GCR RATINGS

Public credit rating report | South African Financial Institution | November 2020

Sasfin Bank Limited

Rated Entity	Rating class	Rating scale	Rating	Outlook/Watch
Sasfin Bank Limited	Long term Issuer	National	BBB+(ZA)	Negative Outlook
	Short term Issuer	National	A2(ZA)	
	Long term Issuer	International	B	Stable Outlook

Strengths

- Specialist originator of equipment lease financing for SMEs
- Strong franchise of Wealth Management subsidiaries within the Sasfin Group.

Weaknesses

- Modest market position with scale disadvantages and no international diversification.
- Limited transactional deposit franchise resulting in higher cost of funds.

Rating rationale

The downgrade of Sasfin Bank Limited's ('Sasfin', 'the bank') international scale rating reflects the strained operating environment of South Africa and increasing banking sector risk post COVID-19. The national scale ratings have been affirmed, however, based on the credit profile reflecting the strengths and weaknesses of the wider Sasfin Group ('the group'). The affirmation balances the group's adequate capital, relatively weak risk and competitive position, weak funding structure and strong liquidity.

Sasfin's competitive position is modest with market share of banking business of less than 1%, and limited corporate and retail franchise in comparison to big banks. Nevertheless, the core strength of the bank is its equipment leasing business for SMEs, and the fact that it contributes materially to group revenues is viewed positively. That said, track record of revenue stability has been good over the years and increasingly benefiting from improving diversification largely from the wealth management business that has a relatively stronger franchise versus peers.

Capitalisation is a neutral ratings factor, reflected by an adequate GCR total capital ratio of 16% as at 31 December 2019. We expect the ratio to range between 15-16% over the next 18-24 months due to anticipated pressure on earnings from a potential increase in cost of risk and the soft interest rate environment. Through the cycle earnings have been modest, with the group returning less than 1% of assets (c.1% at 1H2019). Earnings are expected to trend broadly in line with sector average, balancing some margin pressure and a stable contribution from non-interest income.

The bank's risk position is a neutral ratings factor for now, balancing sector average credit losses recorded through the cycle (1.1% at half year-end December 2019) and higher NPLs measuring 9.4% over the same period. Majority of the NPLs are from the construction sector and given the current low infrastructure spending in the country, heavily SME focused loan book, combined with the aftermath effects of the COVID-19 crisis, credit losses are expected to spike over the next 12-18 months, although the rating factors our expectation of 2%. Positively, loan concentrations are low, with top 20 exposures accounting for 18% of total loans. Limited foreign currency lending also benefits the bank's risk position.

The funding and liquidity assessment factors in some of the structural funding disadvantages of tier 2 banks in South Africa. This is reflected by the relatively limited core transactional deposit franchise which increases the cost of funding. The bank's core deposits (GCR define these as retail and non-financial corporate deposits) as a percentage of total funding accounted for just under 37% as of 31 December 2019. Furthermore, the bank's depositor concentrations are somewhat higher than the larger financial institutions. Positively, the structural funding disadvantages are balanced by good liquidity in the bank. Liquidity is supported by the very short-term loan book that has c.70% of exposures maturing within 12 months. The bank also maintains a good regulatory liquidity coverage ratio of 153% as at 31 Dec. 2019 vs the revised required minimum of 80%.

Outlook statement

The outlook on national scale ratings is negative, as we anticipate the impact of a strained economy on SMEs to weigh on the bank's asset quality reflected by increasing NPLs and cost of risk.

Rating triggers

A national scale downgrade could be caused by higher than anticipated credit losses, poor earnings or a reduction in capital adequacy. The upside to the national scale ratings is limited, although increased business diversification, a stronger funding structure, and stronger capitalisation could result in a rating improvement. Alongside the above, a further downgrade in the international scale ratings could be caused by a worsening operating environment.

Analytical contacts

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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, November 2020
GCR Financial Institutions Sector Risk Score, August 2020

Ratings history

Sasfin Bank Limited					
Rating class	Review	Rating scale	Rating class	Outlook	Date
Long Term issuer	Initial	National	BBB+(ZA)	Stable	May 2016
	Last	National	BBB+(ZA)	Stable	August 2019
	Initial	International	BB	Stable	May 2016
	Last	International	B+	Stable	August 2019
Short Term issuer	Initial	National	A1-(ZA)	N/a	May 2016
	Last	National	A2(ZA)	N/a	August 2019

Analytical Entity: Sasfin Bank Limited

Sasfin Bank Limited is the banking subsidiary within the Sasfin group, contributing materially by both assets (56%) and revenues (over 70%) at HY20. The bank is the originator of loans, and as part of its business model and funding strategy, it securitises a significant percentage of those loans via a true sale to its subsidiary securitisation vehicles. The Sasfin group also has wealth management businesses that meaningfully contribute to revenues. The bank is considered to be a core part of the group because it contributes the most assets and revenues of the Sasfin group. As a result, the ratings on the bank are based the credit profile of the wider group and GCR equalises the ratings to the group Anchor Credit Evaluator ("ACE").

Operating Environment

The operating environment assessment is anchored by Sasfin's 100% exposure in South Africa.

Country risk

The South Africa country risk score of '7.0' reflects GCR expectations that GDP per capita will range between USD6,000 and USD6,500 over the next 12-18 months, balancing deeply negative economic growth in the short term due to COVID-19, with modest in the medium/ long term with stable population growth and continued pressure on the local currency. It also factors in institutional scores in the middle of the range, supported by voice & accountability and regulatory quality, macro-economic stability, infrastructure and the strengths of the financial system. Corruption and politics, innovation and health are the detracting elements of institutional strength for the country. GCR have made a small positive adjustment to the initial score, balancing the size and diversification of the South African economy versus regional peers and strong monetary policy flexibility against the rapidly deteriorating fiscal position of the government and high profile SOEs.

Sector risk

GCR has lowered the South African Financial Institution sector risk score to 7.5 from 8. The onset of the COVID-19 pandemic has compounded an already strained operating environment, with the South African Reserve Bank (SARB) projecting a 7% GDP contraction in 2020. Given the early indicators from the banks, we expect credit losses will increase to between 1.5%-1.7% for the top tier banks, rising to over 2% for the sector has a whole; largely because the 2nd and 3rd tier unsecured and SME lenders will have a disproportionate impact on sector wide credit losses in comparison to their size. See the most up to date South African sector risk scores at www.gcrratings.com.

Business Profile

Competitive position

Modest market position with scale disadvantages and no international diversification

Safin Bank has a modest market position reflected by its share of industry assets of less than 1% at the time of writing. This scale disadvantage also limits branch visibility, ATMs and other digital products in comparison with top tier banks. However, the core strengths of the bank lies in equipment lease financing of SMEs improving its lending franchise within that space.

Business diversification is considered to be modest, given the lack of scale and regional/international market penetration. The group operations are 100% in South Africa and thus lack the geographic diversification to other favorable operating environments. Nonetheless, the group has non-banking subsidiaries that have a solid franchise in their respective operating space, which does benefit the rating. For example, Sasfin Wealth has built a strong institutional asset manager and offshore portfolio management capabilities as reflected in the tremendous growth in assets under management over the past 4-5 years. We believe there are direct and indirect benefits of these businesses to the bank. In terms of digitalisation, the bank has made strides in developing innovative platforms (such as B\\YOND and Hello Paisa) and a product mix with a broad industry focus. In turn, this has helped the bank manage its cost of funds and acquire new accounts.

The bank has demonstrable track record of revenue stability with good growth recorded over the past 4-5 years. However, we are expecting FY21 revenues to be just down on the previous years, due to pressures emanating from the operating environment. Revenue stability has been good, supported by capital light revenues, largely emanating from the wealth franchises, accounting for c.60% over the past 3-5 years.

Going forward, the bank's growth strategy will continuously evolve with changes in the operating environment. Currently, loan disbursements are down with credit largely to specific repeat business. Revenue growth will be greatly aligned with loan growth expectations and interest rate changes.

Management and governance

Management and governance is considered neutral to the ratings.

Financial Profile

Capital and Leverage

Modest capitalisation expected to be sustained throughout the outlook horizon

The capitalisation of the bank is a neutral ratings factor. The GCR total capital to risk-weighted assets ratio was c.15% at FY20 and we expect the ratio to trade within 100bps of the revised range of 14.5%-15.5% over the next 18-24 months balancing modest loan growth, adequate and improving loan loss reserve coverage, and anticipated pressure on earnings. The bank posted a loss in its financial year 2020 resulting from a modest reduction in pre-provision income (attributed mostly to market sensitive trading gains) and a significant 214% increase in impairments.

Our forecast factors in the following over the next 12-18 months:

- Modest loan book growth for the remainder of 2020 and 7% in 2021, with relatively quicker RWA growth due to negative credit risk migration.
- Core earnings to rebound from negative territory to between 0.5% and 0.8% of adjusted assets.
- Cost of risk to remain elevated at just above 2% for majority of 2021 before receding to around 1.4%.
- We are expecting revenues to be down 4% for HY20 and up by around 5% in 2021.
- Costs are expected to be well controlled, with a stable cost to income ratio.

Table 1:

	2022(f)	2021(f)	2020	2019	2018
GCR Total Capital to RWA (%)	14.83%	15.34%	15.16%	14.00%	15.19%
Core Earnings to Adjusted Assets (%)	0.79%	0.51%	-0.45%	0.98%	0.92%

Risk

Asset quality is neutral to the ratings for now

The risk position of the bank is modest, balancing the high and rising NPLs, moderate loan concentrations, heavily SME focused loan book, and low credit losses adequately comparable with peers. NPLs have increased over the past 3 years from 5% to the current 10.3%, mainly due to exposures in the construction sector. Given the cyclical nature of construction, coupled with the impact of COVID-19, we expect to see a number of borrowers negatively migrating to lower loan classifications thus pressuring NPLs to remain elevated at around 11% by end of 2021. Credit losses are expected to remain elevated for the majority of 2021 before receding to 1.4% the following year. Positively, loan concentrations are moderately low with top 20 loans accounting for c.17% of total loan book at Q1 2020. Loan growth has been modest over the past 2 years and going forward disbursements are expected to slowdown over the next 12-

18 months with the bank's selective credit extension. The bank has no FX lending and market risk is minimal, benefiting its risk position.

From a risk perspective, the operational and business continuity risk of COVID-19 has been managed well to date, with branches running at business as usual services but with reduced hours.

Table 2:					
	2022(f)	2021(f)	2020	2019	2018
New loan loss provisions to average customer loans (%)	1.4%	2.5%	2.3%	0.7%	1.3%
Loan loss reserves to non-performing loans (%)	70.6%	72.6%	77.6%	55.3%	48.8%
Gross non-performing loans to average customer loans (%)	10.9%	11.1%	10.3%	9.2%	7.4%

Funding and Liquidity

Funding and liquidity is considered to be a negative ratings factor for the bank. Our assessment factors in the structural funding disadvantages of lower tier banks reflected in structure of deposits mainly comprising confidence sensitive institutional deposits. The bank's funding model relies on securitisation (with c.50% of the loan book securitised at FY20) which we view negatively from the group perspective given it structurally subordinates senior unsecured funders. Positively, on the bank level there is no subordination as the assets are derecognised on the balance sheet via a true sale. In addition, access to the securitisation market has been stable in South Africa. Liquidity on the other hand is very strong, moderating the structural funding disadvantages. GCR liquid assets to customer deposits was 75% at FY20, but expected to increase to over 80% over the next 12-18 months. Liquidity is supported by the short duration loan book, while the term profile of the funding is extended, resulting in positive asset/liability mismatch.

Table 3:					
	2022(f)	2021(f)	2020	2019	2018
Total deposits to funding base (%)	62.1%	61.7%	53.3%	51.8%	44.5%
GCR liquid assets/ customer deposits (%)	84.6%	86.0%	82.3%	75.1%	113.2%

Comparative Profile

The comparative profile is a neutral component for the ratings.

Peer analysis

The peer analysis is neutral to the ratings.

Group support

Group support is not applicable to the ratings.

Rating Adjustment Factors

Structural adjustments

No structural adjustments have been made to the ACE in arriving at the final ratings.

Instrument ratings

Not applicable to the ratings.

Risk Score Summary

Rating Components & Factors	Risk Scores
Operating environment	**14.50**
Country risk score	7.00
Sector risk score	7.50
Business profile	**(3.00)**
Competitive position	(3.00)
Management and governance	0.00
Financial profile	**(0.50)**
Capital and Leverage	0.00
Risk	0.00
Funding and Liquidity	(0.50)
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**11.00**

Glossary

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
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.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Income	Money received, especially on a regular basis, for work or through investments.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
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.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings 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 the rated entity.

The ratings were solicited by, or on behalf of, the rated entities, and therefore, GCR has been compensated for the provision of the ratings.

Sasfin Bank Limited participated in the rating process via teleconference 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 the entities and other reliable third parties to accord the credit ratings included:

- Half year financial results as at 31 December 2019;
- Audited financial results as at 30 June 2020'
- Budgeted financial statements for 2020;
- Latest internal and/or external audit report to management;
- A breakdown of facilities available and related counterparties; and
- Industry comparative data.