Credit Rating Announcement

GCR affirms Finbond Group Limited's South African long-term national scale rating of $BBB_{(ZA)}$; Outlook Stable.

Rating Action

Johannesburg, 22nd November 2019 - GCR Ratings ('GCR') has affirmed Finbond Group Limited's ('Finbond', 'the group') South African national scale long-term and short-term issuer ratings of $BBB_{(ZA)}$ and $A3_{(ZA)}$, respectively. At the same time, GCR has revised Finbond's international scale long-term issuer rating from B+ to B due to a change in the mapping methodology. The lowering of the international scale ratings is not related to a deterioration in Finbond's credit profile or the risk associated to its operating environment (see the Criteria for the GCR Ratings Framework). The outlooks have been accorded as Stable.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
	Issuer Long Term	National	$BBB_{(ZA)}$	Stable Outlook
Finbond Group Limited	Issuer Short Term	National	$A3_{(ZA)}$	n.a
	Issuer Long Term	International	B	Stable Outlook

On May 22, 2019 GCR announced that it had released new criteria for all banks and bank-like entities. This methodology is titled Criteria for Rating Financial Institutions. As a result, the ratings were placed "Under Criteria Observation". Subsequently, GCR has finalised the review under the new methodology. As a result, the ratings have been removed from 'Under Criteria Observation' and revised in line with the new methodology.

Rating Rationale

The ratings accorded to Finbond balance the group's strong capitalisation and sound liquidity, with the group's modest competitive position and weak risk position.

Domiciled in South Africa, Finbond has local operations and international operations in North America. In South Africa, Finbond operates as a regulated Mutual Bank. Throughout North America, the group has a number of small consumer finance lenders. Finbond's presence in these more economically robust countries, compared with South Africa, results in an overall better operating environment for the group relative to rated peers.

Finbond's company profile is a weakness relative to rated peers. Albeit geographically diversified, the group's operations are significantly smaller, less diverse (by product and business lines) and less sophisticated in their respective markets than the major operating banks. The major focus of the group is short-term to medium-term unsecured lending (84% of the loan portfolio at FY18/19). However, the group has a broader range of products and services in South Africa than in North America. Positively, group revenues have been stable and on an upward trend over the past three years on the back of growing international operations.

Finbond's fairly high turnover in top management over the past three years, entrepreneurial owner management, significant downward fair value adjustments of investments properties and the brief breach of the regulatory capital adequacy ratio ('CAR') by Finbond Mutual Bank ('the bank'), are reflected in the slightly negative scoring for the management and governance assessment.

The group's capital and leverage are broadly positive factors for the rating, reflected by a GCR leverage ratio (GCR nominal capital to on and off-balance sheet assets) of c.12% at FY18/19. Moreover, the group generates a high quantum of earnings, which enhance the capital position and protect the entity from shocks. Finbond registered return on assets of 4.5% over the review period and we expect the group to continue to achieve strong return on assets over the rating horizon. However, an increase in the group's cost to income ratio to c.66% at FY18/19 (FY17/18: 58%) due to the expansion of the group's activities is viewed less positively.

Despite the short-term tenure of loans and sufficient loan loss reserving, Finbond's risk position is a ratings weakness, given the high single product concentration of the loan book as well as high credit losses and write offs. The group registered credit losses and write offs of 47% and 41% respectively, while recoveries were c.28% of written off debt over the review period. Write offs recorded in FY18/19 were mainly attributable to the implementation of IFRS 9 and the impact of transitioning of South African Social Security Authority ('SASSA') cards to South African Post Office cards ('SAPO') on the bank. The new SAPO card does not support EFT debits or stop orders, which limited the bank's capacity to collect interest and repayments as well as the ability to extend credit to SASSA beneficiaries. Consequently, collection rates in South Africa decreased by 9% to 81% in 2H18/19. However, we think that collection rates for the group are generally good, supported by an average of 99% in North America and a rebounded collection rate of 89% in South Africa at the end of August 2019. Overall, we think that the group's risk position will likely remain a weakness over the rating horizon on the assumption that high risk is inherent in the nature of the group's lending activities.

Funding and liquidity is a positive ratings factor. The predominance of equity (51%), fixed deposits (31%) and commercial paper (13%) support funding stability. The remainder of the funding comes from overdrafts and loans from shareholders. Finbond's liquidity is sound given the positive asset-liability mismatches that arise from funding short term assets (2.8 months on average) with longer term liabilities (21.6 months on average). Moreover, the loan book turns three times per year on average and collection rates average as high as 94%. The group registered a GCR liquid assets to customer deposits ratio of 62% at FY18/19, and we think that liquidity will continue to be robust over the rating horizon.

Rating Outlook

The outlook is stable, balancing our expectation that the bank will sustain strong capitalisation, sound funding and robust liquidity over the rating horizon.

Rating Triggers

A sustained improvement in capitalisation and credit losses could result in upward rating movement while a weakening in capitalisation as the group expands, further increases in credit losses and a deterioration in funding and liquidity could result in a negative ration action.

Analytical Contacts

Primary analyst Johannesburg, ZA	Nyasha Chikwengo NyashaC@GCRratings.com	Financial Institutions Analyst +27 11 784 1771
Committee chair Johannesburg, ZA	Matthew Pirnie MatthewP@GCRratings.com	Sector Head: Financial Institutions +27 11 784 1771

Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scale, Symbols & Definitions, May 2019
GCR Country Risk Scores, June 2019
GCR Financial Institutions Sector Risk Score, October 2019
Finbond Group Limited report, November 2018.

Ratings History

Finbond Group Limited

Rating class	Review	Rating scale	Rating class	Outlook	Date
Issuer Long Term	Initial	National	BB(ZA)	Stable	October 2011
	Last	National	BBB(ZA)	Stable	December 2018
	Initial	International	BB-	Stable	October 2013
	Last	International	B+	Stable	December 2018
Issuer Short Term	Initial	National	B(ZA)	n.a	October 2012
	Last	National	A3(ZA)	n.a	December 2018

Risk Score Summary

Risk score	
Operating environment	**18.00**
Country risk score	12.00
Sector risk score	6.00
Business profile	**-5.50**
Competitive position	-5.00
Management and governance	-0.50
Financial profile	**-1.50**
Capital and Leverage	2.00
Risk	-4.50
Funding structure and Liquidity	1.00
Comparative profile	**0.00**
Group support	0.00
Peer analysis	0.00
Total Score	11.00
National scale rating	BBB/A3

Glossary

Capital	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to Finbond Group Limited. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Finbond Group Limited participated in the rating process via face-to-face management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Finbond Group Limited and other reliable third parties to accord the credit rating included:

- Audited financial results as at 28 February 2019;
- Unaudited financial results as at 31 August 2019;
- Banking sector information;
- A breakdown of facilities available and related counterparties;
- Industry comparative data.