GCR GLOBAL CREDIT RATING CO.
Local Expertise • Global Presence

Finbond Group Limited

South Africa Bank Analysis **October 2012**

Security class	Rating scale	Rating	Rating outlook	Review date
Long term	National	BB+$_{(ZA)}$	Stable	10/2013
Short term	National	B$_{(ZA)}$		

Financial Data:

(Audited, US$'000 Comparative)

	28/02/11	29/02/12
R/US$ (avg.)	7.3	7.4
R/US$ (close)	7.1	7.7
Total assets	62 543.1	61 964.0
Total capital‡	33 111.9	32 086.8
Borrowings	25 138.4	25 252.2
Net advances	13 481.8	11 620.4
Liquid assets	5 202.6	6 913.3
Operating income	19 493.3	24 187.9
Profit after tax	(2 786.8)	1 814.0
Market cap.	US$6.3m/R52.1m	
Market share*	0.3%	
Market penetrationª	0.9%	

‡ Refers to common shareholders equity.
**As a % of total unsecured credit extended for the 12-months ended 31 March 2012.*
ª Market share based on direct peers only.

Rating History:

Initial/Last Rating (10/2011)
Long-term: BB$_{(ZA)}$
Rating Outlook: Stable

Management appealed the 2012 ratings awarded, and after assessing the latest Information packs the initial decision was overturned (appeal, 24 December 2012).

Related Methodologies/Research:

Banking Criteria (December 2011)
Micro-Finance Supplement (January 2012)
Finbond Rating Reports (2011 to 2012)

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Rating rationale

The ratings are based on the following key factors:

- The ratings are held up by the group's growing franchise value, an experienced management team and also the establishment of a mutual bank (opening access to cheaper, more stable funding).
- From a structural perspective, the group appears well positioned to transition out of infancy into a more stable growth phase, the most obvious of these building blocks relate to: *leadership* - the management team is recruited from the micro-loan and banking fraternity, hence has all the hard skills and expertise to take the business forward and/or respond to challenges; *infrastructure* - opting to build scale upfront has made the group accessible on a country wide basis, whilst also creating a fair amount of spare capacity; and finally, *market prospects* - operating in a growth segment, the group benefits from a steady client demand flow.
- Operationally, the group's recent activities have been varied, with observations thereon categorised as follows: *capital adequacy* - given the current level of shareholder participation, the group is considered suitably capitalised and boasts strong protection ratios (stress tests also confirm a sufficient buffer over risk minima). *asset quality* - notwithstanding the group's success in transforming portfolio efficiency, some underlying quality issues remain, particularly the rate at which loan arrears transition through the ageing buckets after a failed payment/s. The resultant pooling of past due loans, combined with the contraction in gross loans outstanding, over accentuates the observed weakening in asset quality (although here too, stress tests indicate that the group has sufficient resources to withstand and/or absorb a sudden blowout in bad debts); and *profitability* - Balancing the downward pull of flatter loan yields and expansionary business and/or funding expenses with stronger loan/package product sales has seen the group's profitability record a net improvement. Furthermore, the half year results showed that the trend in absolute earnings was sustained (reported numbers ahead of expectations) and hence point to an upbeat full year outcome.

What could trigger a rating action

The ratings would be sensitive to any weakening in asset quality indicators, long-term earnings (on the back of an uncertain economic environment), a change in market sentiment (given the impact on funding access) or a material decline in capital from current levels. Other pressure points include the impact of new regulations on expenses, business and operational models over the medium term.

GLOBAL CREDIT RATING CO.

Corporate profile

Business summary

Finbond is a local mutual savings bank, focussed primarily on providing access to financial assistance /savings to applicants in the lower income brackets.

Channel†	Coverage	Payment platform
Own branches	184 national, 1 regional	Direct debit order

† Summary of distribution points/footprint at end-February 2012.

Ownership structure

The table below provides a basic breakdown of the group's shareholder groupings as at year-end 2012.

Table 1: Effective shareholding	%
Public shareholdersº	32.4%
Private shareholders	67.6%
With the latter split between:	
Statutory directors†	39.2%
Institutional entities	22.1%
Other‡	6.3%

º Being Metropolitan Life, Coronation, Investec and Grindrod Bank.
† Ultimately held by a trust, of which the group CEO is the settlor.
‡ Shares bought OTC by Finbond and those held by other individuals.
Source: Finbond.

Governance structure[1]

The current directorate comprise of three executive and four non-executive directors. In addition, the duties of the chief executive and the non-executive chairman have been separated so that no single individual (and/or minority group) has unfettered control over any part of the decision making process.

The following items were also reviewed by GCR and were found to be broadly in-line with requirements.

Description of key points	Findings
Tenure of non-executive directors	Nine years, then re-elect
Tenure of chief executive officer	Ten year maximum term
Board and management committees	Single layer feeding input
Composition of board/committees	Non-compliance disclosed
Committee charters & procedure docs.	Yes, last updated in 2011
Internal audit & compliance function	Yes (with board level input)
External auditors & rotation policy	KPMG, every seven years
Code of conduct/ Ethical practice rules	Yes, group wide principals

Reporting structure and access to information

The group's accounts are prepared in-line with international accounting standards and the annual and interim accounting information is fairly detailed and transparent. Further, being a listed company, a choice range of performance, planning and other risk information/updates is offered as download/s.

[1] Given the intricacies associated with good corporate governance (and the fact that these issues fall outside the scope of this report), GCR recommends an independent assessment to test true compliance.

Operating environment

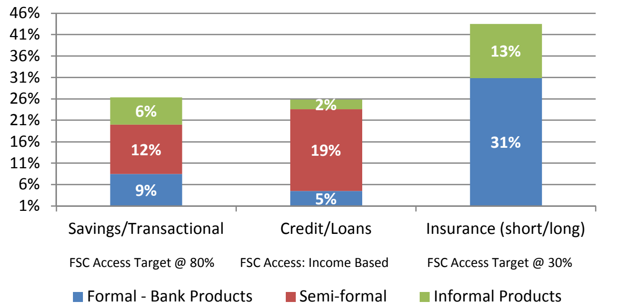
The sections below provide a brief scoping of the group's main operational area (or target segments).

General overview

As is the case with most developing nations, access to financial services is, for the most part, an exclusive concept - with population demographics and slow socio-economic development playing a major role.

This notion is particularly evident when analysing basic product usage statistics - *low client integration*, in combination with active users' choice of service and/or product provider - *constricted access frontier*.

Product Usage Strands*



* As per FinMark Trust Survey 2008 - as percentage of all working age adults (base = 30.8m individuals)

Market metrics

Converting the premise of opportunity into useful numerical boundaries/estimations, however, requires a number of subjective tweaks and assumptions to compensate for the shallow pool of inclusive data.

Description	Spectrumº
Basic target market calculations	
Total number of individuals formally employed	9.9m
Gross wallet size (personal income per annum)	R284.2bn
Haircut: No borrowing desireª	29.2%
Haircut: Do not meet borrowing criteria†	30.0%
Total number of individuals in target zone	4.9m
Gross wallet size (personal income per annum)‡	R22.1bn

º Per FinAccess & Stats SA's latest national estimations (2008/2009).
ª Include total market captured by/provider outreach of MFIs (2.7%).
† Where essential expenses & loan repayments ≥ 70% of gross income.
‡ Affordability based on a 25% effective interest rate and a 20% i2i.

Competitive landscape

Though the group competes mostly against much smaller and equally unknown cash lenders, it does benchmark itself (with regards to both growth and development) against the larger household names - with these the source for all comparative analysis.

Capacity metrics	ABL†	Capitec	RP†	UBank
Contact points	1,400	534	68	58
Value of deposits	-	R10.3bn	-	R2.8bn
Value of loan book	R35.0bn	R16.9bn	R2.7bn	R858.1m

† African Bank and Real People do not rely on deposit/s for funding.

Financial profile

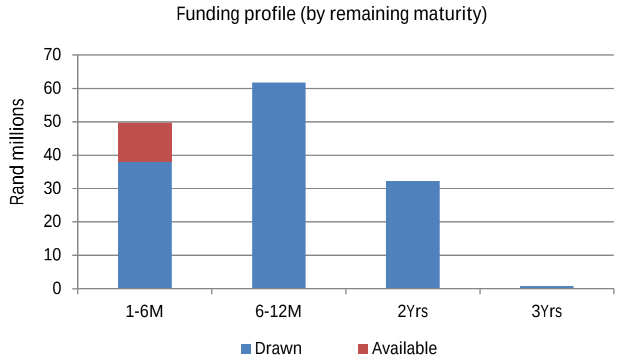
Funding structure

The funding structure here is made up entirely of borrowings and sourced, in part, from international development agencies and local wholesale lenders.

Table 2: Funding base	F11		F12	
	R'000	%	R'000	%
Long-term borrowings	159 112	89.1	159 205	81.9
Term facilities†	*134 800*	*75.5*	*147 085*	*75.6*
Preference shares†	*24 299*	*13.6*	*12 108*	*6.2*
Other	*12*	*< 0.1*	*12*	*< 0.1*
Short-term borrowings†‡	19 371	10.9	35 236	18.1
Total	**178 483**	**100.0**	**194 442**	**100.0**

† With most of the underlying facilities provided on a secured basis.
‡ Includes intergroup borrowings/term loans and shareholder loans.
Source: Finbond.

Though the group has made some strides in adding new lines of credit and diversifying its funding, the pool still required careful running - here, given the lack of committed and available funding buffers, much faith is placed on the cash generative nature of the lending book to keep the business balanced.



Also, with large chunks of the funding base falling due for repayment over the next few months, the latent refinance pressures must not be overlooked - nevertheless, management is of the opinion that the replacement funding (based on its nature, cost and tenures) now either being taken in (deposits) or finalised (term), should see a more stable platform.

Upcoming movements°	Amount in	Amount out	Net change
Senior facilities*	-	(R22m)	reduced
Mezzanine facilities†	R125m	(R50m)	R75m
Preference shares‡	-	(R12m)	removed
Shareholder loans[a]	R15m	(R20m)	(R5m)
Customer deposits[a]	R150 - 300m	-	R150 - 300m

 The funding movement (in and out), only cover the next 12M period.
* Split as R5m by October 2012 and 3 quarterly payments of R5.5m
† The new facility (albeit cash flow date is uncertain) is crucial to settle the outgoing facility (due for repayment by end-December 2012).
‡ The final instalment/repayment of the shares due end-January 2013.
[a] The existing shareholder loan will be flipped up to core equity (as settlement for the rights issue finalised in March 2012), though a new facility was approved in May/June 2012. The customer deposits are projected based on the company's revised status as a Mutual Bank.

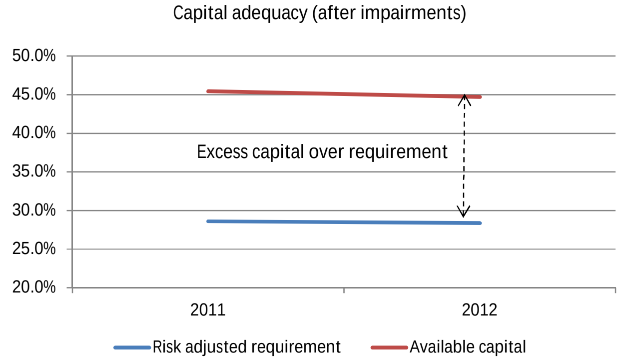
Capital structure

Represented below is a comparative snapshot of the group's equity base (compared to combined assets).

Table 3: Capitalisation	F11	F12
	R'000	R'000
Total reported capital	**228 097**	**240 616**
Paid up common shares	*201 793*	*201 776*
Retained earnings	*26 304*	*38 840*
Add: Qualifying reserves	6 998	6 452
Less: Goodwill	(61 262)	(61 262)
Eligible capital	**173 832**	**185 806**
Total balance sheet assets†	**382 794**	**415 860**
Selected ratios:		
Adjusted capital : Total assets	45.4%	44.7%

† Asset exposures not risk-weighted. Source: Finbond.

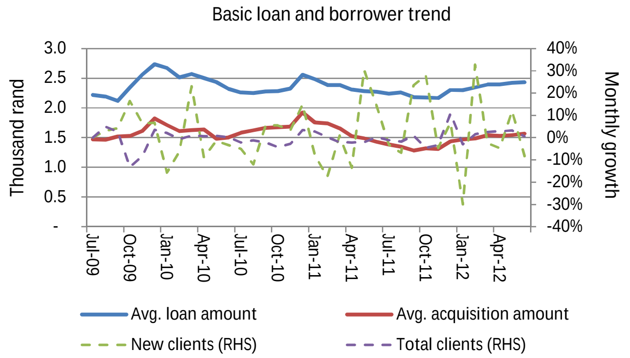
Overall, the group's capital pool has comfortably been able to support the rate of organic business growth, whilst also absorbing the income losses booked - in this regard, the stress test conducted on the group's capital revealed a sizeable buffer to cater for increased risks (and unplanned losses).



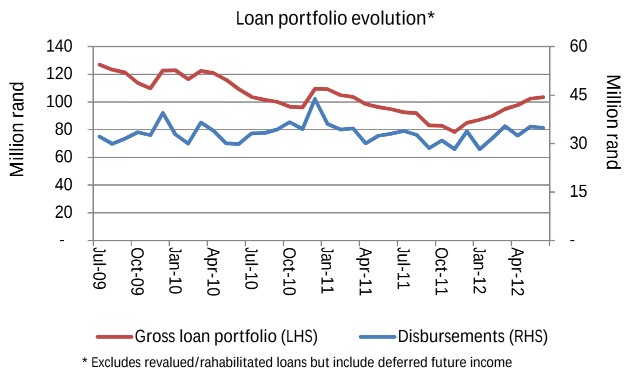
Micro-finance operations

Portfolio evolution

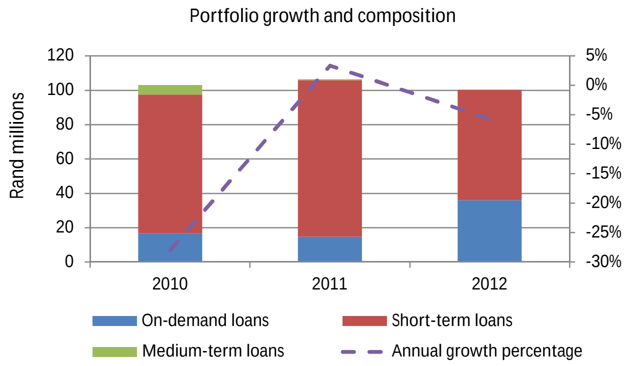
Before considering the group's growth history, note must be taken that the supplied data covers only a limited time frame/period, thus causing in a slight skewing of the business and client evolution trend.



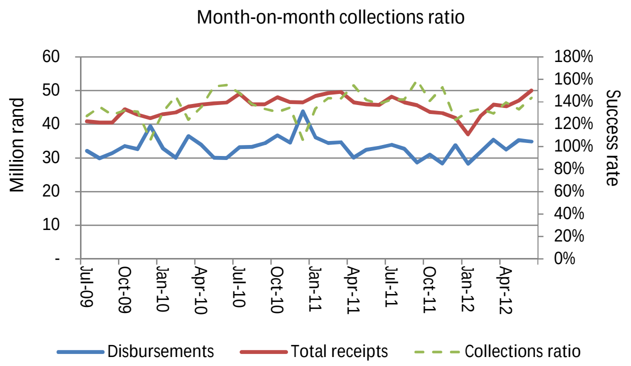
What is more, the extreme short-dated nature of the book largely eliminates the usefulness of standard portfolio growth markers[2] - nonetheless, what was noted was that activity slowed noticeably over the first three quarters, and then accelerated well into/ past the start of the new accounting term (with the loan portfolio down by value at closing, though matching the prior annum's outturn by the interim).



Herein, the book growth of late was accompanied by an upturn in all main components, which being active borrowers, the number, and also the value of loans - yet the risk profile is neutral (given the focus on lending short to better risk/scored clients).



Finally, the increase in the loan churn rate has led to committed cash being collected much faster, thus sustaining the higher inter-month business volumes.



What should also be considered is that the collection success rate is largely concentrated in the earlier loan ageing buckets, and thus relies heavily on the origination frequency of new credits into the book.

Portfolio quality

Despite the group's success in transforming portfolio efficiency, some underlying quality issues remain - particularly the rate at which loan arrears transition through the ageing buckets after a failed payment/s.

Loan behaviour statistics†	Result
Current to 30-days	53.2%
31-days to 60-days	86.3%
61-days to 90 days	96.9%

† Gross forward roll rates, based on days past contractual due date.

The resultant pooling of past due loans, combined with the contraction in gross loans outstanding, over accentuates the observed weakening in asset quality.

Table 4: Asset quality	F11 R'000	F12 R'000
Gross advances	**106 425**	**100 342**
Performing	82 197	66 121
Non-performing	24 228	34 221
Less : Provisions	(10 704)	(10 794)
Net advances	**95 721**	**89 548**

Source: Finbond.

Analysing the back-end data also reveals quite a lot of action off-balance sheet, and whilst credit was given to the relative success of the group's remedial activities, the fact remains that the core of the book must be improved to minimise the reliance on such.

Remedial activity statistics	Result
Average write-off rate*	24.2%
Average term to write-off	9.3 months
Provision coverage (≥ 90-days)º	68.1%
Average recovery rate‡	31.1%

* Shown as a percentage of loans in arrears for 90-days and/or more.
º Relates to the allocation of total provisions to this ageing bucket.
‡ Shown as a percentage of the last 12-month cumulative write-offs.

Nevertheless, stressing the loan book show that the balance sheet is sufficiently resourced to withstand and absorb a rapid blow out in credit impairments.

Bad debt model (R'm)†	Current	If +R10m	If +R50m‡
Impairments/bad debts	34.2	44.2	84.2
Provisions reserved	10.8	-	-
Profits generated	13.6	-	-
Other reserves$^{\sigma}$	31.7	11.9	-
Core equity	140.5	140.5	112.4
Adjusted assets	**415.9**	**405.9**	**365.9**
Adjusted equity	**185.8**	**152.4**	**112.4**
Available capital ratio	**44.7%**	**37.5%**	**30.7%**
Required capital ratio	**28.3%**	**29.4%**	**33.5%**

† Assumes all impairments turn bad (and must be written off, in the incremental bad debt scenarios planned), and that reserves will be consumed in the asset/reserves waterfall sequence laid out here).
σ Relates to the prior years' retained earnings and/or other reserves.
‡ At this level, the impact on capital will be outside safe boundaries.

[2] A significant number of open accounts are settled/paid up before month/year-end, and is therefore excluded from the balance sheet. This, in turn, understates the true level of business/loan activity.

Financial performance and prospects

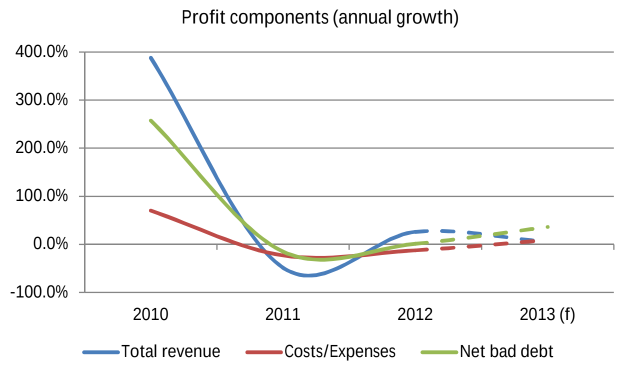
A 5-year financial synopsis is reflected at the back of this report, accompanied by the commentary below.

Balancing the downward pull of flatter loan yields and expansionary business and/or funding expenses with stronger loan/package product sales has seen the group's profitability record a net improvement.

Table 5: Profit share (by source/division)†	F11		F12	
	R'000	%	R'000	%
Including asset based gains/ (losses)				
Micro-finance	7 751	(38.1)	(17 295)	(128.8)
Property investments	(879)	4.3	21 201	157.9
Mortgage origination	717	(3.5)	346	2.6
Group reconciling	(27 933)	137.3	9 172	68.3
Profit/ (loss) after tax	**(20 344)**	**100.0**	**13 424**	**100.0**
Excluding asset based gains/ (losses)				
Micro-finance	7 751	(38.1)	(17 295)	5.9x
Property investments	(902)	4.4	(1 231)	(42.0)
Mortgage origination	717	(3.5)	346	11.8
Group reconciling	(27 933)	137.2	21 111	7.2x
Profit/ (loss) after tax	**(20 366)**	**100.0**	**2 931**	**100.0**

† Bottom line/post tax income before any/all headline adjustments.
Source: Finbond.

Furthermore, after the impact of the revaluations on the property investments is stripped out, the group posted its first positive set of numbers in three years - however, to have a firm impact on the group's ratings, this development in adjusted earnings must be sustained on a continuous basis.



Looking at the group's half year results in turn, and the positive trend in absolute earnings was sustained; thereby coinciding with management's view that the business has turned the corner on generating positive replicable and sustained returns.

Table 6: Interim result comparison†	3Q F12		3Q F13	
	R'000	%	R'000	%
Net interest income	27 056	22.2	23 805	16.4
Other income	94 678	77.8	121 560	83.6
Total operating income	**121 734**	**100.0**	**145 365**	**100.0**
Bad debt charge	(24 438)	(20.1)	(23 111)	(15.9)
Operating expenses	(99 697)	(81.9)	(102 323)	(70.4)
Profit/ (loss) before tax	**(2 401)**	**-**	**19 931**	**-**

† Percentages relate to contribuon/ absorpon of operang income.
Source: Finbond.

Finbond Group Limited

(South African Rand in '000 except as noted)

For the year ended 28 February **Income Statement**	**2008*º**	**2009***	**2010ª**	**2011**	**2012**
Interest income	63 669	55 197	65 599	58 427	47 383
Interest expense	(5 459)	(15 498)	(19 724)	(15 949)	(16 802)
Net interest income	**58 210**	**39 699**	**45 875**	**42 478**	**30 581**
Asset related gains / (losses)ⁿ	4 114	(67 412)	142 520	(19 370)	22 435
Other income	112 155	84 770	89 929	119 193	125 974
Total operating income	**174 479**	**57 057**	**278 324**	**142 301**	**178 991**
Loan loss provision	(3 893)	(7 745)	(27 669)	(23 461)	(23 719)
Operating expenditure	(81 928)	(111 369)	(189 307)	(145 327)	(127 042)
Net profit/ (loss) before tax	**88 658**	**(62 058)**	**61 348**	**(26 487)**	**28 229**
Tax	(25 989)	4 376	(3 150)	6 143	(14 805)
Net profit/ (loss) after tax	**62 669**	**(57 681)**	**58 198**	**(20 344)**	**13 424**
Other after-tax income / (expenses)	(2 403)	(3 279)	-	323	128
Net attributable income/ (loss)	**60 265**	**(60 960)**	**58 198**	**(20 021)**	**13 552**
Balance Sheet					
Ordinary share capital and reserves	276 269	193 689	252 451	235 536	247 638
Total capital and reserves	**293 186**	**213 885**	**252 593**	**235 095**	**247 068**
Long-term borrowings	77 332	145 491	140 026	159 112	159 206
Short-term borrowings	-	8 094	38 009	19 371	35 236
Other liabilities	70 841	47 764	52 145	30 479	35 613
Total capital and liabilities	**441 359**	**415 234**	**482 773**	**444 056**	**477 123**
Cash and liquid assets	47 999	86 759	58 686	36 938	53 233
Net customer loans	109 117	118 391	95 635	95 578	89 477
Other loans	9 210	11 253	540	143	71
Other assets	275 034	198 831	327 912	311 397	334 341
Total assets	**441 359**	**415 234**	**482 773**	**444 056**	**477 123**
Contingencies	**19 409**	**14 766**	**33 686**	**33 798**	**26 576**
Key ratios (%)					
Financial management					
Interest expenses / Average gross advances	7.7	11.4	16.0	15.2	16.3
Interest expenses / Average funding liabilities	13.9	13.4	11.9	8.9	9.0
Interest bearing debt / Total capital (:1)	0.3	0.7	0.7	0.8	0.8
Total capital / Total assets	66.4	51.5	52.3	52.9	51.8
Internal capital generation	14.2	(13.9)	12.1	(4.6)	2.8
Cash and liquid assets / Total assets	10.9	20.9	12.2	8.3	11.2
Asset quality					
Portfolio at risk‡ / Gross advances	no data°	no data°	11.7	17.7	24.2
Loan loss reserves / Average gross advances	16.5	9.8	5.5	10.2	10.4
Loan loss reserves / Portfolio at risk‡	no data°	no data°	56.6	56.8	44.4
Bad debt charge / Average gross advances	5.5	5.7	22.5	22.4	22.9
Bad debt charge / Total operating income	2.2	13.6	9.9	16.5	13.3
Efficiency and Productivity					
Operating expenses / Average gross advances	116.1	81.6	153.9	138.8	122.9
Cost per loan (Rand value)	no data°	no data°	4 082.4	3 298.8	3 309.1
Operating expenses / Operating income	47.0	195.2	68.0	102.1	71.0
Profitability					
Net interest margin	70.9	21.9	25.5	29.6	22.2
Net interest income / Average gross advances	82.5	29.1	37.3	40.6	29.6
Non interest income / Total operating income	64.3	148.6	32.3	83.8	70.4
Net profit margin	50.8	(108.8)	22.0	(18.6)	15.8
Portfolio yield	249.2	102.6	126.4	169.6	167.7
ROaE	39.8	(24.0)	25.0	(8.2)	5.6
ROaA	26.4	(14.2)	13.0	(4.3)	2.9
Nominal growth indicators					
Total assets	28.0x	(5.9)	16.3	(8.0)	7.4
Net customer loans	24.5x	8.5	(19.2)	(0.1)	(6.4)
Shareholders equity	28.4x	(29.9)	30.3	(6.7)	5.1
Attributable income	10.4x	(201.2)	n.a.	(134.4)	n.a.

* Several business acquisitions were made to form the Finbond Group (1 March 2007 & 2009).

º Finbond was listed on the local bourse's second tier, or AltX, on 15 June 2007 (or 2Q F2008).

ª Finbon Group exits mortgage origination business (1 March 2011) - profit contribution now less than 1%.

ⁿ Relates to revaluations, recognotion of goodwill, net profit on sale/purchase and impairment losses on intangibles.

° The ageing data provided were not sufficiently detailed to calculate the risk percentages for these fields.

‡ Refers to loans past due for more than 30-days.