Land Bank

Standing Committee on Appropriations

20 May 2020

Contents

INTRODUCTION

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Introduction

In summary, Land Bank is requested to brief the Standing Committee on Appropriations on the following:

- Magnitude of the Finance and Liquidity Challenges faced by Land Bank.
- The total value of the Land Bank defaulted loans and implications for Land Bank.
- The reasons for the Bank's current liquidity challenges – including timelines involved.
- Alternative solutions and support available to government.

ORGANISATIONAL OVERVIEW

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Organisational Overview
About Land Bank

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About Land Bank

Who we are

We are a wholly government owned DFI promoting inclusive agricultural and rural development for improved food security and economic growth.

Our wholly owned insurance subsidiaries, Land Bank Insurance Company SOC Ltd (LBIC) and Land Bank Life Insurance Company SOC Ltd (LBLIC) complement our other financial services by providing insurance and risk management solutions to the agricultural community.

Our Mission

To collaborate with all stakeholders to build an adaptive and competitive agricultural sector that drives environmental, social and economic development and contributes to food security.

Our Vision

To be a world-class agricultural development bank that stimulates growth, drives solid performance, and spurs innovation.

Our Values

Meaningful contribution
Empowerment
Organisational synergy
Accountability
Pro-activity

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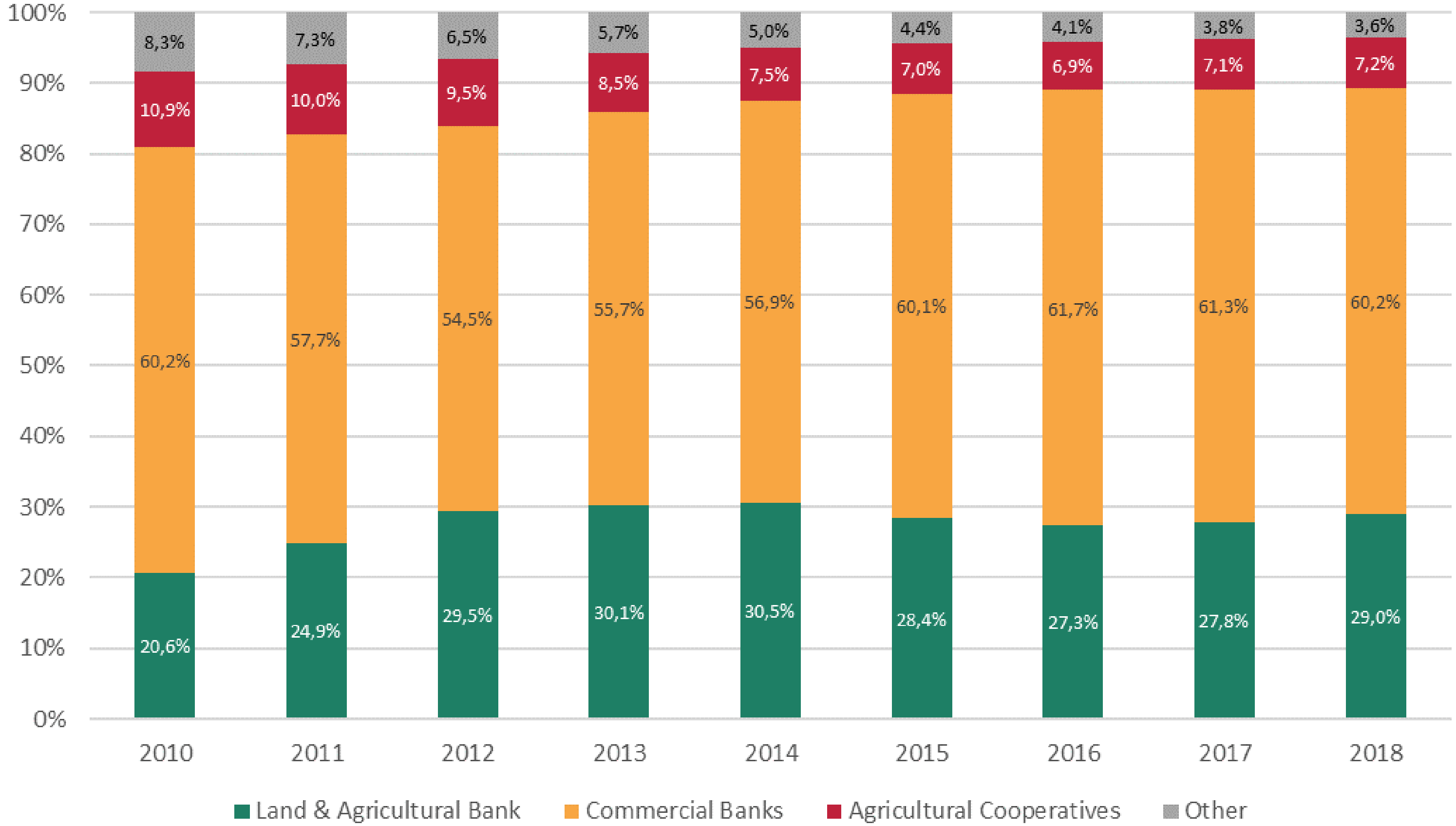
Organisational Overview

Contribution to the Agricultural Sector and the Economy



Take Note

- Land Bank is a significant player and contributor in the agricultural sector with a market share of 29% of South Africa's agricultural debt.
- As an integral part of the South African agricultural economy Land Bank's fate has a significant direct impact on clients financed by the Bank, and indirect impact on the agricultural sector's value chain.

Organisational Overview

Increasing Development and Transformation

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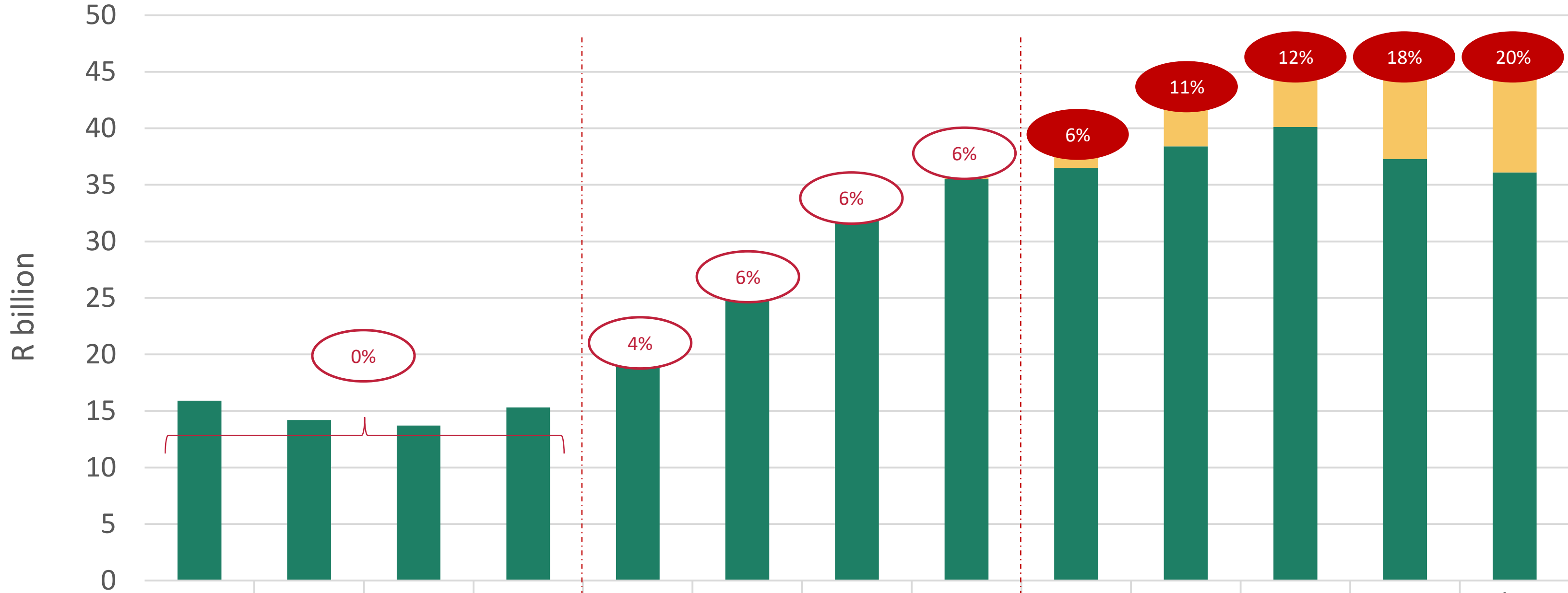
As at the end of February 2020, the value of the Bank's Development and Transformational loans as a percentage of the loan book is approximately 20%.



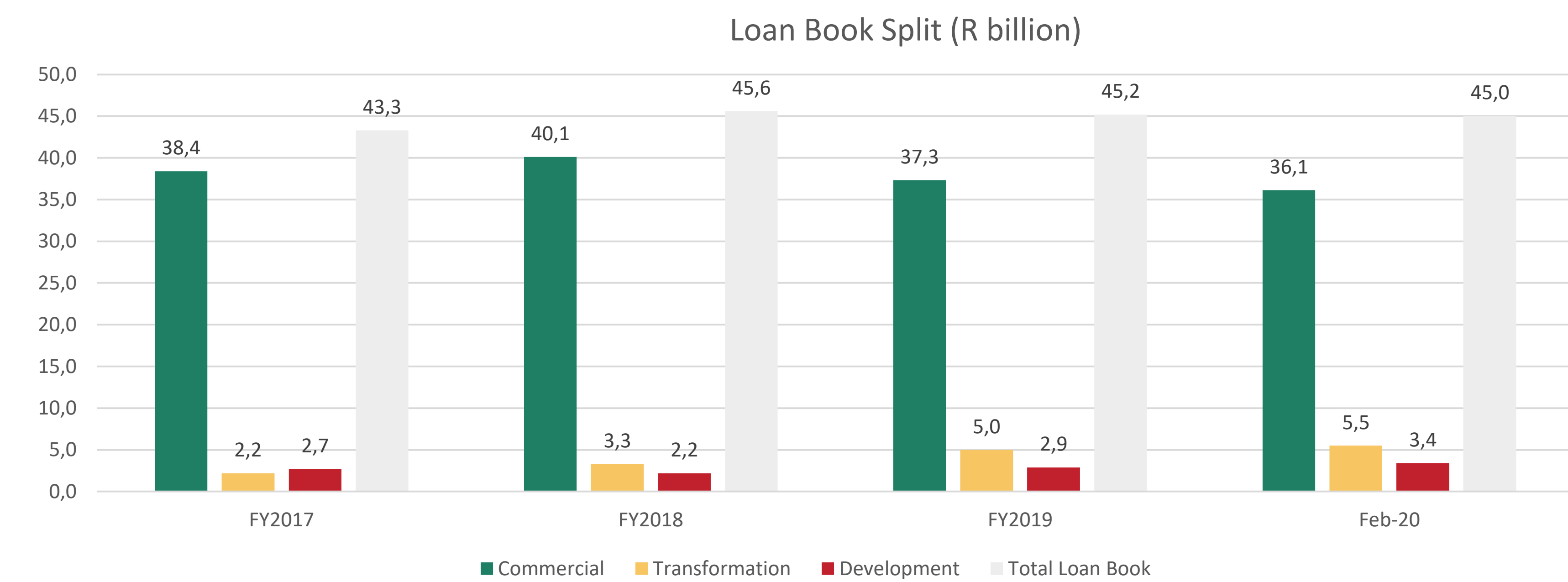
	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	Feb-20
Transformation	0	0	0	0	1	1,7	2	2,3	2,5	4,9	5,5	7,9	8,9
Commercial	15,9	14,2	13,7	15,3	21,4	26,2	32,1	35,5	36,5	38,4	40,1	37,3	36,1

Take Note

- In the last five years significant effort has been made to grow the Development and Transformational Loan Book – this book has grown by **R6.6 billion**.
- Supporting **Development and Transformation** has proven to be a challenging task as a result of:
  - ➢ The cost of the Bank's funding is based on **commercial interest rates from the capital markets**; and
  - ➢ The **strict financial covenants** that the Bank has to adhere to.

Organisational Overview
Increasing Development and Transformation

The Bank's current Development and Transformation Book of R8.9bn makes up approximately 20% of the Total Loan Book, consisting of **R3.4bn of Development loans** and **R5.5bn of Transformation loans**.



Land Bank's definition of Development and Transformation:

- **<u>Development</u>** clients refers to **smallholder farmers** who are usually new entrants with an annual turnover of between R50,000 and R1 million, and **medium-scale commercial producers** with an annual turnover ranging between R1 million and R10 million.
- **<u>Transformation</u>** clients refers to agri-businesses with annual turnover above R10 million, undertaken by persons or entities that are:
  - Wholly Black-owned;
  - Majority Black-owned (Black shareholding of 51% or more); or
  - Substantially Black-owned (Black shareholding of between 30% and 50% and a BBBEE Level of 1 – 4).

FINANCIAL PERFORMANCE TRENDS

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Financial Performance Trends

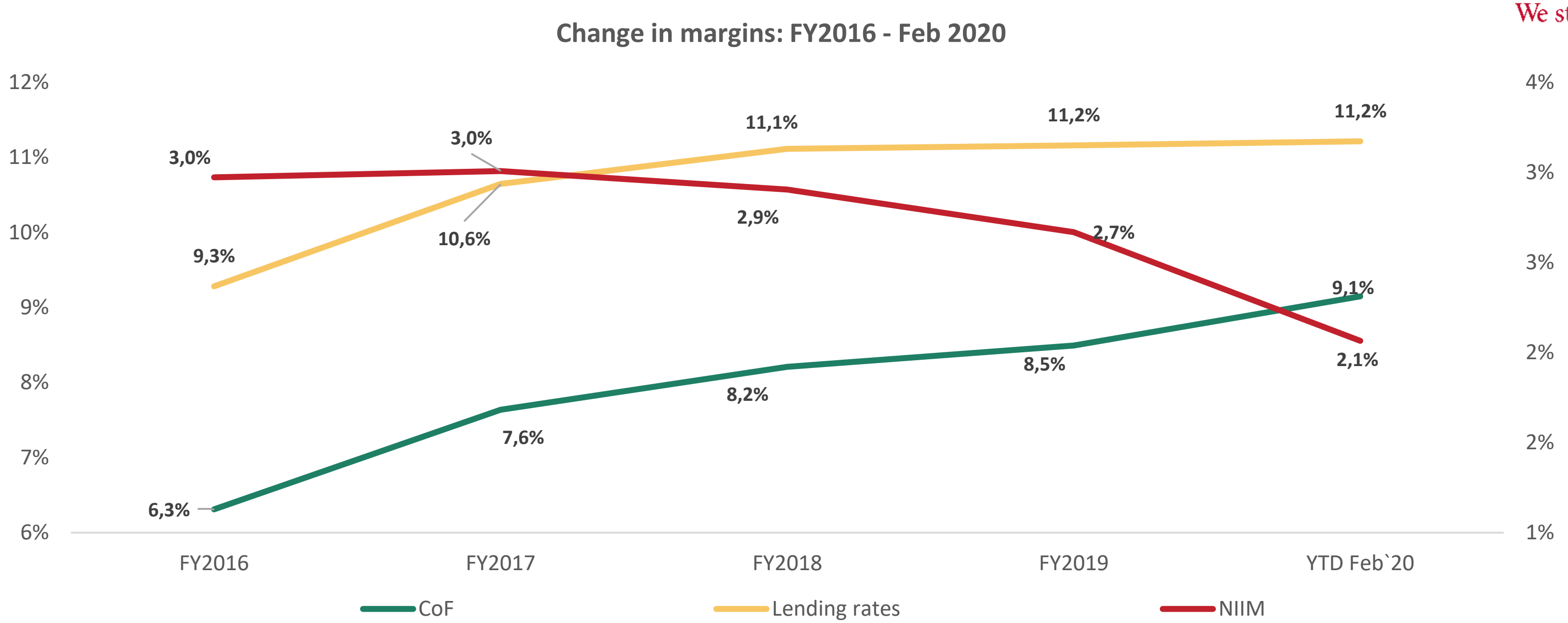
Key Performance Metrics Summary

	FY 2016	FY 2017	FY 2018	FY 2019	Feb 2020
Loan Book (Closing)	R 39.0bn	R 43.3bn	R 45.6bn	R 45.2bn	R 45.0bn
Net Interest Margin	2.7%	2.6%	2.5%	2.1%	2.1%
Operating Profit	R 395.5m	R 319.5m	R 290.2m	R 168.3m	
Cost to Income Ratio (Actual v Target)	56.0%	54.4%	57.5%	62.4%	75.7%
	< 63%	< 63%	< 63%	< 63%	< 63%
NPL Ratio (Actual v Target)	8.8%	7.1%	6.7%	8.8%	10.7%
	< 10%	< 10%	< 10%	< 10%	< 10%
Capital Adequacy Ratio (Actual v Target)	18.8%	17.7%	17.3%	16.4%	15.9%
	≥ 15%	*≥ 15%*	*≥ 15%*	*≥ 15%*	*≥ 15%*
Liquidity Coverage Ratio (Actual v Target)	55.0%	85.0%	214.3%	549.8%	42.7%
		60%	*70%*	*80%*	*90%*
Net Stable Funding Ratio (Actual v Target)	79.0%	86.7%	108.6%	102.0%	96.8%
	≥ 100%	*≥ 100%*	*≥ 100%*	*≥ 100%*	*≥ 100%*
<u>Liability Profile</u> Short-Dated / Long-Dated	70 / 30	58 / 42	43 / 57	50 / 50	*Current*: 42 / 58

Take Note

- The Key Financial Performance Indices have been relatively strong for the past four years with the Operating Profit and Non Performance Loans experiencing strain due to the challenging agricultural operating environment (effect of sector recession; drought; and diseases).
- The Liquidity position of the Bank has been relatively very strong until FY20 when the impacts of the recent challenges were experienced.

Financial Performance – Funding Matters
Cost of Funding



- As the Liability Profile mix shifted from 70% of short term funding in FY2015 to 42% in FY2020 the Cost of Funding increased (from 6.3% in FY2016 to 9.1% in Feb2020).
- Additionally, the Bank has not concomitantly re-priced its loan book to effectively match the increase in Cost of Funding.
- Consequently, the Net Interest Margin has been significantly reduced, and is a subject of the Bank's initiative to correct this negative trend.
- The squeeze on margins poses challenges for the Bank in its developmental mandate given the cost of doing business in the developmental sector (including credit risk and ability to price at affordable rates).

RECENT DEVELOPMENTS AND LIQUIDITY CHALLENGES

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Contextualising the Problem

Leading to the current Liquidity Challenges

Land Bank Act, No. 15 of 2002

Dual Mandate

Established Commercial Agriculture; and Emerging / Development Sector.

Equitable Ownership

Agrarian Reform

HDI Ownership

Land Redistribution

HDI Development

Land Access

Entrepreneurship

Remove Racial & Gender Discrimination

Sector Growth

Productivity, Profitability, Investment, innovation

Commercial Agric

Environmental Sustainability

Rural Development

Job Creation

Food Security

2015 | 2016 | 2017 | 2018 | 2019 | 2020

2015 2016 Drought

Erratic Rainfall

2018 2019 Drought

2017 2018 Avian Flu

2018 2019 Listeriosis

2019 Foot & Mouth

Reduced Yield

Food Security

Herd Culling

Trade Restrictions

Jun 2009

Recapitalisation of R3.5bn

Size of Loan Book = R14.5bn

Aug 2018

Establishment **of a Liquidity Risk Fund**

Jul 2019

Application for Recapitalisation

Size of Loan Book = R45bn

Sep 2019

Deferral of the Fund Raising Programme

2019/11/05 Moody's flags Land Bank for downgrade

2020/01/21 Moody's downgrades Land Bank's ratings

31 March 2020 Moody's downgrades Sovereign debt

2020/03/26 COVID19 National Lock Down

2020/04/28 Moody's downgrades Land Bank's ratings

Environmental, Social & Governance

Credit Risks (NPL's) remain elevated

Liquidity Challenges / Modest Capital Buffers

Organisational Leadership considerations (delayed CEO appointment)

Shareholder Support

Knock-On Effect

COVID 19 and associated lockdown is a significant risk to the SA economy, with job losses imminent – there will be consequent food system impact

Technical Recession

Deteriorating cash flow, access to funding & liquidity position compromise standalone viability

SA government's willingness and capacity to support Land Bank

Feb 2020

Board, recognising the **liquidity challenge**, wrote to the Minister of Finance and the Minister responded with National Treasury's approval of the utilisation of R5.7bn guarantee.

Liquidity Challenges
Pre 1st Downgrade (November 2019)

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On 5 November 2019 Moody's placed Land Bank on review for downgrade / negative outlook due to:

- Weakening standalone credit profile.
- The government's capacity and willingness to support in case of need.
- The weakening standalone credit profile predominantly driven by pressures stemming from:
  - Elevated credit risks evident from increased non-performing loans.
  - Declining capital buffers that will challenge its ability to meet some loan covenants while fulfilling its developmental mandate and related loan growth targets.
  - Environmental risks such as the sustained droughts, uncharacteristic hail in usually hail-free areas, and increased frequency of disease outbursts, which may disrupt the ability of the Bank's customers to repay their loans.
  - Downside risks regarding the impact of the Land Reform Programme.

Liquidity Challenges
Moody's 1st Downgrade (21 January 2020)

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- On 21 January 2020 Land Bank Issuer ratings downgraded to Ba1 from Baa3/P-3, and long-term national scale issuer rating (NSR) to Aa3.za from Aa1.za. Concurrently, the rating agency confirmed Land Bank's b1 Baseline Credit Assessment (BCA) and assigned a Corporate Family Rating (CFR) of Ba1.
  - Global credit rating = Non-Investment Grade (speculative)
  - National scale rating = High Grade
- The ratings downgrade reflects Moody's assessment:
  - Rising solvency pressures due to elevated credit risks (including high environmental risks relating to sustained droughts and increased frequency of disease outbursts);
  - Low earnings and a modest capital cushion;
  - Although the Bank historically had stable funding profile, this remains dependent on market funding in an environment where debt and capital markets are volatile;
  - Increased fiscal challenges suggest that the South African government will be more selective in dispersing financial support to state-owned enterprises, including to Land Bank;
  - 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

Liquidity Challenges

Implications of 1st Downgrade (21 January 2020)

Following the announcement of the initial (January 2020) downgrade:

- The following was experienced from some of the lenders / investors / funders:
  - Withdrawal of unutilised banking facilities;
  - Reduction of exposures to the Land Bank;
  - Disinvestments of funding lines as they matured.

- As a result of the above, the Bank's liquidity came under serious strain – exacerbated by the fact that Land Bank had last been in the debt market in September 2019.

- Land Bank approached and obtained support from the Shareholder with an approval of R5,7bn of guarantees for its fund raising programme.

Liquidity Challenges
Moody's 2nd Downgrade (31 March 2020)

- Following the Sovereign Rating Downgrade, all the Development Finance Institutions were downgraded, including Land Bank:.
- Land Bank's Corporate Family Rating (CFR) and Issuer Ratings downgraded from Ba1 to Ba2, whilst maintaining a negative outlook; Land Bank's Credit Assessment (BCA) from B1 to B2. The Bank's National Scale Ratings with the Long-term Issuer Rating confirmed at Aa3.za.
    - Global scale rating = Non-Investment Grade (speculative)
    - National scale rating = High Grade
- This downgrade happened at the time when the COVID-19 impact was starting to have negative impacts on the economy and the agricultural sector.

- Implications of the downgrade include:
    - Disinvestment by investors continued.
    - Pressures on liquidity increased and breach of loan covenants experienced.
    - Land Bank subsequently defaulted with its funders.
    - The breach of loan covenants and defaults disrupted the conclusion of funding lines that were in the pipeline on the back of the support by the State's R5.7bn guarantees, resulting in significant liquidity challenges.

Liquidity Challenges
Moody's 3rd Downgrade (24 April 2020)

- Resulting from the default event, the third downgrade of the Bank followed on 24 April 2020 wherein the Bank's corporate family rating (CFR) and long-term issuer ratings moved to B1 from Ba2, and its national scale issuer ratings to Baa2.za/P-2.za from Aa3.za/P-1.za.
  - Global scale rating = Non-Investment Grade (Highly speculative)
  - National Scale rating = Lower Medium Grade (Two notches above Investment Grade)

- Implications:
  - At this point the Bank's liquidity position reached distressed levels.

CORRECTIVE INTERVENTIONS

Corrective Interventions

Key Interventions undertaken since the start of the liquidity challenges include:

- In **August 2019** the Bank requested a R5.0bn recapitalisation to address capital buffers and advance the development mandate – these funds would be ring-fenced for disbursements to qualifying development projects or small holder farmers.
- Appointments of CEO and CFO in February and March 2020 respectively, to stabilise executive leadership.
- In **February 2020** the Bank receives support from the Shareholder in the form of R5.7bn of guarantees for its fund raising programme.
- In **March 2020**, following the 2nd downgrade and the increased pressure on liquidity, the Bank undertook an assessment of the magnitude of the liquidity challenge and because of the seriousness of the challenge took a decision to establish a Board-led Restructuring Committee to provide closer guidance and support to the executive management's efforts to address the challenge.
- In **April 2020** the Bank engages Legal services of ENSafrica.
- In **May 2020** the Bank engages Corporate Finance Advisor, RMB.

Corrective Interventions

Approach to finding solutions for the Bank's challenges:

- Engagements are in progress with funders and lenders for:
  - A standstill arrangement
  - A debt restructure plan to avoid further disinvestments in the Bank
  - Arrangements to cure defaults
- Planning is in progress for raising of immediate/emergency liquidity facility.
- A process to undertake balance sheet optimisation is being initiated.
- Plan to review and accelerate implementation of the turn-around strategy for the Bank.

MEDIUM TO LONG TERM STRATEGY

Strategic Problem Statement

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KEY PROBLEM STATEMENT

How will Land Bank remain **financially sustainable** in the future **whilst ensuring a fit for purpose organisation that fulfils its development mandate** in a way that is attractive for funding and supported by National Treasury

KEY PROBLEM AREAS

- INADEQUATE ENABLEMENT OF DEVELOPMENT
- STRUGGLING AGRICULTURAL SECTOR
- UNSUSTAINABLE FINANCIALS and FUNDING MODEL
- INADEQUATE VALUE PROPOSITIONS PER SEGMENT
- UNCLEAR PATHWAY TO GROWTH AND SCALE
- HIGH COST OF FUNDING
- EXPOSURE TO CLIMATE VOLATILITY
- NARROWING MARGINS

Future Land Bank

The Rationale for Repurposing – Journey Towards 2025

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Agric Financial Services

Commercial Agric

Cost of Funding

Commercial Borrowing Rates

Agri Transformation

Debt Collateralisation

Dual Mandate

Concession Finance

Food Security

Risk Based Pricing

Financially Self-Sustaining

Land Distribution

Land Reform

Agrarian Reform

Land Bank Act, No. 15 of 2002

2009

DELOITTE ORGANISATION REVIEW

Value proposition design, branch optimisation, and future process design

2015

MCKINSEY ORGANISATION REVIEW

Operational and structural review of existing business model to drive increased focus & efficiency

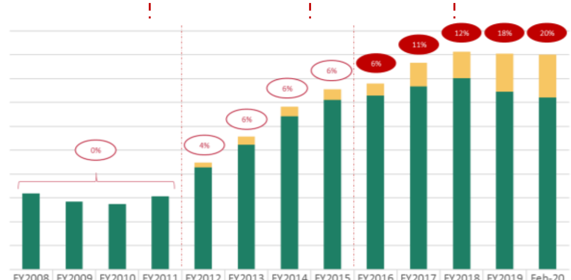
2016 - 2018

2015 2016 Drought

Erratic Rainfall

2017 2018 Avian Flu

2018 2019 Listeriosis



Contribution to development and transformation has increased from 6% to 20% since the 2015 intervention, but remains at levels below expectations.

2019 - 2020

2018 2019 Drought

2019 Foot & Mouth

2019/11/05 Moody's flags downgrade

2020/01/21 Moody's downgrade

March 2020 Moody's Sovereign downgrade

2020/03/26 COVID19 National Lock Down

2020/04/28 Moody's downgrade

REBALANCING OF LIABILITY PORTFOLIO

The Bank's acted to reduce the risk posed by the liabilities portfolio that was skewed toward short term liabilities. The Bank's shift towards longer term liabilities came with an increased cost of funding which is contrary to the need of development clients who need lower or subsidised rates of lending.

Emerging Farmer Challenges:

- Equity
- Affordable Finance
- Collateral
- Skills, Experience, Track Record
- Technological Knowledge & Access
- Climate / Environmental Models
- Risk Management
- Value-chains
- Coordination of Funds / Skills

Today

Narrowing margins, struggling agricultural sector and high cost-to-income ratio impacting financial sustainability with increased expectations to drive development from National Treasury

Capital market funds are relatively expensive, with **Cost of Funds** increasing from **6.3%** in 2016 to **9.1%** in 2020.
Land Bank is thus constrained from providing affordable financing to development farmers.

2025

Repurposing

Run a financially self-sustainable business whilst delivering development& transformation mandate.

Future Land Bank
The Repurposing Journey

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Repurposing

Run a financially self-sustainable business whilst delivering development& transformation mandate.

The Bank can't afford the cost of delivering development funding in its current funding and revenue-generating business model

Funding Model

An appropriate Funding Model must be established.

Balance Sheet Optimisation

2025 Vision

Sustainable Funding Model	Enterprise Risk Framework
Credit Risk Model	Efficient Operating Model

Commercial Unit | **Business Model** | **Development Unit**

- Pricing Strategy
- Ecosystem Based Agricultural Bank
- Funding Model
- Increased Scope of Products & Services
- Marketing & Relationship Management Strategy
- Distribution & Channel Strategy

Commercial Unit

Generate sufficient profitability to cross-subsidise development

Diversification of Revenue Streams:
- Transactional Banking
- Deposits
- Credit Services
- Insurance
- Business Management Systems
- Business Insight
- Marketplace Access
- Industry Insight

Development Unit

Affordable finance for development customers enabled by state funding and subsidisation

Pre Finance
- Land Use
- Project Preparation
- Business Case

Post Finance
- Farm Establishment
- Extension Services
- Ops & Business Mgt
- Financial Mgt / Acc
- Market Access

Determine the optimum match between tenure of our liabilities with those of our lending book profile, whilst ensuring a sustainable level of Cost of Funding;
Commercial Unit raise funds from the capital markets and institutional investors; and
Development Unit leverage funding from Government support and impact investors.

Magnitude of the Challenge

Liquidity Challenges
Magnitude of the Challenge

- At this time the magnitude is of crisis proportions.
- As funding lines mature, the Bank gets into further defaults.
- The Bank is not in a position to support agriculture in the form of new / additional loans – this at the time of the next planting and harvesting cycle.

- The stage of negotiations with funders has necessitated confidentiality from publicly sharing the magnitude in Rand values.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions and Recommendations

- Address immediate liquidity needs.
- Find a longer term liability solution and an optimised balance sheet with the appropriate mix of tenures of funding, and loan profile.
- Repurposing strategy for an improved operating model that will deliver a financially sustainable bank, with increased development impact.
- State Recapitalisation of the Bank is a consideration in the process to strengthen the Bank's balance sheet
  - The Bank must demonstrate a self-sustainable end state with significant development impact to justify significant state capital injection.
- The Ministry of Finance and National Treasury have been an integral part of the process to support Land Bank in its endeavours to find solutions for the current challenges, and for the future sustainability of the Bank.

www.landbank.co.za

THANK YOU!

- 420 Witch-Hazel Avenue
- Eco Glades, Block D, Eco Park
- Centurion Pretoria

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