



Credit Rating Announcement

GCR affirms Finbond Group Limited's South African long term issuer rating of BBB_(ZA); Outlook Negative on heightened country and sector risk

Rating Action

Johannesburg, 17 July 2020 - GCR Ratings ('GCR') has affirmed Finbond Group Limited's ('Finbond', 'the group') South African long term and short term issuer ratings of BBB_(ZA) and A3_(ZA), respectively and outlook accorded as Negative. At the same time, GCR has also affirmed Finbond's international scale long term issuer rating at B, with a Negative outlook.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Finbond Group Limited	Long Term issuer	National	BBB _(ZA)	Negative Outlook
	Short Term issuer	National	A3 _(ZA)	
	Long Term issuer	International	B	Negative Outlook

The rating action follows a reduction in the South African country and financial institutions sector risk assessments.

- On June 24, 2020, the South African Financial Institutions sector risk score was lowered to 7.5, from 8.0 previously. Click [here](#) to access link.
- The South African country risk score was also lowered to 7.0, from 7.5 previously, in a market alert released on the 27th May 2020. Click [here](#) to access link.

Combined, the above country and sector risk scores comprise the operating environment score, which is a key input into GCR's ratings.

Rating Rationale

The ratings on Finbond balances the relative strengths and weaknesses of the North American and South African operations, strong earnings supporting adequate levels of capitalisation, stable funding structure, robust liquidity, weak risk position and a modest competitive position. The outlook on both international and national scale ratings reflects the heightened country and sector risk in the aftermath of COVID-19.

Finbond's competitive position is a relative weakness to the rating. The group is primarily a lender of short-term unsecured consumer loans and has a relatively small retail franchise in comparison to big commercial banks. Albeit geographically diversified, the group's operations are significantly smaller, less diverse (by product and business lines) than banking sector peers in the relative markets. Positively, the group has good track record of revenue stability and this has been bolstered in recent years on the back of growing international operations.

Finbond's historically high turnover in top management, entrepreneurial owner management, historic downward fair value adjustments of investment properties and the brief breach of the regulatory capital adequacy ratio ('CAR') by Finbond Mutual Bank ('the bank') in 2019, are reflected in the slightly negative scoring for the management and governance assessment (noting that the bank currently exceeds the minimum required CAR).

The group's capitalisation is moderately strong, reflected in the GCR leverage of c.11% as at FY20, although representing a slight dip from the prior year due to share buybacks during the year. Capital is managed on a debt/equity basis and the group targets a range of 1-1.5x. The debt/equity ratio was 1.4x at 29 February 2020, which

GCR considers to be strong, supported by strong earnings. The group's return on assets has been over 4% during the past two years, supported by very high interest margins. We expect the GCR leverage ratio to deteriorate slightly over the next 12-18 months, given moderated earnings caused by COVID-19. The group sales are down by between 40% and 50% due to low demand for loans during the various government imposed restrictions in response to COVID-19.

The group's risk position is weak, reflected by high cost of risk of 32% at FY20. This is due to the nature of unsecured consumer lending characterised by higher Loss Given Default 'LGDs' and modest recoveries. Positively, reserving is good and has a conservative buffer over observed defaults through the cycle. Loan concentrations are also very low reflected by average loan size of below R1, 932 as of February 2020. Collections are good for both North America and South Africa, and with reduced disbursements, a significant portion of the loan book is expected to convert to cash.

The group is predominantly funded by equity and term deposits, which GCR considers stable funding sources. Robust levels of liquidity is supported by the very short term loan book registering high collections (close to 100% inclusive of recoveries from bad debts). Given the high collection rates and lower sales due to COVID-19, the resultant reduction in the loan book is expected to be a conversion to cash. Accordingly, liquid assets are forecasted to be c.50% of balance sheet by end of FY21 (currently 30%).

Rating Outlook

The group enters COVID-19 crisis with robust levels of liquidity and we view this to sustain throughout the rating horizon. However, the outlook is negative reflecting the potential impact from the strained operating environment, in the aftermath of COVID-19, on other rating factors. In particular, earnings are likely to come under pressure and the GCR leverage ratio is expected to deteriorate as a result.

Rating Triggers

A downgrade in the group's credit profile could stem from a weakening South African operating environment and a reduction in capitalisation. Upside rating migration is limited, however a sustained improvement in credit losses could improve the ratings.

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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, May 2020
 GCR Financial Institutions Sector Risk Score, June 2020

Ratings History

Finbond Group Limited						
Rating class	Review	Rating scale	Rating class	Outlook	Date	
Long Term issuer	Initial	National	BB _(ZA)	Stable	October 2011	
	Last	National	BBB _(ZA)	Stable	November 2019	
	Initial	International	BB _(ZA)	Stable	October 2013	
	Last	International	B _(ZA)	Stable	November 2019	
Short Term issuer	Initial	National	B _(ZA)	--	October 2012	
	Last	National	A3 _(ZA)	--	November 2019	

Risk Score Summary

Rating Components & Factors	Risk scores
Operating environment	17.50
Country risk score	12.00
Sector risk score	5.50
Business profile	(5.50)
Competitive position	(5.00)
Management and governance	(0.50)
Financial profile	(2.00)
Capital and Leverage	1.50
Risk	(4.50)
Funding and Liquidity	1.00
Comparative profile	0.00
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	10.00

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 2020;
- Banking sector information;
- A breakdown of facilities available and related counterparties; and
- Industry comparative data.

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