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CREDIT OPINION
12 September 2018

Update

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RATINGS

Land and Agricultural Development Bank

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

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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Land and Agricultural Development Bank

Update to credit analysis

Summary

We assign Baa3/Prime-3 issuer ratings to Land and Agricultural Development Bank (Land Bank), which reflects the application of our rating methodology for government-related issuers and the following inputs: (1) Land Bank's standalone credit profile of ba3, (2) South Africa's Baa3 bond rating, (3) the high probability of government support for Land Bank, and (4) a very high default dependence. The ratings carry a stable outlook, while we also assign Aa1.za/P-1.za national-scale issuer ratings.

Land Bank's standalone credit profile (derived using the Finance Companies rating methodology) of ba3 reflects the still challenging operating environment, resulting in 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. These risks are balanced against the bank's capital buffers, with an equity-to-assets ratio of 13.4% as of March 2018, which can absorb some unexpected losses although capital buffers have been coming down in recent years. Land Bank has taken steps to improve its funding structure by extending maturities and diversifying its funding sources, which include numerous multilateral organisations. Nonetheless, the bank's reliance on short-term funding, with around 43% of total funding maturing within 12 months, remains relatively high, albeit on a declining trend. At the same time, plans for strong balance sheet growth will require Land Bank to find new funding sources in an environment where the capital and debt markets remain volatile.

We are also monitoring developments around South Africa's Land Reforms and specifically the principle of "expropriation without compensation". Poor implementation and execution of this strategy could result in (1) a loss of investor confidence; (2) an increase in problem loans; and (3) the drying up of funding sources for the bank, as ZAR9 billion of Land Bank's debt include a market clause on "expropriation" as an Event of Default, which would require Land Bank to immediately repay these. 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.

Land Bank's issuer rating of Baa3 is three notches above its stand-alone credit profile of ba3, and incorporates (1) our assumption of a high probability of government support, underpinned by the bank's government ownership, its development mandate and the government's ongoing capital and funding support; (2) South Africa's Baa3 government bond rating, which acts as the anchor for potential support to the bank; and (3) the very high default dependence, which reflects the strong probability that, in the event of a sovereign credit default, the risk of a potential financial crisis affecting the bank would be very high.

Credit strengths

» Land Bank's government ownership, policy mandate and the resulting high probability of government support underpin its issuer ratings

» The bank's capital buffers provide some loss-absorption capacity (but potentially more capital will be needed if Land Bank implements its growth strategy)

» The bank maintains a leading franchise in the agricultural sector and is well placed to benefit from the sector's growth potential

Credit challenges

» Elevated credit risks in light of the challenging operating conditions and high concentrations

» Challenges in finding new funding sources and extending maturities (though current funding pipeline remains strong, according to management)

» Upcoming Land Reforms

Rating outlook

The stable outlook assigned to Land Bank is predominantly driven by the stable outlook assigned to the sovereign rating. It balances Land Bank's capital buffers and assumptions that government support will be forthcoming in case of need, against its high asset risks and projections for strong balance sheet growth that will require it to raise significant new funding.

Factors that could lead to an upgrade

» A positive rating action will require a significant improvement in macro-economic conditions, also leading to an improvement in the sovereign credit profile; Land Bank will also need to strengthen its asset quality metrics and capital buffers.

Factors that could lead to a downgrade

» Any weakening of the South African government's credit profile and/or willingness to support Land Bank, or any significant deterioration in its capacity to extend financial support, could negatively affect its issuer ratings. In addition, a weakening of Land Bank's stand-alone credit profile, driven by a deterioration in asset quality and capital buffers or the poor implementation of the Land Reforms, would likely exert downward ratings pressure.

Key indicators

Exhibit 1

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

	3-18[2]	3-17[2]	3-16[2]	3-15[2]	3-14[2]	CAGR/Avg.[3]
Total managed assets (ZAR thousand)	51,724,542	45,747,009	41,941,414	38,939,106	37,924,212	8.1[4]
Total managed assets (USD thousand)	4,365,401	3,411,728	2,851,606	3,213,792	3,605,683	4.9[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 (%)	3.7	4.7	3.4	5.1	5.2	4.4[5]
Short Term Debt / Total Debt (%)	46.8	65.2	70.7	68.6	74.4	65.1[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	16.7	14.3	15.3	14.8	20.3	16.3[5]
Effective Leverage (%)	482.1	579.3	516.7	535.5	366.6	496.1[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) (%)	27.8	33.8	37.4	16.1	13.0	25.6[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 Financial Metrics

Profile

Land and Agricultural Development Bank of South Africa is a government-owned development finance institution. According to management, Land Bank commands a market share of around 28% in lending to the agricultural sector. The 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 reported total assets of ZAR49.5 billion as of March 2018.

Detailed credit considerations

Land Bank maintains a leading franchise in the agricultural sector and is well placed to benefit from the sector's growth potential...

Land Bank is a government-owned entity, operating as a development finance institution within the full agricultural value chain. This mandate has allowed the bank to build a strong franchise and expertise in lending to the agricultural sector, being the government's key delivery agency in the agricultural sector, aiming to create jobs, reduce poverty and strengthen sustainable economic performance. The bank commands a market share of around 28% in lending to the agricultural sector and is well placed to take advantage of the growth opportunities within the sector.

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.

In respect of Land Bank's governance structure, the National Treasury remains its executive authority, which also appoints an independent board of directors. The Credit and Investment Committee consists of an independent non-executive chairman and four individual non-executive members, with credit decisions now requiring a two-thirds majority; a policy on lending to politically exposed persons has also been approved by the board.

...but the still challenging operating environment poses risks

Despite our expectations that the recovery in the country's institutions – on the back of a more transparent and predictable policy framework – will gradually support a corresponding recovery in the economy, operating conditions still remain challenging. More specifically, South Africa's economic strength is hindered by relatively low average incomes, wide income disparities, while for 2018 and 2019 we forecast GDP growth to remain well-below potential and the rate required to create new jobs. To add to the above problems, a drought attributed to the onset of an El Niño event exacerbated output challenges in agriculture and other water-dependent sectors, while the government's policy agenda contains elements that have the potential to create tensions, such as the still-to-be agreed land appropriation without compensation initiative.

With respect to South Africa's Land Reforms and specifically the principle of expropriation without compensation, we note that poor implementation and execution of this strategy could result to (1) loss of investor confidence; (2) an increase in problem loans; and (3) the drying up of funding sources, as ZAR9 billion of Land Bank's 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.

The challenging operating conditions have hurt the performance of financial institutions, with government-owned institutions with a development mandate also being affected, given the expectation to show a more social and flexible approach in dealing with troubled customers. Notwithstanding the above, the agricultural sector, especially the grain and livestocks subsectors, presented a remarkable recovery following recent good rains. However, large sections of the horticultural subsector remain under pressure because of continuing drought in certain areas of the Western, Northern and Eastern Cape.

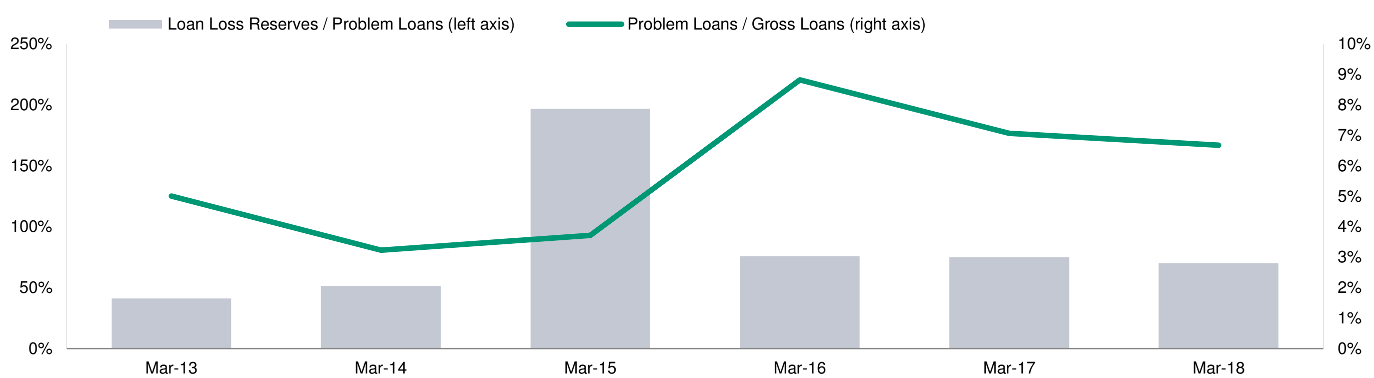
Land Bank faces elevated credit risks

As of March 2018, Land Bank's NPLs were 6.7% of gross loans (March 2017: 7.1%; March 2016: 8.8%), with an additional 7.6% of gross loans classified as underperforming, with the entity already adopting IFRS9. Going forward, we expect Land Bank to continue to face elevated credit risks because of the still subdued economic growth. 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.

Exhibit 2

Credit risks remain elevated despite improved asset quality



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

Set against these risks, there is some optimism about a better agricultural season and a gradual recovery in economic growth, which implies that any deterioration in asset quality could be muted. Also, around half of the bank's portfolio is dispersed to agricultural co-operative organisations — in the form of service level agreements — which include risk-sharing agreements with the individual co-operatives. Improved risk management capabilities, including the implementation of a new model, with credit risk-related tools integrated in the credit (origination) process through to credit approval, should also support a more robust calculation of probability of default, loss given default and IFRS9 impairments.

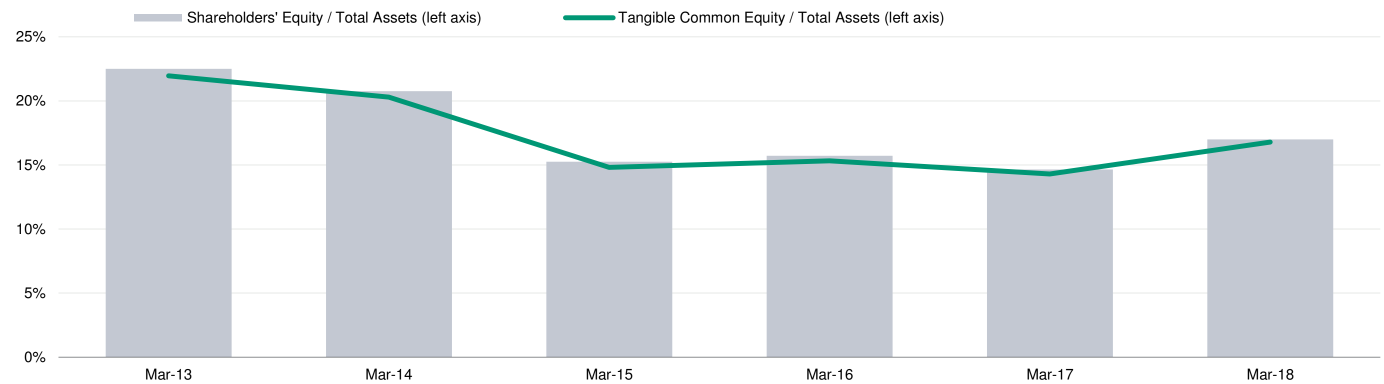
Land Bank also maintains a modest earnings-generating capacity, impaired by a still-high cost base, rising funding costs and elevated provisioning requirements. For year ended March 2018, the bank reported net profit of ZAR254.2 million, which translates into a return on equity of around 4%. We expect broadly stable profitability metrics, given the still challenging operating conditions, and 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 if Land Bank implements its growth strategy)

As of March 2018, Land Bank held consolidated capital and reserves of ZAR6.6 billion, equivalent to 13.4% of its total assets. Such capital buffers provide some protection against unforeseen losses, although they are materially reduced from ZAR7.6 billion that was originally reported in March 2015. The drop in consolidated capital and reserves over the past two years is primarily owing to a restatement of general reserves, which were reduced by ZAR1.7 billion as a result of the early adoption of IFRS9.

Exhibit 3

Capital levels provide some loss-absorption capacity



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

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, with lending covenants requiring a minimum of 15%. The bank's capitalisation ratios incorporate a ZAR2.8 billion capital guarantee from the National Treasury; the ZAR1.3 billion is, however, earmarked for a funding facility and will be reduced/eliminated over the next year.

In future, and if the bank pursues a stronger balance sheet growth strategy in an effort to deepen its developmental impact, we believe it will require additional capital. The shareholders have historically been injecting new capital on an ongoing basis, but large fiscal deficits and other government priorities may require Land Bank's management to also pursue other options, such as the issuance of a subordinated instrument that would classify as capital or revise down its growth projections.

Challenges in finding new funding sources and extending maturities in light of the bank's high, although declining, reliance on short-term market funding and projected aggressive balance sheet growth

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 (for example, a $300 million 10-year facility from Standard Chartered [and backed by a MIGA guarantee], $93 million 25-year funding from the World Bank, a 10-year KfW facility and a 12-year loan from European Investment Bank). 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 the Bank's 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 and its dependence on related-party lending or lending that is backed by a government guarantee (currently at around ZAR5 billion). 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 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.

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

Land Bank's Baa3 issuer rating is underpinned by a high probability of government support on the back of its government ownership via the National Treasury. 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.

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. Bank-specific figures originate from banks' reports 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

Exhibit 4

Land and Agricultural Development Bank of South Africa

Rating Factors	Aa/A	Baa	Ba	B	Caa	Historical View	Forward View
Non-Financial Factors						**Ba**	**Ba**
Factor: Franchise Positioning						**Ba**	**Ba**
- Market Position and Sustainability		x					
- Operational Diversification				x			
Factor: Risk Positioning						**Ba**	**Ba**
- Potential Volatility of Assets/Cashflows		x					
- Governance and Management Quality			x				
- Risk Management			x				
- Key Relationship Concentrations				x			
- Liquidity Management			x				
Factor: Operating Environment [1]						**Ba**	**Ba**
- Economic Strength			x				
- Institutional Strength			x				
- Susceptibility to Event Risk		x					
Financial Factors						**B**	**B**
Factor: Profitability						**Ba**	**Ba**
- PPI / AMA				**0.85%**			
- Net Income / AMA			**0.59%**				
- Pre-tax Income Coefficient of Variation		**18.53%**					
Factor: Liquidity						**B**	**Ba**
- 24 Month Coverage Ratio					**40.25%**		
- Secured Debt / Gross Tangible Assets	**0.16%**						
Factor: Capital Adequacy						**Aa/A**	**Baa**
Capital Bucket: Traditional Finance Company							
- TCE / TMA	**16.70%**						
Factor: Asset Quality						**Caa**	**Caa**
- Problem Loans / Gross Loans					**7.52%**		
- Problem Loans / (Shareholders Equity + LLR)					**32.98%**		
Scorecard estimated stand-alone credit assessment:						**B1**	**Ba3**
Assigned stand-alone credit profile:						**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	Stable
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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