MOODY'S INVESTORS SERVICE

CREDIT OPINION

21 January 2020

Update

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RATINGS

Land and Agricultural Development Bank

Domicile	South Africa
Long Term Rating	Ba1
Type	LT Corporate Family Ratings
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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EMEA 44-20-7772-5454

Land and Agricultural Development Bank

Update following downgrade to Ba1, outlook changed to negative

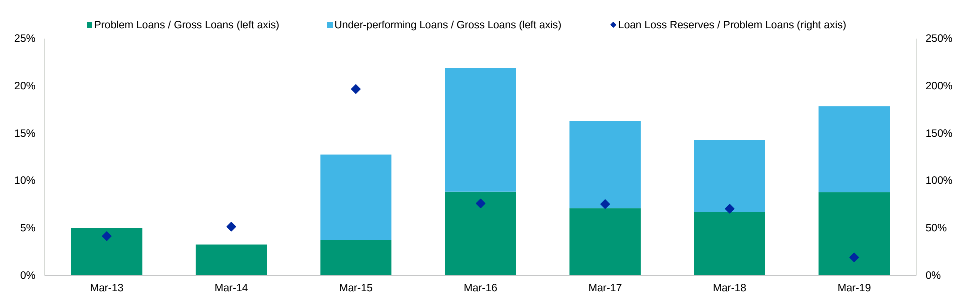
Summary

Land and Agricultural Development Bank's (Land Bank) Ba1 corporate family rating (CFR) reflects its Baseline Credit Assessment (BCA) of b1 and three notches of government (South Africa, Baa3 negative) support uplift; the latter balances Land Bank's full government ownership and developmental mandate with increased fiscal challenges that suggest that the South African government will be more selective in dispersing financial support to state-owned enterprises. We also assign a Ba1 issuer rating, based on the Ba1 CFR and the application of our Loss Given Default (LGD) analysis for speculative-grade companies, reflecting the priority of claims and coverage for its capital stock. Land Bank's national-scale ratings are set at Aa3.za/P-1.za. The issuer outlook is negative.

Land Bank's b1 BCA reflects elevated credit and environmental risks (relating to climate change and a persistent drought), with nonperforming loans (NPLs) at 9.9% of gross loans as of September 2019, and low profitability, with a return on managed assets of 0.4% as of March 2019. Land Bank's March 2019 tangible common equity (TCE)/tangible managed assets of 12.7% compares well with that of its global peers, but its capital adequacy ratio (CAR) of 15.9% as of September 2019 provides only a modest buffer to the 15% minimum required by lending covenants. Land Bank's funding structure benefits from extended maturities and more diversified funding sources, but remains reliant on market funding in an environment of volatile capital and debt markets. The challenging operating conditions, as well as the inability to appoint a permanent CEO who will ensure sustained oversight of Land Bank's operations and strategic direction, also place pressure on its financial performance.

Exhibit 1

Credit risks remain elevated



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

Credit strengths

» Land Bank's government ownership and expected support in case of need

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

Credit challenges

» Modest capital buffers

» Elevated credit risks

» Rising environmental, social and governance (ESG) risks, including risks related to the impact of climate change and social risks surrounding upcoming land reforms

Key indicators

Exhibit 2

Land and Agricultural Development Bank (Consolidated Financials) [1]

	03-19[2]	03-18[2]	03-17[2]	03-16[2]	03-15[2]	CAGR/Avg.[3]
Total managed assets (ZAR Million)	52,436.4	49,574.5	45,497.0	41,441.4	38,939.1	7.7[4]
Total managed assets (USD Million)	3,636.0	4,183.9	3,393.1	2,817.6	3,213.8	3.1[4]
Net Income / Average Managed Assets (%)	0.4	0.5	0.8	0.4	0.8	0.6[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	12.7	13.1	13.8	14.3	14.8	13.8[5]
Problem Loans / Gross Loans (Finance) (%)	8.8	6.7	7.1	8.8	3.7	7.0[5]
Net Charge-offs / Average Gross Loans and Leases (%)	0.5	0.6	1.0	0.4	0.1	0.5[5]
Debt Maturities Coverage (%)	14.5	13.5	7.2	13.4	7.3	11.2[5]
Secured Debt / Gross Tangible Assets (%)	0.1	0.2	0.1	0.2	0.2	0.2[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; Company Filings

Outlook

The negative outlook primarily reflects the increasing risk of a weakening capacity of the South African government to support Land Bank in case of need, as captured by the negative outlook assigned to the sovereign rating. The latter reflects the material risk that the government will not succeed in arresting the deterioration of its finances through a revival in economic growth and fiscal consolidation measures. The challenging operating conditions, as well as the inability to appoint a permanent CEO who will ensure sustained oversight of Land Bank's operations and strategic direction, also place pressure on its financial performance, standalone assessment and investor confidence.

Factors that could lead to an upgrade

There is a low likelihood of upward rating movement in view of the negative issuer outlook. Land Bank's outlook could change back to stable, if both the sovereign rating outlook is stabilized and Land Bank is able to stop the deterioration in its asset quality, strengthen its capital metrics and develop and implement a credible strategy for the future.

Factors that could lead to a downgrade

Any weakening in the South African government's credit profile or willingness to support Land Bank, could lead to a downgrade. In addition, any material further deterioration in Land Bank's asset portfolio that would affect its capital buffers, continued uncertainties about its future strategic direction and vacant CEO position that could lead to a tightening of its funding and liquidity position, would also exert downward rating pressure. Likewise, Land Bank's issuer ratings could be downgraded due to an increase in leverage through secured borrowings that would reduce the recovery rate for senior unsecured debt classes, although this remains a low probability event.

Profile

Land and Agricultural Development Bank (Land Bank) is a government-owned development finance institution, with reported total assets of ZAR52.4 billion as of March 2019. It commands a market share of around 28% in lending to the agricultural sector and maintains a strong franchise and expertise in the 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.

Detailed credit considerations

Land Bank faces elevated credit risks

We assign a Weighted Average Asset Risk score of Caa1 to Land Bank, six notches below its initial score, capturing (1) a significant proportion of loans classified as underperforming and an increasingly difficult operating environment; and (2) rising physical environmental risks from climate change and a sustained drought, which have the potential to disrupt the ability of the bank's customers to repay their loans.

As of March 2019, Land Bank's NPLs were 8.8% of its gross loans (increased from 6.7% in March 2018), with an additional 9.1% of gross loans classified as underperforming. We expect Land Bank to continue to face elevated credit risks because of the still-subdued economic growth, with Land Bank already reporting an increase in NPLs to 9.9% of gross loans as of September 2019. For 2020, we forecast a GDP growth rate of 1.0%, well below potential and the rate required to create new jobs. Similarly, Land Bank's asset-quality metrics are affected by the sustained drought in several areas, the late start of the grain planting season and diseases in various livestock sectors.

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 13% of NPLs as of March 2019, while the coverage for underperforming loans was just 2%. However, management maintains that the balance is covered by collateral.

Around half of the bank's portfolio is dispersed to agricultural cooperative organisations, in the form of service-level agreements (SLAs) 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 SLA portfolios. Land Bank's management is engaging with its partners to remediate the issues that caused their NPLs to rise.

Low earnings-generating capacity

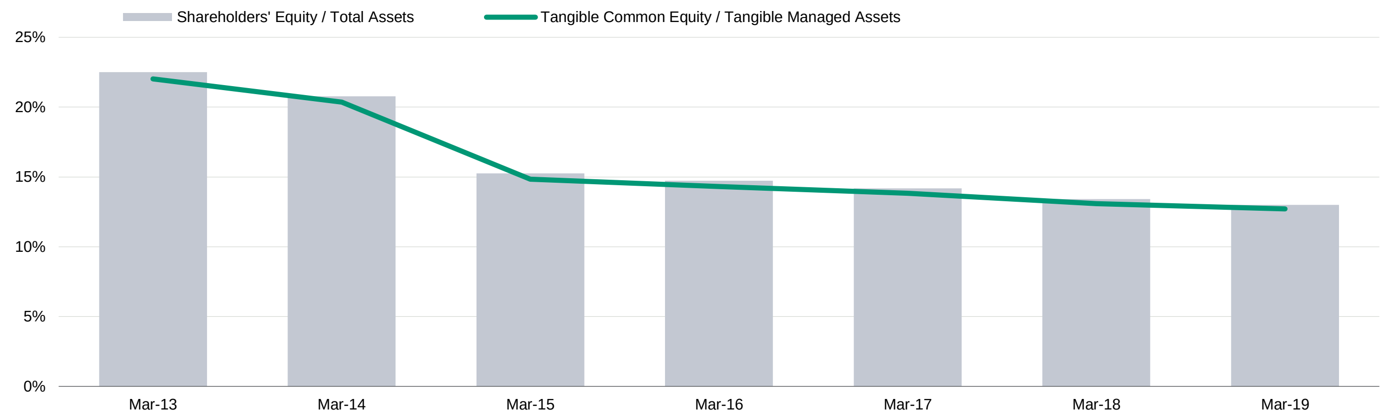
We assign a Profitability score of B2 to Land Bank, one notch below its initial score, reflecting its historical and potential earnings volatility.

Land Bank maintains a low earnings-generating capacity, impaired by rising funding costs, elevated provisioning requirements and a narrow revenue base, primarily dependent on interest income. For fiscal year ended March 2019 (fiscal 2019), the bank reported net profit of ZAR181.2 million, which translates into a return on average managed assets of 0.4%. We do not expect any material improvement in its profitability, given the still-difficult operating conditions — both on the macro and environmental side — as well as the bank's development mandate and potentially higher funding costs. For the six months ended September 2019, Land Bank reported a further 37% decline in its net profit because of a decline in its net interest income (by 19.5%) and a significant increase in provisions.

Capital metrics compare well with those of its global peers, but its CAR remains close to the lending covenant minimum requirements

We assign a Capital score of Ba1 to Land Bank, one notch below the initial score, to reflect its limited capital buffer over the minimum required by related lending covenants. As of March 2019, Land Bank held a TCE of ZAR6.7 billion, equivalent to 12.7% of tangible assets, a ratio that compares well with that of its global peers. 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 CAR of 15%. The bank's reported total CAR was 15.9% as of September 2019.

Exhibit 3
Capital levels provide some loss-absorption capacity, but remain modest



Sources: Moody's Financial Metrics and 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 15.9% incorporating a ZAR2.7 billion capital guarantee from the National Treasury as part of the equity. However, ZAR1.2 billion (or 2.3% of risk weighted assets) is earmarked for a World Bank funding facility, which will be reduced/eliminated over the coming quarters as the funding line is utilised. This could bring the CAR ratio down to around 14%; (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 (such as a possible Tier 2 capital issuance) 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

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

Historically, Land Bank has 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, funding lines from local banks and maintains a contingency plan in case its usual funding sources become unavailable; this includes potentially selling part of its loan portfolio or readjusting its growth targets. Land Bank has also adopted the Basel liquidity coverage ratio (352% as of September 2019) and a net stable funding ratio (106% as of September 2019), although with certain board-approved deviations from the regulations to cater to its unique business model.

However, Land Bank faces a number of challenges, primarily relating to its high – but declining – portion of existing funding (around 50% as of March 2019), which matures within the next 12 months, and its limited cash-flow-generating capacity (Land Bank's funds from operations/total debt was negative as of March 2019). Also, its 12-month debt maturities coverage ratio of around 15% suggests that the bank's ability to cover debt maturing in the next 12 months is only partly covered by readily available liquidity sources. However, we understand that a significant portion (ZAR9.7 billion) of this short-term funding is sourced from the Public Investment Corporation, which has historically always been reinvested back into Land Bank. Land Bank also benefits from ZAR8 billion of funding guarantees from the government, of which ZAR5 billion has been drawn.

Plans for 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 increase 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 on its operations, as noted in the section "Land reform developments are also a key social risk" below.

Macro-level indicator

The macro-level indicator does not have any weighting in the scorecard because the Macro-level Indicator score (Baa2) is higher than the Ba Industry Risk score.

Industry risk

The Ba Industry Risk score reflects (1) the finance companies' high market share in South Africa's industrial and infrastructure lending market; (2) the ongoing high demand, given the country's need for infrastructure, energy and industrial projects; and (3) a product base that faces a low risk of obsolescence. Barriers to entry are moderate, with both banks and the capital markets in a position to provide lending for agricultural sector projects. However, to compete effectively, market competitors need access to long-term funding, while substantial capital is also required. These strengths are, however, balanced against strong competition from the country's leading banks (which also translates into limited pricing power for the finance companies) and relatively high regulatory/legal risks relating to changes to South Africa's Mining Charter and upcoming land reforms.

Environmental, social and governance considerations

Environmental risks are high for Land Bank

Although the global banking sector has been classified as "low" risk in our Environmental risk heat maps, for Land Bank, specifically, the risks are high as climatic conditions are a key risk for a company serving the broader agricultural sector. More specifically, South Africa has been affected by a sustained drought over the past few years, which is still affecting several areas. The sector is also faced with diseases in various livestock sectors, as well as with unexpected challenges, such as the listeriosis crisis, outbreaks of foot-and-mouth disease and uncharacteristic hail in usually hail-free areas. In response to these challenges, Land Bank is now studying climate changes and how it can adjust its business/exposures to mitigate risks, and proactively support and advice clients who are at risk. These risks are incorporated into our assessments of asset risk.

Land reform developments are also a key social risk

We expect banks to face moderate social risks (for further information see our Social risk heat map). In the case of Land Bank, the most relevant social risk relates to the upcoming land reforms, and particularly the prospect of land expropriation without compensation. It is expected that the approach that will eventually be taken will bring more land into production and, hence, strengthen agricultural production, employment creation and food security. We also understand that the government plans to apply the principle to unused and government-owned land, rather than to privately owned productive land.

However, there is also the risk that a poorly executed expropriation without compensation could result in (1) loss of investor confidence; (2) increase in problem loans; and (3) the drying up of funding sources, as investors might not be willing to continue to fund Land Bank in particular, or agriculture in general. In addition, ZAR9 billion of Land Bank's debt includes a standard market clause on expropriation as an event of default.

Corporate governance remains a key credit consideration

Governance is highly relevant for Land Bank. Over the recent past, South African state-owned enterprises have attracted considerable attention, as some have exhibited high-level corruption and state capture. Land Bank has taken a number of initiatives to strengthen governance, which include credit decisions now requiring a two-third majority, while a policy on lending to politically exposed persons has also been approved by the board. Land Bank also acted swiftly in cases where bank executives were found guilty of misconduct (individual dismissed) or where there were allegations of possible misconduct (individual requested to take precautionary leave).

Nonetheless, while we acknowledges initiatives taken by Land Bank to strengthen governance, the prolonged period of uncertainty in relation to appointing a permanent CEO who will ensure sustained oversight of the bank's operations and strategic direction is a cause for concern. For Land Bank, corporate governance remains a key credit consideration and, while we do not adjust for corporate behaviour in our assessment, we will continue to monitor developments going forward.

Support and structural considerations

High probability of government support, driven by government ownership and policy mandate, underpins ratings

Land Bank's Ba1 CFR is three notches above its BCA of b1, incorporating our assumptions of a high probability of government support in case of need because of its government ownership and a history of the government providing capital and funding support when required. However, the increased fiscal challenges suggest that the government will be more selective in providing financial support to state-owned enterprises. Thus, we now cap our support assumptions at “high” for all the three South African development banks (IDC, DBSA and Land Bank).

Land 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 bank's capital and funding positions, 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.

Notching considerations

Land Bank's Ba1 issuer rating is based on our Loss Given Default (LGD) analysis for speculative-grade companies, reflecting the priority of claims and coverage in the company’s capital stock. In the case of Land Bank, issuer ratings are aligned with the CFR, reflecting the absence of structural subordination of unsecured obligations under our LGD model.

National-scale ratings

Land Bank’s Aa3.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 our Finance Companies rating methodology, published in November 2019, and Government-Related Issuers rating methodology, published in June 2018.

Exhibit 4

Rating factors

Land and Agricultural Development Bank

Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	0.36%	B1	**B2**	Earnings volatility	Expected trend
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	12.71%	Baa3	**Ba1**	Excessive growth	
Asset Quality						
Problem Loans / Gross Loans (%)	10%	8.75%	Caa2	**Ca**	Expected trend	Portfolio composition
Net Charge-Offs / Average Gross Loans (%)	10%	0.72%	Aa2	**B1**	Expected trend	Portfolio composition
Weighted Average Asset Risk Score			Ba1	**Caa1**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	14.51%	Caa3	**Ba3**	Pro-forma adjustments	Other adjustments
FFO / Total Debt (%)	15%	-0.48%	Ca	**Ca**		
Secured Debt / Gross Tangible Assets (%)	20%	0.14%	Aa1	**Ba1**	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			Ba2	B1		
Financial Profile Score	**100%**		**Ba1**	**B1**		
Operating Environment						
Home Country						
	Factor Weights	**Sub-factor Score**	**Score**			
Macro Level Indicator	0%		Baa2			
Economic Strength	25%	baa2				
Institutions and Governance Strength	50%	baa2				
Susceptibility to Event Risk	25%	baa				
Industry Risk	100%		Ba			
Home Country Operating Environment Score			Ba2			
	Factor Weights			**Score**	**Comment**	
Operating Environment Score	**0%**			**Ba3**		
ADJUSTED FINANCIAL PROFILE				**Score**		
Adjusted Financial Profile Score				**B1**		
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				**B1**		
					Comment	
Sovereign or parent constraint				**Baa3**		
Standalone Assessment Scorecard-indicated Range				ba3 - b2		
Assigned Standalone Assessment				**b1**		

Exhibit 5

Government -Related Issuer	Factor
a) Standalone Credit Profile	B1
b) Government Local Currency Rating	Baa3
c) Default Dependence	Very High
d) Support	High
e) Final Rating Outcome	Ba1

[1] Capped at Ba; the Risk Management subfactor score will not exceed the weighted average of scores assigned to a firm's other risk positioning subfactor 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
Corporate Family Rating	Ba1
Issuer Rating	Ba1
NSR Issuer Rating	Aa3.za
ST Issuer Rating	NP
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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