MOODY'S
INVESTORS SERVICE

CREDIT OPINION
1 March 2019

Update

Rate this Research

Land and Agricultural Development Bank

Update following outlook change to negative

Summary

We assign Baa3/Prime-3 issuer ratings to Land and Agricultural Development Bank of South Africa (Land Bank), which reflects Land Bank's standalone assessment of ba3, and three notches of uplift, incorporating our assumption of a high probability of government support from South Africa (Baa3 stable) in case of need, owing to its full government ownership, developmental mandate and evidence of past capital and funding support. The issuer outlook is negative. We also assign Aa1.za/P-1.za national-scale issuer ratings.

Land Bank's ba3 standalone assessment reflects elevated credit risks, with non-performing loans (NPLs) at 6.7% of gross loans as of March 2018 and an additional 7.6% classified as underperforming. Its tangible common equity (TCE)-to tangible managed assets ratio of 13.1% compares well with global peers but has been declining, while its capital adequacy ratio of 17.3% only provides a modest cushion to the 15% minimum required by lending covenants. Land Bank has also taken steps to improve its funding structure by extending maturities and diversifying its funding sources. Nonetheless, Land Bank's plans for strong growth, will require it to find both new capital and funding sources in an environment of volatile capital and debt markets.

Operating conditions also remain challenging, including developments around South Africa's Land Reforms. Poor implementation could result in (1) loss of investor confidence; (2) increase in problem loans; and (3) the drying up of funding sources for Land Bank, as ZAR9 billion of its debt include a market clause on "expropriation" as an Event of Default. We understand, however, that the government plans to execute this strategy in a way that maintains productivity and without threatening food security, primarily by applying the principle to unused and government-owned land.

THIS REPORT WAS REPUBLISHED ON 4 MARCH 2019 TO REFLECT THE NEGATIVE ISSUER LEVEL OUTLOOK ON THE RATINGS TABLE ON THE FRONT PAGE AND ON EXHIBIT 8.

RATINGS

Land and Agricultural Development Bank

Domicile	South Africa
Long Term Rating	Baa3
Type	LT Issuer Rating - Fgn Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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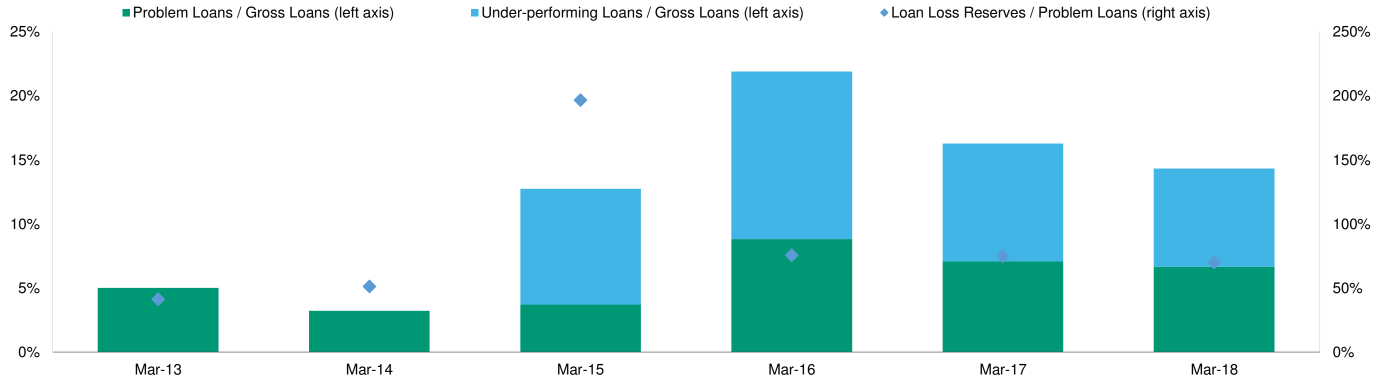
Exhibit 1
Credit risks remain elevated despite improved asset quality metrics



Sources: Moody's Financial Metrics, Land Bank's financials

Credit strengths

» Leading franchise in the agricultural sector, benefiting from its policy role

» Land Bank's government ownership and high probability of government support underpin its issuer ratings

Credit challenges

» Declining capital buffers

» Elevated credit risks

» Challenging operating conditions and uncertainties surrounding the Land Reforms

Rating outlook

The negative outlook assigned to Land Bank is predominantly driven by pressures on its standalone assessment, stemming from (1) declining capital buffers that will challenge its ability to meet some loan covenants while fulfilling its developmental mandate and related loan growth targets; and (2) downside risks regarding the impact of the upcoming Land Reforms.

Factors that could lead to an upgrade

» A change in outlook back to stable will require Land Bank to build up its capital buffers, as well as greater clarity surrounding the impact of the upcoming Land Reforms. Further positive actions will additionally require a significant improvement in macroeconomic conditions, also leading to an improvement in the sovereign credit profile.

Factors that could lead to a downgrade

» Failure to strengthen its capital buffers and further diversify its funding sources, and continued uncertainty relating to the Land Reforms, will negatively affect ratings. In addition, any weakening of the South African government's credit profile and/or in its willingness and capacity to support Land Bank, would also exert downward ratings pressure.

Key indicators

Exhibit 2

LAND AND AGRICULTURAL DEVELOPMENT BANK OF SOUTH AF (Consolidated Financials) [1]

	3-18[2]	12-16[2]	12-15[2]	12-14[3]	12-13[3]	CAGR/Avg.[4]
Total managed assets (ZAR thousand)	49,574,542	45,497,009	41,441,414	38,939,106	37,924,212	6.9 [4]
Total managed assets (USD thousand)	4,183,947	3,393,084	2,817,610	3,213,792	3,605,683	3.8 [4]
Pretax Preprovision profits / Average Managed Assets (%)	0.7	1.0	0.9	1.8	1.4	1.2 [5]
Net Income / Average Managed Assets (%)	0.5	0.8	0.4	0.8	1.0	0.7 [5]
ROE (%)	4.4	5.0	3.5	5.1	5.2	4.6 [5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	13.1	13.8	14.3	14.8	20.3	15.3 [5]
Effective Leverage (%)	641.8	602.3	560.3	535.5	366.6	541.3 [5]
Problem Loans / Gross Loans (Finance) (%)	6.7	7.1	8.8	3.7	3.2	5.9 [5]
Problem Loans / (Shareholders' Equity + Loan Loss Reserve) (Finance) (%)	34.6	34.7	39.5	16.1	13.0	27.6 [5]
Net Charge-Offs / Gross Loans (%)	0.6	1.0	0.4	0.1	0.3	0.5 [5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime.
Source: Moody's Investors Service

Profile

Land and Agricultural Development Bank of South Africa is a government-owned development finance institution, and reported total assets of ZAR49.5 billion as of March 2018. It commands a market share of around 28% in lending to the agricultural sector, maintains a strong franchise and expertise in the sector, and is well placed to take advantage of the growth opportunities within the agricultural sector. Land Bank is the government's key delivery agency in the agricultural sector, aiming to create jobs, reduce poverty and strengthen sustainable economic performance.

Land Bank's government ownership and close co-operation with the National Treasury has allowed the bank to benefit from operational and financial support. Additionally, the finalisation of a comprehensive organisational review has led to improvements in the bank's business model, processes and operational efficiencies. However, the bank's franchise strength is constrained by its monoline status, which exposes it to significant concentration risks.

Detailed credit considerations

Land Bank faces elevated credit risks

We assign a weighted average asset risk score of B2, five notches below its initial score, capturing high sectoral concentrations and a significant proportion of loans classified as “underperforming”.

As of March 2018, Land Bank's NPLs were 6.7% of gross loans (and increasing to 7.4% in September 2018), with an additional 7.6% of gross loans classified as underperforming. Going forward, we expect Land Bank to continue to face elevated credit risks because of the still subdued economic growth. For 2019 and 2020 we forecast GDP growth rates of 1.3% and 1.5%, respectively, well-below potential and the rate required to create new jobs. Similarly, drought relief assistance provided by Land Bank, including the restructuring/ capitalisation of installments due and the extension of repayment periods, will exacerbate asset-quality issues in case weather conditions do not continue to improve and extend to Western, Northern and Eastern Cape.

Asset quality pressures could also be exacerbated by Land Bank's high credit concentrations (we estimate that the top 10 exposures account for over 160% of the bank's capital), while we understand that the bank has taken a strategic decision to focus more on developmental rather than commercial projects, which have historically proved to be more risky. Another source of risk is the generally low level of provisioning coverage, with specific provisions at 26% of NPLs, while the coverage for underperforming loans stood at 34%; management maintains, however, that the balance is covered by collateral.

Around half of the bank's portfolio is dispersed to agricultural co-operative organisations, in the form of service level agreements (SLA) and with a total of seven such agreements currently in place. Although these have historically performed well, there has recently been a deterioration in a couple of these portfolios; Land Bank's management is engaging with its partners to remediate the issues that caused the climb in their NPLs.

Modest earnings generating capacity

We assign a B2 profitability score, two notches below its initial score, reflecting historical and potential earnings volatility.

Land Bank maintains a modest earnings-generating capacity, impaired by a still-high cost base, rising funding costs and elevated provisioning requirements. For year ended March 2018, the bank reported net profit of ZAR254.2 million, which translates into a return on equity of around 4% and net income on average managed assets of 0.5%. Going forward, we do not expect any material increase in profitability given the still challenging operating conditions, the bank's development mandate and expectations of higher funding costs.

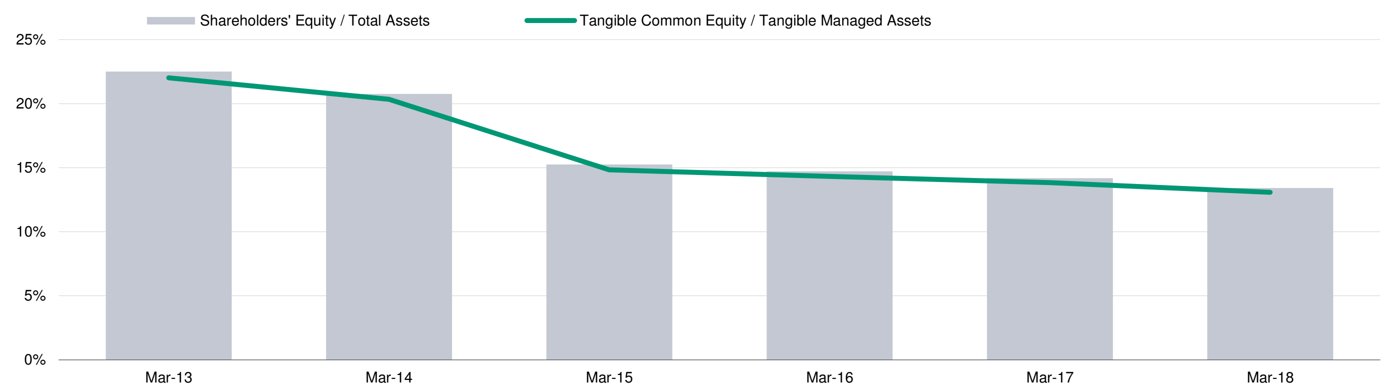
Capital buffers provide some loss-absorption capacity, but potentially more capital will be needed for Land Bank to implement its growth strategy

We assign a capital score of Baa3, in line with its initial score.

As of March 2018, Land Bank held TCE of ZAR6.5 billion, equivalent to 13.1% of tangible assets, which provide some protection against unforeseen losses. Land Bank has also adopted the Basel II standardised approach to determine the amount of capital needed to ensure solvency and liquidity, and has targeted a minimum capital adequacy ratio of 15%. The bank's total capital adequacy ratio (CAR) stood at 17.3% as of March 2018.

Exhibit 3

Capital levels provide some loss-absorption capacity, but remain close to minimum capital covenants



Sources: Moody's Financial Metrics, Land Bank's financials

We do, however, highlight two issues relating to Land Bank's capital: (1) its lending covenants require a minimum CAR of 15%, with the reported ratio of 17.3% incorporating a ZAR2.8 billion capital guarantee from the National Treasury as part of the equity. However, ZAR1.3 billion is earmarked for a World Bank funding facility that will be reduced/eliminated over the coming quarters as the funding line is utilised. This will bring the CAR ratio down to around 15%; (2) if the bank is to pursue its high balance sheet growth strategy, it will require additional capital as its internal capital generating capacity remains low. The government, as the major shareholder, has historically been injecting new capital on an ongoing basis, but large fiscal deficits and other government priorities may require Land Bank's management to pursue other options or revise down its growth projections.

Land Bank has successfully met its funding needs, but could face challenges in finding new funding sources and extending maturities in light of its targeted aggressive balance sheet growth

We assign a weighted average Cash Flow and Liquidity Score of B1, two notches below its initial score, primarily to reflect the limited benefits derived from Land Bank's very low secured debt, given the limited size and depth of the South African securitisation market.

Land Bank has historically raised funding from (1) the local capital markets, primarily as part of its outstanding ZAR30 billion domestic medium-term note programme; (2) local institutional investors; and (3) related parties, such as the Public Investment Corporation. The bank has also raised funding from multilateral development institutions. Land Bank also has approved, but not utilised, lines from local banks, and maintains a contingency plan in case its usual sources of funding become unavailable; this includes potentially selling part of its loan portfolio or re-adjusting its growth targets. Land Bank has also adopted the Basel liquidity coverage ratio (214% as of March

2018) and net stable funding ratio (109% as of March 2018), albeit with certain Board approved deviations from the regulations to cater for its unique business model.

However, Land Bank faces a number of challenges, primarily relating to the high – but declining – portion of existing funding (around 43% as of March 2018) that matures within the next 12 months; its dependence on related-party lending or lending that is backed by a government guarantee (currently at around ZAR5 billion); and its limited cash-flow generating capacity (Land Bank had a negative funds from operations-to-total debt ratio as of March 2018). Also, its 12-month debt maturities coverage ratio of around 14% suggests that the bank's ability to cover debt maturing in the next 12 months is only partly covered by readily available liquidity sources. We understand, however, that a significant portion (ZAR9.7 billion) of this short-term funding is sourced from the Public Investment Corporation, which has historically always been re-invested back into Land Bank.

Plans for strong balance sheet growth will also require Land Bank to find new funding sources at a time when it remains vulnerable to potential risk aversion by institutional investors. The bank has navigated through past market turmoil, but any event that adversely affects investor confidence could still jeopardise its capacity to further lengthen and diversify its funding sources, while also leading to higher funding costs.

Operating environment

We assign a Ba3 score to Land Bank's operating environment, based wholly on our assessment of the (Ba) industry risk of South African industrial and infrastructure lenders. Land Bank's score is adjusted downwards (from Ba2) as the potential implementation of the Land Reforms could have significant implications to its operations, as noted above.

Macro-level indicator

The macro level indicators does not have any weighting in the scorecard, since the macro-level indicator score (Baa2) is higher than the Ba industry risk score.

Industry risk

The Ba industry risk score reflects the finance companies' high market share in South Africa's industrial and infrastructure lending market; ongoing high demand given the country's needs for infrastructure, energy and industrial projects; and a product base that faces a low risk of obsolescence. Barriers to entry are moderate, as the market is open to both banks and the capital markets, but access to long-term funding and substantial capital is required. These strengths are, however, balanced against strong competition from the country's leading banks (which also translates to a limited pricing power for the finance companies) and relatively high regulatory/legal risks relating to potential changes to South Africa's Mining Charter and upcoming Land Reforms.

Corporate governance remains a key credit consideration

Over the recent past, South African state-owned enterprises have attracted considerable attention, as some have exhibited high-level corruption and 'state capture'. In the case of Land Bank, no such issues were raised, while a number of initiatives were taken to further strengthen governance. For example, credit decisions now requiring a two-thirds majority, while a policy on lending to politically exposed persons has also been approved by the board. Nonetheless, corporate governance remains a key credit consideration and, while we do not adjust for corporate behaviour in our scorecard, we will continue to monitor developments going forward.

Support and structural considerations

Government ownership, policy mandate and the resulting high probability of government support underpin the issuer rating

Land Bank's Baa3 issuer rating is three notches above its standalone assessment of ba3, incorporating our assumptions of a high probability of government support in case of need, on the back of its government ownership and a history of the government providing capital and funding support when required. Ongoing support to state-owned-enterprises has led to a deterioration in government finances but we continue to assess government support to be a policy priority, which will continue to come at the detriment of further fiscal erosion.

The bank is regulated by the Public Finance Management Act and the Land Bank Act, and submits a corporate plan to the National Treasury, which also documents the key performance measures and targets against which organisational performance is assessed. The government's track record of supporting both the capital and funding positions of the bank, as well as the lack of any legal barriers for the bank's timely support, also informs our support assumptions. Land Bank's crucial role in the development of South Africa's agriculture sector, including acting as a financial intermediary for smaller farmers with limited access to bank funding, which is considered one of the cornerstones of South Africa's economy according to the National Development Plan, provides further support to the rating.

We also note, however, that increased fiscal challenges suggest that – going forward – the government will be more selective in dispersing financial support to state-owned enterprise. It is for this reason why we now cap our support assumptions at "high" for all three South African development banks (Land Bank, DBSA and IDC). Similarly, we assume a "very high" default dependence, which reflects the strong probability that, in the case of a sovereign credit default, the risk of a potential financial crisis affecting Land Bank is very high.

National-scale ratings

Land Bank's Aa1.za long-term and P-1.za short-term South African national-scale ratings are derived from its global-scale issuer ratings. The ratings demonstrate that Land Bank remains one of the strongest credits in the country, primarily reflecting its close links with the government and our assessment of a very high probability of support, in case of need.

Source of facts and figures in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Company-specific figures originate from Land Bank's financial statements and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

Rating methodology and scorecard factors

The principal methodologies used in rating Land and Agricultural Development Bank of South Africa were Finance Companies published in December 2018, and Government-Related Issuers published in June 2018.

Exhibit 4

Land and Agricultural Development Bank of South Africa

Financial Profile	Historical			Assigned		
	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	0.53%	Ba3	**B2**	Expected trend	Earnings volatility
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	13.08%	Baa3	**Baa3**	Other adjustments	Excessive growth
Asset Quality						
Problem Loans / Gross Loans (%)	10%	7.52%	Caa1	**Caa1**	Expected trend	
Net Charge-Offs / Average Gross Loans (%)	10%	0.67%	Aa1	**Ba2**	Pro-forma adjustments	Differences in accounting and reporting
Weighted Average Asset Risk Score			Baa3	**B2**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	13.49%	Caa3	**Ba3**	Other adjustments	
FFO / Total Debt (%)	15%	-0.24%	Ca	**Ca**	Expected trend	
Secured Debt / Gross Tangible Assets (%)	20%	0.17%	Aa1	**Ba1**	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			**Ba2**	**B1**		
Financial Profile Score	**1**		**Ba1**	**Ba3**		
Operating Environment						
Home Country	Factor Weights	Qualitative Scale	Score			
Macro Level Indicator	0%		Baa2			
Economic Strength	25%	Moderate +				
Institutional Strength	50%	Moderate +				
Susceptibility to Event Risk	25%	Low +				
Industry Risk	100%		Ba			
Home Country Operating Environment Score			Ba2			
	Factor Weights			Score	Comment	
Operating Environment Score	**0**			Ba3	Adjustment due to higher political risks relating to Land Reform	
ADJUSTED FINANCIAL PROFILE				**Score**		
Adjusted Financial Profile Score				**Ba3**		
Financial Profile Weight	100%					
Operating Environment Weight	0%					
Business Profile and Financial Policy				Adjustment	Comment	
Business Diversification, Concentration and Franchise Positioning				0		
Opacity and Complexity				0		
Corporate Behavior / Risk Management				0		
Liquidity Management				0		
Total Business Profile and Financial Policy Adjustments				**Ba3**		
					Comment	
Sovereign or parent constraint				**Baa3**		
Standalone Assessment Range				ba2 - b1		
Assigned Standalone Assessment				**ba3**		

Exhibit 5

Government -Related Issuer	Factor
a) Standalone Credit Profile	Ba3
b) Government Local Currency Rating	Baa3
c) Default Dependence	Very High
d) Support	High
e) Final Rating Outcome	Baa3

[1] Capped at Ba; The risk management sub factor score will not exceed the weighted average of scores assigned to a firm's other risk positioning sub-factor scores.
[2] Capped at Ba; The operating environment score will not exceed the weighted average of scores assigned to a firm's other non-financial factors.
Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
LAND AND AGRICULTURAL DEVELOPMENT BANK	
Outlook	Negative
Issuer Rating	Baa3
NSR Issuer Rating	Aa1.za
ST Issuer Rating	P-3
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454