part of other expenses, due to a change in the business which now differs to what was originally acquired.

(ii) Amortisation methods and useful lives

The Group amortises intangible assets using the straight-line method over the following periods:

- Software costs and licence fee - over the expected life of the software - usually up to 3 years
- Mortgage servicing rights - over the average expected life of the rights
- South Korean Mutual Banking Registration - indefinite life
- Goodwill - indefinite life

(iii) Goodwill

Goodwill arising on an acquisition of a business is carried at cost as established at the date of the acquisition of the business less accumulated impairment losses, if any.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units (or groups of cash generating units) that is expected to benefit from the synergies of the combination.

(iv) Mortgage servicing rights & South Korean banking registration

Both of these intangible assets have been acquired through business combinations and were initially recognised at their fair value on the acquisition date (which is regarded as their cost).

Subsequent to initial recognition, the servicing rights, which have a finite life, are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over their estimated useful life. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

The South Korean mutual savings bank registration (KMBR) is considered to have an indefinite useful life as it is expected to contribute future economic benefits to the Group indefinitely through the right to operate as a savings bank established under the Mutual Savings Bank Act of the Republic of Korea. The KMBR, being an indefinite life intangible, is carried at cost less accumulated impairment losses. Before recognition of impairment losses, the carrying amount of the KMBR was allocated to the South Korean cash-generating unit for impairment testing purposes and collectively compared to the value in use of the South Korean cash generating unit.

(v) Impairment tests for goodwill

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units).

(v) Impairment tests for goodwill (continued)

	South Korea	**Oakwood**
Nature of intangible assets	Banking registration	Goodwill
Recoverable amount methodology used	Value in use	Value in use
Period ended December 2018		
Carrying amount of intangible asset ($'000)	27,201	15,321
Valuation assumptions used:		
Forecast period (years)	3 years	3 years
Revenue (% annual growth rate)	30%	14%
Long term growth rate beyond 3 years (%)	1.5%	2.5%
Pre-tax discount rate (%)	10.6%	10.3%
Period ended December 2017		
Carrying amount of intangible asset ($'000)	25,619	14,625
Valuation assumptions used:		
Forecast period (years)	3 years	3 years
Revenue (% annual growth rate)	22%	22%
Long term growth rate beyond 3 years (%)	2.1%	2.6%
Pre-tax discount rate (%)	11.5%	10.5%

Optimum Credit and Hellas were acquired during the year. Both businesses are performing to plan with no indicators of impairment as at the 31 December 2018.

Approach followed to determine the value of assumptions used

Assumption	**Approach used to determining values**
Forecast period	The forecast period is the period over which management consider forecasting most reliable (and is consistent with the Group's approach to forecasting).
Average revenue growth rates	This is based on management's expectation of the cash generating unit's development in the market over the 3 year period when considering past performance.
Terminal growth rate	Regional inflation rates, consistent with external sources of data and economic conditions.
Discount rate	Reflect specific risks relating to the relevant segments and the countries in which they operate.

The Group performed sensitivity analysis and stress testing of the above assumptions for all cash generating units. As a result of the testing performed, Directors believe, as at 31 December 2018, any reasonable possible change in the key assumptions on which recoverable amount is based would not cause the aggregate carrying amount to exceed the aggregate recoverable amount of the cash-generating unit.

12 Business combination

(a) Business combinations

The acquisition method of accounting is used to account for all business combinations, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the:

- fair values of the assets transferred,
- liabilities incurred to the former owners of the acquired business,
- equity interests issued by the Group,
- fair value of any asset or liability resulting from a contingent consideration arrangement, and
- fair value of any pre-existing equity interest in the subsidiary.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquired entity on an acquisition-by-acquisition basis either at fair value or at the non-controlling interest's proportionate share of the acquired entity's net identifiable assets.

Acquisition-related costs are expensed as incurred.

The excess of the

- consideration transferred,
- amount of any non-controlling interest in the acquired entity, and
- acquisition-date fair value of any previous equity interest in the acquired entity

over the fair value of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the business acquired, the difference is recognised directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

Contingent consideration is classified either as equity or a financial liability. Amounts classified as a financial liability are subsequently remeasured to fair value with changes in fair value recognised in profit or loss.

If the business combination is achieved in stages, the acquisition date carrying value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date. Any gains or losses arising from such remeasurement are recognised in profit or loss.

(b) Summary of acquisitions

On 13 December 2018 Pepper Money (Pepper) acquired 100% of the shares of Optimum Credit Ltd, a second charge mortgage business in the UK. Pepper acquired Optimum Credit's entire business, which includes a UK second charge loan portfolio of more than $950.7m residing in securitised term funding and warehouse funding vehicles.

On 14 May 2018 Pepper acquired 100% of the shares in Avent S.A. and its 100% owned subsidiary Avent IKE (together 'Hellas') a Greek real estate advisory business. Pepper paid $5.5m to acquire the shares resulting in the recognition of $5.5m of new net assets (including $5.2m goodwill).

(b) Summary of acquisition (continued)

	Optimum Credit $'000	Hellas $'000	Total $'000
Total consideration	59,950	5,500	65,449
Assets			
Cash and cash equivalents	112,737	157	112,894
Investment securities	-	16	16
Receivables	1,162	423	1,585
Other assets	1,666	-	1,666
Loans and advances	950,675	-	950,675
Property, plant and equipment	711	80	791
Intangible assets	-	58	58
Total assets	**1,066,951**	**734**	**1,067,685**
Liabilities			
Borrowings	(911,857)	-	(911,857)
Other liabilities	(134,605)	(385)	(134,990)
Provisions	(356)	-	(356)
Deferred tax liabilities	(133)	-	(133)
Total liabilities	(1,046,951)	(385)	(1,047,336)
Net identifiable assets acquired	(20,000)	349	(20,349)
Goodwill acquired on acquisition	**39,950**	**5,151**	**45,101**

The $40m goodwill balance arising on the acquisition of Optimum Credit represents the synergies expected to arise from combining the operations of Optimum Credit and Pepper Money (collectively UK Lending). The acquisition is expected to enhance the growth of UK Lending's intermediary led secured lending, supported by excellent systems and intermediary relationships in the United Kingdom. The acquisition of Hellas is expected to enhance Pepper's capability to provide a full range of asset management services to clients with loan portfolios across Europe. No goodwill balances above are expected to be deductible for tax purposes.

Due to the proximity of the Optimum Credit acquisition to 31 December 2018, some of the balances reported above may be retrospectively adjusted in accordance with AASB 3.

If the acquisition of Optimum Credit had occurred at the beginning of the annual reporting period the acquired business would have contributed $6m of net interest revenue to the Group. The loans and advances acquired in the table above are reported net of a $2.1m loan loss provision.

On 10 December 2018 Pepper Ireland sold their $363m residential loan portfolio and associated funding liabilities for total consideration of $41m, recording a gain on sale of $11m in other revenue. Pepper Ireland will continue to service the residential portfolio under the terms of the agreement.

13 Deposits

Deposits are the primary source of funding for the South Korean Savings Bank. Subsequent to initial recognition, deposits are measured at amortised cost using the effective interest rate method.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Deposits from customers		
At call	**78,836**	71,735
Term deposits	**2,747,507**	1,847,554
Total deposits	**2,826,343**	1,919,289

14 Borrowings

All borrowings are initially recognised at fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing borrowings are measured at amortised cost using the effective interest rate method. For further detail on the amortised cost basis of accounting see note 4 revenue and expenses.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Securitised term funding facilities	**7,376,641**	4,586,569
Warehouse facilities - secured	**5,559,278**	3,383,003
Corporate debt facilities	**517,067**	222,485
Total borrowings	**13,452,986**	8,192,057

Securitised term funding facilities are secured on the assets of each of the individual securitisation trusts. Warehouse facilities are secured by the loans and advances and other cash collateral residing in the warehouse trusts. Corporate debt facilities are secured over certain assets of the Group.

On 15 May 2018 Red Hot Australia Holdco Pty Ltd (ultimate parent entity - Holdco) issued a €230m, 4 year, fixed rate, subordinated bond (high yield bond). When Holdco received the funds, it invested the full amount into Red Hot Australia Bidco Pty Ltd (Bidco) in exchange for ordinary shares. Bidco then entered an agreement to loan Pepper Group Limited €230m on economically similar terms to the high yield bond, reported within corporate debt facilities. This increase was partially offset by the net repayment of an existing corporate debt facility in Australia.

15 Other liabilities

(i) Settlement balances

Settlement balances arising from the timing of funds collected by the Group yet to be passed onto customers. These balances are predominantly held within the Group's servicing and the South Korean banking businesses.

(ii) Deferred consideration and other

This balance is made up of deferred consideration payable to sellers of businesses acquired by the Group and a large number of individually immaterial amounts. Among the drivers of this balance are accruals built up within Pepper's servicing businesses which will be subsequently passed on to customers.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Settlement balances	**181,876**	128,197
Deferred consideration and other liabilities[1]	**71,725**	33,218
Trail commissions payable to third parties	**2,448**	2,587
Total other liabilities	**256,049**	164,002

Note 1: Closing balance as at 31 December 2018 contains $44.7m and $3.3m of deferred consideration for the acquisition of Optimum Credit and Hellas respectively.

16 Leases where the Group is the Lessee

(i) Accounting policy

Leases are classified as finance leases whenever the terms of the lease substantially transfer all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

(ii) Operating leases

Operating leases primarily relate to the lease of buildings with lease terms generally being of between 2 and 10 years. Most operating lease contracts over 2 years contain clauses for annual yearly market rental reviews or increases linked to annual inflation rates. The Group does not have an option to purchase the leased properties at the expiry of the lease periods.

(ii) Operating leases (continued)

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred. In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

(iii) Future minimum lease payments under non-cancellable operating leases

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Future operating lease payments		
Not later than 1 year	**17,825**	12,989
Later than 1 year and not later than 5 years	**47,161**	47,246
Later than 5 years	**1,537**	7,733
Total commitments	**66,523**	67,968

17 Provisions

(i) Accounting policy

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

(ii) Bonuses & other employee benefits

Employee benefit liabilities are recognised for benefits accruing to employees predominantly in respect of wages and salaries, bonuses, annual leave and long service leave and are recognised in respect of employees' services up to the end of the reporting period. The measurement of such employee benefit liabilities is as follows:

• Short-term employee benefits (those expected to be settled within 12 months after the end of the reporting period) are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.
• Long term employee benefits are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to the reporting date.

	Employee benefits $'000	**Other $'000**	**Total $'000**
Balance at 31 December 2016	34,735	78	34,813
Increase in provisions	36,151	-	36,151
Provision utilised	(31,384)	(78)	(31,462)
Exchange differences	712	-	712
Balance at 31 December 2017	40,214	-	40,214
Increase in provisions	**47,845**	**-**	**47,845**
Provision utilised	**(33,656)**	**-**	**(33,656)**
Exchange differences	**1,268**	**-**	**1,268**
Balance at 31 December 2018	**55,671**	**-**	**55,671**

	Employee benefits $'000	Other $'000	Total $'000
Expected timing for utilisation of provisions:			
Less than 12 months	36,215	-	36,215
Greater than 12 months	3,999	-	3,999
Balance at 31 December 2017	40,214	-	40,214
Less than 12 months	**50,151**	**-**	**50,151**
Greater than 12 months	**5,520**	**-**	**5,520**
Balance at 31 December 2018	**55,671**	**-**	**55,671**

18 Issued capital

	Number of shares '000	$'000
As at 31 December 2016	181,955	298,080
Shares issued	2,414	8,021
As at 31 December 2017	184,369	306,101
Shares issued	13,723	50,000
As at 31 December 2018	**198,092**	**356,101**

19 Other equity and other reserves

Equity/Reserve	Nature
Employee benefits reserve	The employee benefits reserve has arisen as a result of equity settled share based payments accounted for under AASB 2. Further information about share based payments to employees is set out in note 23.
Common control reserve	The common control reserve arose as a result of a transaction between entities with common control.
Currency translation reserve	The currency translation reserve represents the cumulative gains and losses on the retranslation of the Group's net investment in foreign operations.
Cash flow hedge reserve	The cash flow hedge reserve represents the cumulative effective portion of gains or losses arising on changes in fair value of hedging instruments entered into for cash flow hedges. The cumulative gain or loss arising on changes in fair value of the hedging instruments that are recognised and accumulated in the cash flow hedge reserve will be reclassified to the income statement only when the hedged transaction affects the profit or loss.

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Employee benefits reserve	**(523)**	9,624
Common control reserve	**(18,653)**	(18,653)
Total other equity	**(19,176)**	(9,029)
Currency translation reserve	**30,633**	14,221
Cash flow hedges reserve	**(5,848)**	(401)
Other reserves	**51**	-
Total other reserves	**24,836**	13,820

20 Structured entities

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity and the relevant activities are directed by means of contractual arrangements. The Group considers all limited recourse entities in which it has interests to be structured entities.

(i) Consolidated structured entities

Pepper primarily utilises warehouse facilities and the securitisation markets to fund the origination of new loans.

Once loans are transferred into funding vehicles, they are funded by third-party senior and mezzanine debt, and equity, or other “first loss” capital, contributed by Pepper as part of a warehouse facility arrangement. The majority of warehouse facility funding is represented by the senior debt facilities, which are typically provided by highly-rated, regulated financial institutions and are available to Pepper on a revolving basis subject to eligibility criteria and other terms specific to each warehouse facility.

Periodically, warehouse facilities are refinanced through term securitisations involving the issuance of asset-backed securities which are long term match funding transactions placed by Pepper through the debt capital markets to a range of financial investors.

In both warehouse facility and term securitisation structures, the third-party providers of the senior notes have first ranking priority over cash flows generated by the loans held by the funding vehicle and their contractual interest and principal repayments rank at the top (or near the top) of payment waterfalls (after certain expenses). Mezzanine funding providers’ priority ranks below that of the senior funding providers. Pepper as the provider of “first loss” capital and residual unitholder receives its distributions only when the senior and mezzanine funders have received their contractual payments, and as the residual income unitholder, benefits from any additional incremental profits generated in the funding vehicle.

Pepper’s limited-recourse financing structures transfer the risk of credit losses on mortgage portfolios to the capital providers to the funding vehicles. Pepper’s exposure to losses is therefore limited to its rights to current and future residual income from its funding vehicles, along with the value of the equity notes that Pepper contributes as “first loss” capital to the funding vehicles.

Should a material increase in losses on Pepper’s mortgages occur, the level of income available for distribution from the funding vehicles will decline, resulting in a reduction in equity note coupons and residual income paid to Pepper by the funding vehicles.

As losses increase beyond certain thresholds, the funding vehicles would cease distributing residual income and making distributions on Pepper’s equity notes, and cash will instead be applied to repay the senior and mezzanine funding components of the funding vehicles; however, Pepper will have no legal obligation to contribute additional capital to offset the realised losses. In such a scenario, Pepper is able to increase the interest rate that it charges to its mortgage customers in order to offset the reduction in income due to credit losses.

Pepper is deemed to control these funding structures for accounting purposes due to the combination of Pepper’s investment in each funding vehicle (exposure to variable interest) and Pepper’s role as servicer (power to influence those variable returns). As a result, Pepper consolidates the assets and liabilities, income and expenses of most of these entities.

(ii) Non-consolidated structured entities

The Group’s interests in non-consolidated structured entities can be categorised as follows:

- Investments in non-Pepper special purpose vehicles (SPVs). Each of the SPVs Pepper has an investment in, is designed to invest in and manage consumer, commercial or residential loan portfolios. The SPVs finance themselves by issuing note securities which entitle the holder to a specified stream of cash flows from the loan portfolios.
- Receivables earned in the course of servicing non-Pepper SPVs.

(ii) Non-consolidated structured entities (continued)

The nature and extent of the Group's interests, as well as the Group's maximum exposure to loss, can be summarised as follows:

	Commercial $'000	Residential $'000	Consumer $'000	Total $'000
As at 31 December 2018				
Balance Sheet				
Assets				
Investments in non-consolidated SPVs	**10,802**	**2,586**	**-**	**13,388**
Receivables from non-consolidated SPVs	**-**	**453**	**586**	**1,039**
Total assets	**10,802**	**3,039**	**586**	**14,427**
Maximum exposure to loss	**10,802**	**3,039**	**586**	**14,427**

	Commercial $'000	Residential $'000	Consumer $'000	Total $'000
As at 31 December 2017				
Balance Sheet				
Assets				
Investments in non-consolidated SPVs	17,283	2,535	-	19,818
Receivables from non-consolidated SPVs	-	391	792	1,183
Total assets	**17,283**	**2,926**	**792**	**21,001**
Maximum exposure to loss	17,283	2,926	792	21,001

The Group's maximum exposure to loss is limited to the carrying value of any investments in or receivables from the structured entities, as listed above. There are no additional off balance sheet arrangements with non-consolidated structured entities which would expose the Group to potential loss.

During the year the Group earned interest from its investments and servicing revenue from servicing contracts with a number of structured entities. Refer to note 4 for further information on revenues earned.

21 Related parties

(a) Key management personnel compensation

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Key management personnel remuneration		
Short-term employee benefits	**5,454**	4,267
Post-employment benefits	**45**	106
Share-based payments	**5,146**	1,362
	10,645	5,735

(b) Transactions with other related parties

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below.

During the year, group entities entered into the following transactions with related parties that are not members of the Group:

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Transactions with related parties (excluding employees)		
Fees and other revenue received from associates	**6,343**	6,857
Dividend received from associates	**5,758**	4,707
Interest received from related parties	**332**	270
Fees and other revenue received from other related parties	**1,521**	1,439
Total revenue received	**13,954**	13,273
Interest paid to Red Hot Australia Bidco Pty Ltd and other related parties	**(13,199)**	(247)
Transaction costs paid on behalf of Red Hot Australia Holdco and Bidco Pty Ltd	**(13,067)**	(9,851)
Total costs paid	**(26,266)**	(10,098)
Balances held with related parties (excluding employees)		
Receivables due from associates and other related parties	**9,134**	5,293
Receivables due from Red Hot Australia Bidco Pty Ltd	**11,616**	11,616
Loan payable to Red Hot Australia Bidco Pty Ltd	**377,424**	-
Total net receivables due from related parties	**398,174**	16,909

(c) Parent entity and equity transactions

The ultimate parent entity of the Group is Red Hot Australia Holdco Pty Limited (Holdco), an entity incorporated in Australia. Holdco owns 100% of the shares in Red Hot Australia Bidco Pty Limited (Bidco) and Bidco owns 95.5% of the shares Pepper Group Limited (and its controlled subsidiaries).

As outlined in note 23, the Group's employees are participants in share schemes in which Holdco is required to settle awards in the form of Holdco ordinary shares or cash. In accordance with AASB 2, as Holdco is required to settle the awards, the $14.54m of employee benefits received by the Group are presented in the statement of changes in equity as capital contributions from Holdco (2017: $19.57m).

The Group also receives capital injections from Bidco in exchange for ordinary shares, as outlined in note 18.

22 Notes on the statement of cash flows

Cash and cash equivalents comprise cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to a known amount of cash, which are subject to an insignificant risk of changes in value and have a maturity of three months or less at the date of acquisition.

The Group's cash and cash equivalents include: balances held in corporate entities on behalf of servicing clients and balances held in limited recourse entities (collectively: cash and cash equivalents held on trust); balances held in Pepper Savings Bank in South Korea (subject to local regulations); and other balances held in Pepper's corporate entities.

	As at 31 December 2018 $'000	31 December 2017 $'000
(a) Reconciliation of cash and cash equivalents		
Held on trust	**851,200**	658,817
Pepper Savings Bank (South Korea)	**244,251**	134,429
Other corporate entities	**104,916**	60,943
	1,200,367	854,189

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
(b) Reconciliation of profit for the year to net cash flows from operating activities		
Profit for the period	**20,949**	41,430
Non-cash items:		
Depreciation and amortisation expenses	**16,927**	14,901
Loan loss expenses	**161,256**	92,742
Share of profits of associates	**(10,741)**	(10,457)
Share-based payment expense	**14,535**	10,568
Tax expense	**3,613**	16,182
Cash movements in:		
Receivables	**(3,497)**	(2,685)
Other assets	**(632)**	(32,199)
Loans and advances	**18,782**	(39,022)
Trade payables	**4,904**	8,126
Borrowings	**26,665**	107
Other liabilities	**40,138**	(2,995)
Provisions	**1,993**	(6,375)
Other movements	**(1,707)**	11,537
Total operating cash movements	**293,185**	101,860

(c) Changes in liabilities arising from financing activities

	Issued Capital (Note 18) $m	Borrowings (Note 14) $m	Deposits (Note 13) $m	Total $m
As at 1 January 2017	298	6,253	1,383	7,934
Financing cash flows	3	1,968	456	2,427
Acquisition/Disposals (Note 12)	-	-	-	-
Foreign exchange losses/(gains) and other movements	5	(29)	80	56
As at 31 December 2017	**306**	**8,192**	**1,919**	**10,417**
Financing cash flows	50	4,540	749	5,339
Acquisitions/Disposals (Note 12)	-	547	-	547
Foreign exchange losses/(gains) and other movements	-	174	158	332
As at 31 December 2018	**356**	**13,453**	**2,826**	**16,635**

23 Share-based payments

General

The Group provides benefits to employees of the Group through share-based incentives. Employees are paid for their services or incentivised for their performance in part through shares or rights over shares.

Equity-settled share-based payments

During the year a limited number of equity settled share based payment plans have been in place. These transactions involve the Group receiving services and compensating the relevant parties via the provision of equity instruments of the Group or its parent entities.

Measurement

As part of the process of accounting for share based payments the Group is required to measure the fair value of the options granted because it is not possible to reliably measure the fair value of the employee services rendered. The LTI Scheme was valued using the Black Scholes option valuation model, interest free loans using a discounted cash flow model and the 2018 LTI Scheme was valued using a probability-weighted expected returns model. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions (including the probability of meeting market conditions attached to the option) and behavioural considerations.

Recognition

The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period, the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in the income statement such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the share based payment reserve.

Description of schemes

Scheme	Description	Status
Long-term incentive (LTI) Scheme	The Company established a LTI Scheme to assist in the motivation, retention and reward of senior management and to align the interests of executives and senior management with the interests of shareholders. The LTI Scheme permits the grant of awards comprising of: - Performance Rights; or - Either Options or Loan Shares. On 4 December 2017, all existing Pepper Group Limited Loan Shares and Performance Rights held by an existing LTI Scheme participant deemed to be a relevant person at that date in accordance with the Scheme of Arrangement were either: converted, exercised, amended, cancelled or exchanged for Red Hot Australia Hold Co Pty Ltd Loan Shares or Performance Rights. Red Hot Australia Hold Co Pty Ltd Performance Rights are an entitlement to receive a Red Hot Australia Hold Co Pty Ltd Share for no consideration upon satisfaction of applicable vesting conditions. Red Hot Australia Hold Co Pty Ltd Loan Shares are an entitlement to acquire a Share upon satisfaction of applicable vesting conditions and payment of an applicable exercise price. Participants were provided with a loan for the sole purpose of subscribing for Loan Shares to be held on trust for participants subject to satisfaction of applicable vesting conditions and subject to repayment of the loan and with recourse limited to the Loan Shares.	Open

Terms & Conditions for material schemes

Scheme	Terms & Conditions
LTI Scheme	The key management personnel and other senior management are eligible to participate in the LTI scheme. For the year ended 31 December 2018 the awards were delivered using a combination of Performance Rights and Loan Shares. The LTI awards are divided into three equal tranches. The relevant performance periods for 2015 and 2016 are as follows: - Tranche 1: 1 January 2016 to 31 December 2016 - Tranche 2: 1 January 2017 to 31 December 2017 - Tranche 3: 1 January 2018 to 31 December 2018 The relevant performance periods for 2017 are as follows: - Tranche 1: 1 January 2017 to 31 December 2017 - Tranche 2: 1 January 2018 to 31 December 2018 - Tranche 3: 1 January 2019 to 31 December 2019 Each LTI award will vest based on the performance of the Group in each of the three consecutive financial years (the first tranche vested in 2017 in the case of the 2015 and 2016 LTI awards and in 2018 in the case of the 2017 LTI Award). With the exception of the first tranche of each of the 2015 and 2016 LTI awards, the vesting conditions for the LTI awards were apportioned: - 50%, to an adjusted net profit after tax (NPAT) growth performance condition, and - 50%, to a return on equity (ROE) performance condition. For the NPAT performance condition of the 2015 LTI awards, vesting occurred on achievement of a 25% increase, or greater, in NPAT for 2016 relative to 2015. On 4 December 2017 all NPAT and ROE performance conditions were waived as part of the acquisition of Pepper Group Limited by Red Hot Australia Bidco Pty Ltd.
Employee loans	The Group provided limited-recourse loans to Pepper Group Limited's executives and senior employees enabling them to exercise previously issued options. In accordance with AASB 2 the Group treated these as share options and treasury shares. The exercise date of the options is the date or dates the loans are repaid. On 4 December 2017 all employee loans were novated from Pepper Group Limited to Red Hot Australia Holdco Pty Ltd.
Red Hot loans	On 19 December 2017, Red Hot Australia Holdco Pty Ltd provided interest free limited-recourse loans to Pepper Group Limited's executives and senior employees, secured against shares held by executives and employees in Red Hot Australia Holdco Pty Ltd. In accordance with AASB 2 the Group reflected the employee benefit from the interest free loan as a share based payment expense in the Company. Red Hot Australia Holdco Pty Ltd treats these loans as Treasury Shares.

Scheme	Terms & Conditions
2018 LTI Scheme	The 2018 LTI Scheme provides an incentive to select management employees of Pepper Group companies and is structured to reward participants who contribute to the growth in value of the Pepper businesses they are involved with. The 2018 LTI Scheme involves various classes of shares (tracker shares) being issued by Red Hot Australia Holdco Pty Limited. Each class of tracker shares entitles the holders to a share in the gain in value of a specific Pepper business unit (BU). The calculation considers: - an initial BU starting value using a valuation as at 31 December 2017, - the impact of capital flows into and from the BU since 31 December 2017, - an allocation of group costs (including interest expense and tax reserves) since 31 December 2017; and - the value achieved on realisation of the BU. Participants will either be BU Participants or Group Participants. BU Participants will only hold tracker shares of a class relating to their BU whereas Group Participants will hold tracker shares of multiple classes relating to some or all the BU's. A small number of BU Participants will also hold tracker shares of multiple classes reflecting their involvement in Group activities as well as BU. The LTI Scheme start date was 1 January 2018 for BU's in existence on 1 January 2018. The vesting period for participants is 3 years from the date the tracker shares are issued. The service conditions will be met for a tranche if a participant is engaged by a Group company as at the relevant anniversary of the start of their vesting period.

Quantitative data

The following share-based payment arrangements were in existence within the Group as at 31 December 2018:

Long term incentive schemes	Number	Grant date	Expiry date	Exercise price	Fair value at grant date
2015 Long term incentive scheme - loan shares	340,799	August 2015	August 2022	$2.60	$0.18
2015 Long term incentive scheme - rights	330,571	August 2015	n/a	nil	$0.47
2016 Long term incentive scheme - loan shares	437,294	April 2016	August 2023	$2.42	$0.16
2016 Long term incentive scheme - rights	495,316	April 2016	n/a	nil	$0.41
2017 Long term incentive scheme - loan shares	1,756,874	April & August 2017	August & April 2024	$2.70	$0.40
2017 Long term incentive scheme - rights	2,168,518	April & August 2017	n/a	nil	$1.02

No 2018 LTI Scheme tracker shares had been granted at 31 December 2018. In accordance with AASB 2, the Group has recorded an estimate of employee service with reference to the expected grant date fair value, spread across the vesting period. As Red Hot Australia Holdco Pty Ltd is required to cash settle the awards, the accrual is presented as a capital contribution by the Group.

The following share-based payment arrangements were in existence within the Group as at 31 December 2017:

Long term incentive schemes	Number	Grant date	Expiry date	Exercise price	Fair value at grant date
2015 Long term incentive scheme - loan shares	1,012,197	August 2015	August 2022	$2.60	$0.23
2015 Long term incentive scheme - rights	775,585	August 2015	n/a	nil	$0.60
2016 Long term incentive scheme - loan shares	622,229	April 2016	August 2023	$2.42	$0.16
2016 Long term incentive scheme - rights	625,148	April 2016	n/a	nil	$0.42
2017 Long term incentive scheme - loan shares	1,856,641	April & August 2017	August & April 2024	$2.70	$0.40
2017 Long term incentive scheme - rights	2,290,464	April & August 2017	n/a	nil	$1.02

Movements in share-based payment arrangements during the year

The following reconciles the Group's share options and long-term incentive (LTI) schemes outstanding at the beginning and end of the year:

(a) Movements in share-based payment arrangement during the year

	LTI schemes - loan shares		LTI schemes - rights		Other Pepper Group share options	
	Number of units	Exercise price ($)	Number of units	Exercise price ($)	Number of units	Exercise price ($)
At 31 December 2016	2,194,358	2.53	2,277,675	-	300,000	2.60
Granted during the year	1,856,641	2.70	2,290,464	-	-	-
Forfeited	(323,860)	2.60	(319,273)	-	-	-
Exercised during the year	(236,172)	2.60	(557,674)	-	(300,000)	2.60
At 31 December 2017	**3,490,967**		**3,691,192**	**-**	**-**	**-**
Forfeited	**(83,097)**	**2.66**	**(91,666)**	**-**	**-**	**-**
Exercised during the year	**(872,903)**	**2.57**	**(605,131)**	**-**	**-**	**-**
At 31 December 2018	**2,534,967**		**2,994,395**	**-**	**-**	**-**

24 Remuneration of auditors

During the year the following fees were paid or payable for services provided by the auditor of the parent entity, its related practices and non-related audit firms:

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Audit and review of financial statements - Deloitte Touche Tohmatsu	**2,173**	1,940
Audit and review of financial statements - Other firms	**585**	664
Advisory services	**1,143**	628
Total auditor remuneration	**3,901**	3,232

The auditor of Pepper Group Limited is Deloitte Touche Tohmatsu. It is the Group's policy to employ Deloitte Touche Tohmatsu on assignments additional to their statutory audit duties, in compliance with the Group's independence policies, where Deloitte Touche Tohmatsu's expertise and experience with the Group are important.

25 Financial assets and financial liabilities

For related accounting policies and classification in comparative year please see note 1. The Group holds the following financial instruments:

	Basis of measurement	**As at 31 December 2018 $'000**	As at 31 December 2017 $'000
Financial assets			
Cash and cash equivalents	Amortised cost	**1,200,367**	854,189
Investment securities - government bonds	FVTOCI	**76,344**	35,924
Investment securities - equity	FVTPL	**4,430**	4,201
Derivative financial assets	FVTPL	**84,660**	1,104
Receivables	Amortised cost	**118,836**	87,338
Other investments	FVTPL	**20,149**	17,001
Loans and advances	Amortised cost	**15,366,495**	9,628,278
Total financial assets		**16,871,281**	10,628,035
Financial liabilities			
Deposits	Amortised cost	**2,826,343**	1,919,289
Trade and other payables	Amortised cost	**61,083**	41,870
Derivative financial liabilities	FVTPL	**14,011**	16,929
Borrowings	Amortised cost	**13,452,986**	8,192,057
Total financial liabilities		**16,354,423**	10,170,145

Fair value measurements and valuation processes

The following assets and liabilities are measured at fair value by the Group for financial reporting purposes.

Financial instruments	Fair value hierarchy	Valuation technique(s) and key input(s)	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Investment securities	Level 2	Discounted cash flow, forward interest rates, contract interest rates, appropriate discount rates	**80,774**	40,125
Equity investments	Level 2	Recent arm's length market transactions	**7,234**	6,124
Debt investments	Level 2	Recent arm's length market transactions and Discounted cash flow, appropriate discount rates	**20,149**	17,001
Interest rate swaps	Level 2	Discounted cash flow, forward interest rates, contract interest rates, appropriate discount rates	**(7,471)**	(1,242)
Foreign exchange contracts	Level 2	Discounted cash flow, forward interest rates, contract interest rates, appropriate discount rates	**5,564**	472
Cross currency interest rate swaps	Level 2	Discounted cash flow, forward interest rates, contract interest rates, appropriate discount rates	**72,556**	(15,055)

In the year to 31 December 2018 there has been no change in the fair value hierarchy or the valuation techniques applied to any of the balances above.

Fair value of assets and liabilities not measured at fair value

The Group has considered all financial assets and liabilities not carried at fair value to determine whether the carrying value is an accurate reflection of fair value. For financial assets and liabilities whose carrying value does not accurately reflect the fair value, the Group performed a discounted cash flow valuation to determine fair value at the balance date.

The table below shows a comparison of the carrying amounts, as reported on the balance sheet and the fair values of those financial assets and liabilities that are measured at amortised cost where the carrying value recorded in the balance sheet does not approximate to fair value.

	As at 31 December 2018		As at 31 December 2017	
	Carrying value $'000	**Fair value $'000**	Carrying value $'000	Fair value $'000
Loans and advances	**15,366,495**	**15,376,560**	9,628,278	9,630,795

26 Financial risk management

This note explains the Group's exposure to financial risks and how these risks could affect the Group's future financial performance.

Risk	Exposure arising from	Measurement	Management
Market risk - foreign exchange	Future commercial transactions, recognised foreign currency financial assets and liabilities.	Cash flow forecasting, Sensitivity analysis.	Forward foreign exchange contracts and cross currency interest rate swaps.
Market risk - interest rate	Mismatch in interest rates between assets and liabilities.	Sensitivity analysis.	Cross current interest rate swaps, Interest rate swaps.
Credit risk	Cash and cash equivalents, trade receivables, derivative financial instruments, loans and advances.	Credit risk analysis, Credit ratings.	Diversification, Strong collections/portfolio management.
Liquidity risk	Borrowings, deposits, derivative financial liabilities and other liabilities.	Rolling cash flow forecasts.	Availability of committed credit lines and borrowing facilities, Securitisation, Structuring terms of obligations.

(a) Risk management program

The Holdco Board has overall responsibility for the establishment and oversight of the Group's risk management framework. The Holdco Board has established an Audit and Risk Committee which is responsible for overseeing a number of risk areas across the Group, including: the Company's relationship with internal and external auditors; the preparation of the financial statements and reports; the process of identification and management of risks (including financial controls and systems). The Holdco Audit and Risk Committee reports to the Holdco Board on its activities.

The Group's activities expose it to a variety of financial risks: credit risk, market risk (including interest rate risk and foreign currency risk) and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group.

(b) Derivatives and hedge accounting

The Group enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risks (detailed in tables below), including, cross currency interest rate swaps, interest rate swaps, foreign exchange forward contracts and foreign exchange options.

Derivatives are recognised initially at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each reporting date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

Derivatives are used for hedging financial risks as part of the Group's approach to risk management. They are not used for speculative purposes.

The Group designates certain derivatives as hedging instruments in respect of foreign currency risk and interest rate risk in fair value hedges, cash flow hedges, or hedges of net investments in foreign operations as appropriate. Hedges of foreign exchange risk on firm commitments are accounted for as cash flow hedges.

At the inception of the hedge relationship, the Group documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument is effective in offsetting changes in fair values or cash flows of the hedged item attributable to the hedged risk, which is when the hedging relationships meet all of the following hedge effectiveness requirements:

- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of hedged item.

(b) Derivatives and hedge accounting (continued)

Fair value hedges

Fair value hedges are accounted for as follows: the fair value gain or loss associated with the derivative is recognised in profit or loss, the fair value gain or loss associated with the hedged item is recognised in profit or loss.

During the year the fair value movement on the derivatives and the hedged item offset with no significant ineffectiveness.

Cash flow hedges

Cash flow hedges are accounted for as follows: the fair value gain or loss associated with the effective portion of the derivative is recognised initially in other comprehensive income (cash flow hedge reserve - CFHR) and then recycled to the income statement in the same periods the hedged item affects the income statement. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement immediately.

Hedges of net investments in foreign operations

The Group use net investment hedges to mitigate the foreign exchange risk arising from the Group's net investments in foreign operations. Net investment hedges are accounted for similarly to cash flow hedges. The details of the fair values of the derivative instruments used for hedging purposes and the movements in the reserves in equity are set out in the note below.

• The effective portion of the gain or loss on the hedging instrument shall be recognised in other comprehensive income (in the foreign currency translation reserve - FCTR); and
• The ineffective portion shall be recognised in profit or loss.

The cumulative gain or loss on the hedging instrument that has been accumulated in the foreign currency translation reserve shall be reclassified from equity to profit or loss as a reclassification adjustment on the disposal or partial disposal of the foreign operation.

Interest rate risk management

The Group is exposed to interest rate risk because entities in the Group borrowed and lent funds at both fixed and floating interest rates. The risk is managed by the Group by the use of interest rate swap contracts.

Interest rate swap contracts

Under interest rate swap contracts, the Group agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the Group to mitigate the cash flow exposures on interest rates and the fair value risk of changing interest rates.

The Group designates the interest rate swaps in cash flow hedges and fair value hedges.

Interest rate swap contracts - cash flow hedges

As the critical terms of the interest rate swap contracts and their corresponding hedged items are the same, the Group performs a qualitative assessment of effectiveness and it is expected that the value of the interest rate swap contracts and the value of the corresponding hedged items will systematically change in opposite direction in response to movements in the underlying interest rates.

Interest rate swap contracts - fair value hedges

The Group also enter into interest rate swap contracts to mitigate the fair value risk of changing interest rates.

The Group has applied the hedge ratio of 1:1 to all hedge relationships.

(b) Derivatives and hedge accounting (continued)

Foreign currency risk management

The Group is exposed to exchange rate fluctuations relating to non-Australian dollar borrowings as well as its investments in foreign operations.

The Group uses cross currency interest rate swap contracts to hedge fair value interest rate risk and foreign exchange risk.

The Group designates the cross currency interest rate swap contracts in:
• fair value hedges of changing interest rates on foreign currency fixed rate borrowings;
• cash flow hedges of foreign currency exposure on foreign currency borrowings;
• hedges of net investments in foreign operations.

The foreign currency basis spread of a cross currency interest rate swap is excluded from the designation of that financial instrument as the hedging instrument. Changes in fair value of the foreign currency basis spread of a financial instrument is accumulated in the cost of hedging reserve, and is amortised to profit or loss on a rational basis over the term of the hedging relationship.

As the critical terms of the cross currency interest rate swap contracts and their corresponding hedged items match, the Group performs a qualitative assessment of effectiveness. The main source of hedge ineffectiveness in these hedge relationships is the effect of the counterparty and the Group's own credit risk on the fair value of the cross currency interest rate swap contracts, which is not reflected in the fair value of the hedged item attributable to the change in interest rates. No other sources of ineffectiveness emerged from these hedging relationships.

The Group also uses forward exchange contracts to hedge firm commitments. Hedges of foreign exchange risk on firm commitments are accounted for as cash flow hedges. On 20 July 2017 Pepper signed a share purchase agreement to acquire 100% of Portuguese consumer finance bank, Banco Primus S.A Lisbon ("Primus") from parent company Credit Foncier de France ("CFF"). The transaction remains subject to a standard change of control approval from Bank of Portugal and the European Central Bank and is expected to complete during 2019. Upon completion, Pepper will pay €83m in cash for 100% of the Primus shares. A forward exchange contract is in place to hedge this acquisition.

Only the spot element of the forward contract is designated as the hedging instrument. Changes in fair value of the forward element of a forward contract is accumulated in the cost of hedging reserve, and is amortised to profit or loss on a rational basis over the term of the hedging relationship. The forward exchange contracts are also considered to be highly effective.

The Group also designates EUR denominated debt as a net investment hedge of its net investment in EUR proportionally.

(b) Derivatives and hedge accounting (continued)

Quantitative information

The following table details the notional principal amounts and remaining terms of the cross currency interest rate swap, interest rate swap and foreign exchange contracts outstanding as at the end of the financial year. For the detail of derivative contract types, please refer above.

	< 1 year	1 - 2 years	2 - 5 years	Over 5 years
Interest rate risk - Interest rate swap contracts				
Average contracted fixed rate	1.73%	1.73%	1.74%	2.09%
Average notional Amount $'000	2,492,314	1,654,686	620,792	20,274
Foreign currency risk - Cross currency interest rate swap contracts				
Average contracted rate (AUD/USD)	0.7452	0.7493	0.7493	-
Average notional Amount $'000	1,302,415	441,173	165,204	-
Average contracted rate (AUD/EUR)	0.6426	0.6426	0.6426	-
Average notional Amount $'000	146,669	102,810	63,378	-
Foreign currency risk - Cross currency interest rate swap contracts				
Average contracted rate (EUR/AUD)	1.5936	1.5936	1.5936	-
Average contracted rate (EUR/HKD)*	9.2940	9.2940	9.2940	
Average contracted rate (EUR/KRW)*	1,280.8235	1,280.8235	1,280.8235	
Average notional Amount $'000	167,017	167,017	167,017	-
Foreign currency risk - Forward exchange contracts				
Average contracted rate (EUR/AUD)	1.5760	-	-	-
Average notional Amount $'000	176,506	-	-	-

*Note: These instruments are designated into cash flow hedge and net investment hedge to hedge the EUR debt and net investments in HKD and KRW.

(b) Derivatives and hedge accounting (continued)

Quantitative information (continued)

The following tables detail various information regarding interest rate swap contracts, cross currency interest rate swaps and foreign exchange forward contracts outstanding at the end of the reporting period and their related hedged items.

Derivative financial assets / (liabilities):

	Current notional amount $'000	Carrying amount of hedging instrument Assets $'000	Carrying amount of hedging instrument Liabilities $'000	Change in value of hedging instrument $'000	Change in value of hedged item $'000	CFHR opening balance before tax Dr/(Cr) $'000	Movement in CFHR Dr/(Cr) $'000	Transfer from CFHR to P&L Dr/(Cr) $'000
Cash flow hedges								
Interest rate swaps	2,724,769	36	(8,721)	(8,774)	8,774	(499)	14,058	(5,648)
Cross currency interest rate swap	1,879,228	77,404	(33)	92,426	(93,962)	1,072	(92,359)	95,804
Foreign currency forward contract	176,506	5,564	-	5,564	(5,564)	-	(5,564)	1,491
Fair value hedges								
Interest rate swaps	256,459	1,656	(442)	2,545	(2,545)	-	-	-
Net investment hedges								
Cross currency interest rate swap	151,081	-	(4,815)	(4,815)	4,815	-	-	-
Derivative not designated in hedging relationship								
Foreign currency option contract	-	-	-	(472)	-	-	-	-
Total	5,188,043	84,660	(14,011)	86,474	(88,482)	573	(83,865)	91,647

Non-derivative liabilities designated in net investment hedging relationship - natural hedge:

	Carrying amount of hedging instrument Liabilities $'000	Change in value of hedging instrument $'000	Change in value of hedged item $'000
EUR denominated borrowing	(154,196)	(6,655)	6,655

The cumulative deferred gain or loss on the hedging instrument is recognised in profit or loss only when the hedged transaction impacts the profit or loss, which is mainly due to the (gain) / loss from the hedged item spot rate revaluation and the foreign currency basis spread (FCBS) amortised to profit or loss on a rational basis over the term of the hedging relationship. The 2018 opening balance of the cash flow hedge reserve (CFHR) contained $2.1m FCBS that subsequently increased by $8.8m during the year due to changes in fair value, partially offset by $1.4m transferred to profit and loss. The 2018 movement in foreign currency translation reserve (FCTR) due to the change in value of hedging instrument in the net investment hedging relationship (included the natural hedge) was $11.5m which was effective and offset the FX movement of hedged item. Part of the FCTR movement on the hedging instrument included a $7m FCBS movement.

There is no significant ineffectiveness in all hedges applied for both current and prior years.

(c) Credit risk

Credit risk arises from the financial assets outlined below, as well as credit exposures to customers, including outstanding receivables.

To manage credit risk, the Group has established strong risk management teams who bring together a wealth of knowledge and experience in loan origination, servicing and arrears management capabilities across the Group.

Maximum exposure to credit risk

The carrying amount of the Group's financial assets and undrawn customer facilities represents the maximum credit exposure. The Group's exposure to credit risk at the reporting date was:

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Cash and cash equivalents	**1,200,367**	854,189
Investment securities	**80,774**	40,125
Derivative financial instruments	**84,660**	1,104
Receivables	**118,884**	87,338
Debt investments at FVTPL	**20,149**	17,001
Financial assets other than loans and advances	**1,504,834**	999,757
Loans and advances at amortised cost - balance subject to credit risk	**15,423,937**	9,612,337
Total potential exposure to credit risk	**16,928,771**	10,612,094

As at 31 December 2018, over 66% of the Group's cash and cash equivalents are held with banks or financial institutions with a credit rating of AA- or better (2017: over 75%).

In addition to the balances in the table above, the Group had $1,023m of undrawn customer facilities as at 31 December 2018 (2017: $873m).

Distribution of financial assets - loan and advances and provisions by credit quality

	As at 31 December 2018 $'000		As at 1 January 2018 $'000	
	Loans and advances	**Loss provision**	Loans and advances	Loss provision
Stage 1	**14,902,525**	**141,155**	9,313,370	83,609
Stage 2	**226,029**	**25,620**	126,554	9,854
Stage 3	**295,383**	**84,612**	172,413	40,338
	15,423,937	**251,387**	9,612,337	133,801

Provision balances above incorporate ECL provisions on undrawn customer commitments, and redraw balances (customer overpayment) and are not considered material to the Group. The loan loss provision increase is commensurate with the absolute increase in the number of loans originated.

The majority of the Group's exposure to loans and advances is limited, as they are legally owned by the special purpose entities (trusts) with no recourse to the Group. Losses on mortgage loans are therefore limited to the Group's investments in notes in these trusts and the cash collateral retained in the trust. The trusts' structures are designed such that losses are covered by excess spread generated from the assets within the trusts before the investment in notes is impacted.

As distinct from the above, Pepper South Korea's loan originations are funded on-balance sheet primarily through retail customer deposits and loan portfolio sales. There is a limited market for securitisation and warehouse funding in South Korea, unlike in Pepper's other core markets and the Group retains the associated credit risk with lending in South Korea.

(d) Liquidity and capital risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due.

Pepper's funding platform currently comprises a mix of warehouse facilities, term securitisations, secured debt facilities, balance sheet cash and customer deposits in the case of South Korea.

The majority of the Group's liabilities represent bonds issued by special purpose trusts through warehouse facilities and term securitisation transactions. Under such arrangements, bondholder recourse is limited to the assets of the relevant special purpose vehicle to which the liability relates and the repayment profile of the bonds is matched to the repayments collected from the loan assets. Given the limited recourse nature of these borrowings, $12.9bn at 31 December 2018 (2017: $7.9bn), they have not all been included in the table below.

The Group seeks to have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The Group has cultivated valuable long term relationships with a range of domestic and global investment banks and professional mezzanine debt and fixed income investors. Refer to note 14 for more information on the Group's borrowings.

At 31 December 2018	Carrying amount $'000	At call $'000	3 mnths or less $'000	3 to 12 mnths $'000	1 to 5 years $'000	Over 5 years $'000	Total contractual cash flows $'000
Financial liabilities							
Deposits	**2,826,343**	**78,831**	**163,494**	**658,375**	**2,104,288**	**-**	**3,004,988**
Payables and other liabilities	**61,083**	**23,113**	**28,922**	**8,536**	**652**	**-**	**61,223**
Borrowings	**3,425,752**	**775**	**40,491**	**599,453**	**3,105,505**	**-**	**3,746,224**
Derivative liabilities	**14,011**	**-**	**733**	**1,906**	**11,372**	**-**	**14,011**
Total	**6,327,189**	**102,719**	**233,640**	**1,268,270**	**5,221,817**	**-**	**6,826,446**
At 31 December 2017							
Financial liabilities							
Deposits	1,919,289	71,683	135,267	408,618	1,414,403	-	2,029,971
Payables and other liabilities	41,870	29,472	5,227	6,549	622	-	41,870
Borrowings	1,687,511	492	9,793	200,261	1,783,716	-	1,994,262
Derivative liabilities	16,929	-	6,830	2,684	7,415	-	16,929
Total	3,665,599	101,647	157,117	618,112	3,206,156	-	4,083,032

Pepper Savings Bank in South Korea (the Bank) is governed by the country's Mutual Savings Bank Act and is regulated by the Financial Supervisory Service and Financial Services Commission. The Bank must hold a portion of highly liquid assets on its balance sheet to meet regulatory liquidity requirements and hold regulatory capital against its assets in South Korea. The Bank is currently required to maintain a minimum South Korean regulatory Bank for International Settlements (BIS) capital ratio of 8%. As of 31 December 2018, the Group is compliant with the regulatory requirement.

(e) Market risk

Market risk is the risk of an adverse impact on the Group's earnings resulting from changes in market factors, such as interest rates and foreign exchange rates.

(i) Cash flow and fair value interest rate risk

Interest rate risk is the risk that the Group will experience deterioration in its financial position as interest rates change over time.

Interest rate exposure is created due to mismatches in interest rates between assets and liabilities (i.e. borrowing at floating interest rates and lending with fixed interest rates). Interest rate risk may be managed by entering into interest rate swaps subject to the Group's hedging and derivatives policies.

(e) Market risk (continued)

(i) Cash flow and fair value interest rate risk (continued)

Sensitivity

As outlined above, the majority of the Group's liabilities are issued through warehouse facilities and term securitisations in special purpose entities. Under such arrangements, the repayment profile of the bonds is matched to the repayments collected from the loan assets.

For illustrative purposes the Group has calculated the impact of a potential increase or decrease in borrowing costs in limited recourse entities for the year in the event of a +/- 10bps change in interest rates as shown in the table below:

10 bps +/-	**Year ended 31 December 2018 $'000**	Year ended 31 December 2017 $'000
Borrowing costs in special purpose entities	**7,246**	4,677

Any impact on funding costs in the special purpose entities as a result of changes to interest rates would be offset by a corresponding +/- impact on interest revenue proportionate to assets held.

The remainder of the Group's loan portfolio and liabilities are held in corporate entities (predominantly Pepper South Korea). The impact of a potential +/- 10bps change in interest rates on interest revenue and borrowing costs on balances held by corporate entities for the year is set out in the table below:

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
10 bps +/-		
Corporate interest revenue	**2,724**	2,139
Corporate funding costs	**(2,459)**	(1,922)
Total impact on corporate interest	**265**	217

(ii) Foreign exchange risk

The Group's financial reports are prepared in Australian dollars. The Group's revenues, expenses, cash flows, assets and liabilities in regions outside Australia are denominated in local currencies which include the Euro, South Korean Won, Pound Sterling, Hong Kong Dollar and United States Dollar. The Group manages its foreign exchange risk by matching the currency of loan receivables and funding and by monitoring the cash flow requirements of the business and regional operating subsidiaries on an ongoing basis.

The Group does not currently hedge its offshore earnings or the capital invested in the overseas operations, thereby accepting the foreign currency translation risk on invested capital and offshore earnings.

The figures in the table below indicate the potential increase or decrease in profit after tax for the year due to a +/- 10% variance in the exchange rates.

Sensitivity

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
10% variance +/-		
Change in AUD : EUR exchange rate	**2,633**	2,248
Change in AUD : KRW exchange rate	**1,548**	1,919
Change in AUD : GBP exchange rate	**1,476**	722
Change in AUD : HKD exchange rate	**1,354**	1,083
Change in AUD : USD exchange rate	**26**	767

27 Parent entity financial information

(a) Summary financial information

The individual financial statements for the parent entity show the following aggregate amounts:

	Year ended 31 December 2018 $'000	Year ended 31 December 2017 $'000
Income statement		
Revenue	**194,206**	210,850
Expenses	**(194,191)**	(173,128)
Profit before tax	**15**	37,722
Income tax expense	**(3,403)**	(4,578)
(Loss)/Profit after tax	**(3,388)**	33,144

	As at 31 December 2018 $'000	As at 31 December 2017 $'000
Balance sheet		
Current assets	**656,176**	314,646
Non-current assets	**546,251**	405,901
Total assets	**1,202,427**	720,547
Current liabilities	**4,584**	7,039
Non-current liabilities	**618,364**	270,268
Total liabilities	**622,948**	277,307
Total net assets	**579,479**	443,240
Issued capital	**356,101**	306,101
Other reserves	**2,147**	6,554
Retained earnings	**221,231**	130,585
Total equity	**579,479**	443,240

(b) Contingent liabilities of the parent entity

The Company has provided guarantees over funding facilities provided by several external parties to the Group. As at balance date the balance drawn on the guaranteed facilities was $456m (2017: $178m).

28 Events occurring after the reporting period

There has not been any matter or circumstance occurring subsequent to the end of the financial year that has significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.