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Finbond Group Limited

South Africa Bank Analysis **October 2015**

Rating class	Rating scale	Rating	Rating outlook	Review date
Long-term	National	BBB-$_{(ZA)}$	Stable	October 2016
Short-term	National	A3$_{(ZA)}$		
Long-term	International	BB	Stable	October 2016

Financial data:

(USDm comparative)

	28/02/14	28/02/15
R/USD (avg.)	9.98	10.95
R/USD (close)	10.80	11.52
Total assets	100.5	117.1
Total capital	30.5	30.0
Total borrowings	64.4	81.3
Net advances	19.5	25.2
Liquid assets	8.0	17.1
Operating income	23.7	34.3
Profit after tax	3.7	4.6
Market cap.‡	R2,583m/USD189m	

‡ Finbond's JSE listing on 26 October 2015 (R/USD 13.61).

Rating history:

Initial rating (October 2011)
Long-term: BB$_{(ZA)}$
Rating outlook: Stable

Initial rating (October 2013)
Long-term (International): BB-
Rating outlook: Stable

Last rating (October 2014)
Long-term: BBB-$_{(ZA)}$
Short-term: A3$_{(ZA)}$
Rating outlook: Stable
Long-term (International): BB
Rating outlook: Stable

Related methodologies/research:

Global Criteria for Rating Banks and Other Financial Institutions, updated March 2015
Finbond rating reports (2011-14)

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Summary rating rationale

- The ratings of Finbond Group Limited ("Finbond", "the group") reflect its growing reputation as a leading mutual bank and short-term credit provider in South Africa. Finbond offers short and medium-term unsecured loans, insurance and savings products, and (since F15) transactional banking and mortgage finance products, through its 321 branches.
- Adequate capital, conservative credit/risk management, and improving profitability and earnings diversification (despite regulatory risk) support the ratings, which exclude the prospect of systemic support, given its low likelihood. The rating outlooks consider Finbond's prospects/strategic direction, within the context of challenging and uncertain economic and regulatory environments.
- High liquidity levels (42.3% of assets at FYE15) and adequate capitalisation (Finbond Mutual Bank's capital adequacy ratio ("CAR") was 35.1% at FYE15) support the group's moderate credit appetite. The loan/deposit ratio was maintained at c.31% at FYE15.
- Asset quality metrics broadly improved, despite the negative market trends. As c.90% of loans issued are short-term, traditional asset quality measures may overstate bad debt experience. Gross/net impairment ratios (impairments being defined as instalments in arrears) improved to 19.1%/11.5% at 1H F16 (FYE14: 21.2%/14.1%). However, net impairments vs. instalments due (management's key asset quality measure) rose from 6.3% (FYE14) to 7.3% (1H F16). Over the same period, collection rates remained strong, and loan rejection rates as well as arrears levels/roll-rates were stable. Provisioning appeared adequate, but close monitoring is required given the challenging operating conditions.
- In F15, operating income rose by 59.2% to R375.9m (net income – 37.9% to R50.9m). Despite 47.5% cost growth in F15 (driven by the group's investment in infrastructure and internal controls) the cost/income ratio declined to 64.5% (F14: 69.6%). Of concern, impairment costs grew 141.4% in F15 and by 2.0x in 1H F16.

Factors that could trigger a rating action may include

Positive change: A sustained improvement in business profile (particularly scale and earnings diversification), as well as asset quality, capital and profitability, would be positively considered.

Negative change: A significant deterioration in Finbond's asset quality, long term earnings, funding and liquidity profiles, as well as in its capital ratios, could lead to negative rating action.

Corporate profile

Business summary[1]

History

Finbond commenced trading in 2003, listed on the Johannesburg Securities Exchange ("JSE") in 2007, and was awarded a Mutual Banking licence from the Registrar of Banks in July 2012, after complying with the relevant South African Reserve Bank ("SARB") requirements. In 2014, Finbond transferred its listing to the main board of the JSE, following a sector reclassification from "consumer finance" to "banks".

Business profile

The group operates four divisions, providing:

- Short- and medium-term micro credit products;
- Investment and saving products (mainly fixed term and indefinite term products);
- Insurance products; and
- Transactional banking products.

The holding company (Finbond Group Limited) is the entity through which insurance products are provided, while its wholly-owned subsidiary, Finbond Mutual Bank ("FMB", "the bank"), provides the savings, loan and transactional banking products through its SARB-regulated infrastructure.

Finbond offers personal cash loans, selected short-term insurance products (credit life, retrenchment cover and funeral insurance), and transactional solutions to South Africa's under-banked but employed population. Clients in the lower-to-middle income brackets (Living Standards Measure ("LSM") bands 1-7) are targeted, and reached through the extensive branch network, growing employee base, and understandable product offering/loan repayment platform. Finbond also provides investment/savings products and mortgage finance solutions to clients in higher income brackets (LSM bands 6/7-10).

Channel	National coverage	Staff complement	Payment platform
Own branches	321 (FYE15: 286)	1 079 (FYE15: 880)	Direct debit order

Source: Finbond (data as at 31 August 2015).

While many consumer finance providers are lending-only organisations, the FMB banking license enables the group to meet borrowing/saving/risk management (insurance) needs of clients, but remains primarily a specialist consumer finance institution. The long-term strategy, which includes the provision of a broader range of banking and financial services to individuals and small and medium-sized enterprises ("SMEs"), requires Finbond to convert its Mutual Banking license to a Commercial Banking license. This conversion, which is only expected to take place in 12-18 months' time, requires enhancements to the group's risk management systems, given the more onerous capital (adequacy), governance, risk management and regulatory reporting requirements under Basel III, compared to simpler requirements under the Mutual Banks Act.

Finbond has seen rapid net loan book growth over the last three years (FYE13: 36.7%; FYE14: 72.5%; FYE15: 37.8%). Consequently, Finbond's short term unsecured loan market share (loans below R8,000 with a tenure between 30-180 days) grew from c.12.5% at FYE14 to c.20% at FYE15, according to management. Nevertheless, Finbond's share of the total unsecured lending market in South Africa remains insignificant.

Ownership structure

Table 1 provides a breakdown of the group's shareholder structure.

Table 1: Effective shareholding	F14	F15
Public shareholders	27.9%	17.8%
Private shareholders	72.1%	82.2%
With the latter split between:		
Statutory directors†	44.7%	38.8%
Institutional entities	25.9%	40.7%
Other‡	1.5%	2.7%

† Ul mately held by a trust, of which the group CEO is the founder and him and his family are the beneficiaries.
‡ Shares bought OTC by Finbond and those held by group employees.
Source: Finbond.

Governance structure[2]

Table 2 summarises the composition of the board of directors ("board") and adherence to aspects of the King III Code of Corporate Governance ("King III"). There were no changes to the board in F15/1H F16.

Table 2: Corporate governance summary	
Number of directors	9
Independent non-executives	*6*
Non-independent non-executives	*1*
Executives	*2*
Separation of the chairman	Yes
Frequency of meetings	At least quarterly. Four board meetings were held in F15.
Board committees	Audit; Remuneration; Social and Ethics; Risk; Executive; and Investment*.
External auditors	KPMG Inc.
Internal control and compliance	Internal audit reports to Audit Committee, and together with compliance also reports to SARB on a quarterly basis.

* Established in 1H F16. Source: Finbond.

A review in 2015 by Ernst & Young Inc., which was commissioned by SARB, confirmed that Finbond's corporate governance, internal audit function and compliance function complies with all relevant legislation and regulation.

[1] For a detailed review of the group's history, organisational structure and individual business operations, refer to previous GCR reports.

[2] Given the intricacies associated with good corporate governance, GCR recommends an independent assessment to test compliance.

The SARB is Finbond's primary regulator. The group is also subject to the National Credit Act ("NCA"), National Credit Regulator ("NCR") codes, provisions of the Companies' Act, and JSE rules, and is a registered Financial Services Provider.

Legal/compliance matters

On 10 June 2015, the NCR applied to the South African National Consumer Tribunal ("the Tribunal") to *inter alia* order Finbond to:

- Refund five consumers whom the NCR believes Finbond overcharged in respect of credit life insurance;
- Perform an audit to determine how many other customers have been charged more than the industry average since commencement of the credit life business, and to refund those customers; and
- Pay an administrative fine of R1m.

The NCR alleges that Finbond's customers, when taking out a short-term unsecured loan, are required to pay unreasonable premiums for the provision of credit life insurance, in contravention of the NCA. In addition, the commission charged for this insurance is not properly disclosed to customers.

Finbond is, however, confident that it at all times complied with all relevant laws and regulations, and that the NCR application does not have legal merit and will be dismissed. The insurance premium rates of the credit life insurance products that Finbond sells to consumers are risk based, product specific, value adding, fully justified and not unreasonable (nor at an unreasonable cost to the consumer) and Finbond intends to demonstrate this to the Tribunal.

The group has investigated the allegations and has sought legal advice, and believes the matter will be satisfactorily resolved in Finbond's favour through due legal process.

Control structure

The group's operations are segregated into functional areas (Operations, Risk, Internal Audit, Compliance, Human Capital Development, Finance, Business Development and Information Technology), which feed through to the group's Executive Committee ("EXCO") sub-committees (Asset and Liability, Credit, Operational, Bank Information Technology and Finance and Tax Committees). As such, operations are subject to several layers of internal oversight and external control (including the Internal Audit and Compliance functions).

The bank and group have extensive operational and reporting policies in place, and high-level monitoring is supported by extensive and detailed management and risk reporting, which is produced on a regular and timely basis.

Reporting structure and access to information

Finbond's financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). The annual and interim financial reports are detailed, transparent and timely. KPMG Inc, the group's external auditors, issued an unqualified audit opinion on the FYE15 financial statements of the bank and the group. Performance data, changes in risk appetite and other relevant information are regularly updated and disseminated on the Stock Exchange News Service ("SENS").

Operating environment

Economic overview

Real economic activity again fell below expectations in 2014, with GDP growth moderating to 1.5%, from 2.2% in 2013. Growth was impacted by continued labour unrest and energy constraints, both of which contributed to lower productivity and rising inflationary pressures. However, the economy staved off recession due largely to strong growth achieved in 4Q 2014, as manufacturing and mining output recovered some of the ground lost earlier in the year. According to SARB, 2014 real GDP growth would have remained unchanged at 2013's 2.2%, excluding the impact of the strikes.

The Rand traded weaker against major currencies in 2014, closing at R/USD11.60 on 31 December 2014 (31 December 2013: R/USD 10.50). This exacerbated inflationary pressures for most of 2014, and with its foremost focus on inflation targeting, the SARB raised the repo rate by a cumulative 75 basis points ("bps") in 2014, citing rising inflation. In 2014, the official inflation rate averaged 6.1%, just exceeding the SARB's 3-6% target range. While lower oil prices have offered some respite in 2015, the Rand has remained weak (trading above R/USD12.00 in 1H 2015 and peaking at R/USD14.06 in 3Q 2015). The government has been forced to increase certain taxes to fund the deficit, re-igniting inflation, which has risen steadily from 3.9% in February to 4.6% in August 2015.

Several factors continue to weigh on South Africa's economic growth prospects, including electricity supply constraints, the potential for rising interest rates, volatile labour relations, and increasing polarisation of socio-political sentiment. The impact of higher indirect taxes, coupled with a weak Rand and other aspects of the relatively austere national budget (including upward recalibration of income tax and plans to reduce government spending) are expected to place further pressure on disposable incomes going forward. Given the continued economic challenges being faced, the SARB's real GDP growth projections for 2015 have again been revised down to 2.2%, from 2.5%. Actual performance in 2015 has in large part been an extension of 2014's challenges, in both the corporate and consumer environments.

Consumer
Consumer spending and household income growth showed a slight upward trend in the latter quarters of 2014 and 1Q 2015, moderating in 1H 2015. That said, these metrics are at historically low levels, and have declined significantly relative to previous years. In the main, pre-2013 consumer spending and household income growth were buoyed by certainty of real sector incomes, together with credit extension.

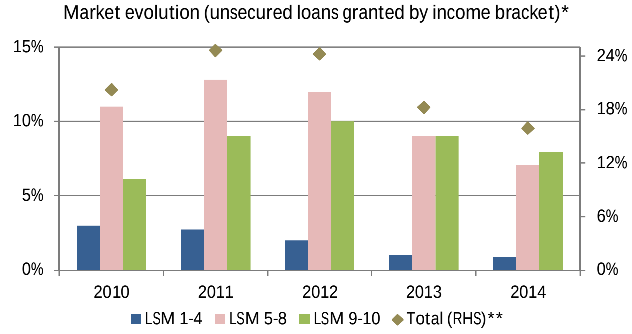
Diminished household income/consumption growth during 2014 was due to income constraints during the strikes, persistent high unemployment levels, and lustreless consumer confidence, which in turn have moderated lending growth. In light of the worsening consumer environment, credit demand has reduced while negative trends in non-performing loan ("NPL") data has crimped supply, more notably in loans to lower-income customers. Debt to disposable income levels (a debt affordability proxy) trended downward to 78.2% in 2014 and 77.8% in 2Q 2015, implying slight improvement in consumer debt capacity, in an environment of slow consumption growth. Debt service costs have risen slightly since 2014 due to higher interest rates, adding to consumer strain. While lower-income consumers continue to show strain, the net wealth of the household sector increased in 2014, and rose further in 1H 2015, as rising values of fixed and financial assets outpaced the rate of increase in households' financial liabilities. Share price appreciation was a major contributor to the declining debt-to-assets ratios of households, but negative stock market performance during 3Q 2015 could have reversed this trend somewhat.

Industry overview
Economic and political underperformance and their impacts on household income and consumption expectations have placed the consumer credit markets in challenging territory in recent years. As such, understanding the context of the unsecured credit market evolution, as well as its consequences for credit risk and asset quality, is essential to an evaluation of unsecured credit providers.

Credit market evolution
The value of unsecured loans outstanding increased fourfold between 2007 and 2014. The highest growth period (early 2010 to mid-2012) saw unsecured credit granting grow at an average annual rate of 54%. The significant growth in unsecured lending prior to 3Q 2012 can be explained by several factors, including:

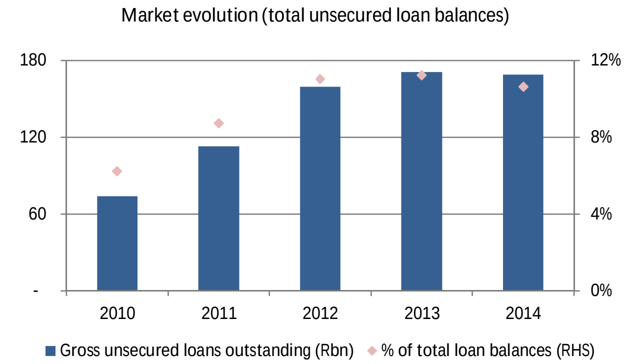
- The promulgation of the NCA, which enabled all credit providers to extend term and alter the risk profile of unsecured lending;
- Improved access to credit for middle-income earners, and increased size of the middle class;
- Substitution of secured for unsecured credit in upper-middle income clients;
- Increased competition in unsecured lending, resulting in longer tenors and larger loans being made available on an unsecured basis; and
- Increased lending to higher risk customers (primarily in 2011 and 2012) in a search for yield.

2H 2012 evidenced moderating, positive growth in unsecured credit granting, which turned negative in mid-2013 (given rising NPLs), since which time unsecured balances have remained fairly stable, with credit granting broadly matching write-offs.



* As a percentage of total loans granted (secured and unsecured)
** Unsecured loans as a percentage of total loans granted
Source: NCR.

Unsecured loans' share of consumer credit increased from 8% (2007) to 25% (2011), but has fallen back to 16% (2014) after unsecured credit growth contracted more than total consumer lending growth. During the unsecured lending boom, both the SARB and NCR periodically raised concerns over the pace of this growth, and the ability of lower-middle income consumers to cope with their indebtedness levels.



Source: NCR.

Credit risk and asset quality
In this regard, early 2013 provided initial evidence of an impending rise in NPLs/bad debt, as consumer finance providers/banks began to see the effects of profligate lending and/or stressed consumers in their books. This lead to tighter underwriting standards from early 2013, and crystallised with the collapse of African Bank Investment Limited[3] ("ABIL").

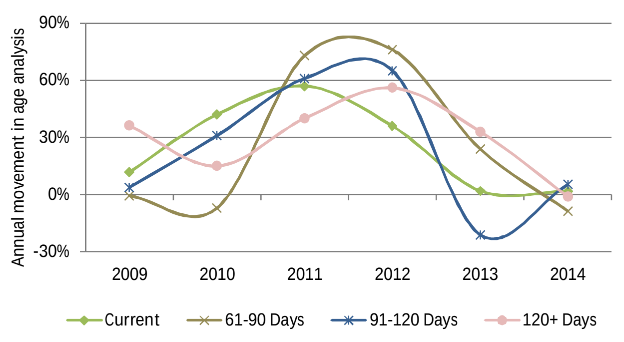
[3] Following a trading update from ABIL in early August 2014, highlighting the challenges facing its subsidiary, African Bank Limited ("ABL"), a dominant lender of unsecured credit to low- and middle-income consumers, the SARB implemented a number of measures to enable ABL to continue operating, and to maintain and enhance the stability of the South African Banking system. A key measure was to place ABL under curatorship on 10 August 2014. The SARB restructuring plan

The negative credit experience indicates that from at least 4Q 2012, selected market participants were granting unsecured credit to increasingly high risk customers, at a time when the macroeconomic environment was becoming more challenging for consumers, particularly in lower LSM bands which comprise the traditional unsecured lending market.

The effect of rising asset quality concerns combined with uncertainty regarding the future of one of South Africa's largest unsecured loan providers has resulted in stagnation of unsecured loan balances, as well as a reversal of several previously established trends. NCR data indicates that the pullback in unsecured credit has been driven by demand-side and supply-side factors, and is resulting in slow de-risking of the unsecured credit, evidenced by:

- Lower credit demand – illustrated by lower credit application rates which appear to be stabilising;
- Contraction in credit supply – evidenced by declining average credit approval rates from 56% (2011) to 44% (2014). Unsecured loans as a proportion of consumer loans granted (by number) has fallen from 21% to 18% over the past two years, confirming that unsecured credit supply has fallen more than for consumer credit overall;
- Decreasing average loan sizes – from R18,500 in 2012 to R17,000 in 2014; and
- Contracting loan tenor – 61+ month loans granted in 2014 are 1/3 of 2012 levels, partly due to ABL's dominance in this product.

Credit quality and ageing trends have been in sharp decline since mid-2012. Current unsecured loans (as a proportion of total unsecured loans) fell from 79% (2011) to 70% (2014), and delinquent loans (90+ days overdue) rose from 14% to 20% over the same period. That said, 4Q 2014 data indicates a convergence of growth in all aging buckets around zero, which may be initial evidence that NPL formation is slowing, or at least that NPLs are being written-off and loan books cleaned up.



Source: NCR.

Where previously growth in NPLs and non-current loan balances have substantially exceeded unsecured loan book growth, in 2014, unsecured loan books declined by 1% YoY, while non-current and delinquent loans rose 4% YoY, supporting anecdotal evidence that unsecured loan book performance is stabilising, noting that rising NPLs are amplified by the negative book growth. Following from this, NPL ratios also seem to be showing slight improvements, which is partly a depiction of more conservative provisioning/ write-off policies, which has enabled banks and other lenders to reflect a more realistic picture of collectible loans.

Industry outlook

While market participants' de-risking of their books and increases in provisions and write-off rates should to some extent mitigate the challenges of the past two years, the sector's outlook remains constrained by the fact that even if an asset quality floor has been reached, it is inappropriate to call a turn in the fortunes of unsecured credit providers, given the increasingly negative consumer environment, together with regulatory tightening, which are likely to constrain growth and profitability over the forthcoming 18-24 months.

Looking ahead, regulatory oversight should increase as a result of amendments to the NCA that came into effect in March 2015. These measures serve to tighten criteria for affordability assessments and require credit providers to calculate discretionary income more strictly, taking cognisance of all existing debt and maintenance obligations. This is expected to improve the efficacy of the cap on interest rates that consumers can be charged, as well as other charges such as initiation collection, service fees and default administration charges. It should be noted that a tightening of Finbond's affordability calculations was not required given that its existing credit granting process already complied with the newly updated affordability calculation requirements.

A case[4] currently before the courts on the use of emolument attachment orders ("EAOs") could also impact debt collection processes. An EAO is a court order that compels an employer to deduct money from an employee's salary every month for debt owed to a creditor that has obtained judgment against the employer. In Finbond's case, legal collections are handed over to various external debt collection

imposed losses of 10% on both senior debt and wholesale deposits, as well as the possible suspension of interest payments on such obligations (although interest would still accrue).

[4] A class action law suit was brought to the Western Cape High Court by the University of Stellenbosch's Legal Aid Centre ("LAC") and 15 consumers. The LAC alleges among other things that in many instances EAOs had been obtained in Magistrate's Courts outside the area of jurisdiction relating to where the loans had been obtained. The LAC is also concerned that clerks of the court, instead of magistrates, have been issuing EAOs. The LAC also seeks to determine whether it is constitutionally permissible for an EAO to be issued without any form of judicial oversight. Further, when the EAO is issued, a magistrate should ensure a debtor has sufficient means to maintain himself and any dependents. The list of respondents in the matter include the Minister of Justice and Correctional Services, the Minister of Trade and Industry, and the NCR, as the action is intended to get the law on EAOs redrafted.

agents, who are responsible for tracing the debtors, facilitating payment arrangement and, if deemed necessary, take legal action (in the form of obtaining EAOs).

In June 2015, The Department of Trade and Industry ("the DTI") and the NCR proposed new limits on interest rates and fees. In particular:

- The DTI is proposing a maximum prescribed interest rate of 24.8% for unsecured credit transactions (classified as loans with a term of more than six months) versus the current 32.7%. Since the vast majority (79.6% at 1H F16) of loans that are originated by Finbond are of a term of six months or less, the impact of this proposed restriction on interest for unsecured transactions is expected to be minimal.
- For short-term transactions (1-6 month loans), the DTI's proposed prescribed rate is 5% per month on the first loan and 3% per month on subsequent loans within a calendar year. Given that the maximum prescribed rate is currently 5% per month, Finbond anticipates there to be a much more significant impact on its revenues because a large component of monthly sales will be affected by the reduction of interest rates on subsequent loans in a calendar year.

The proposed reductions of maximum interest rates will to some extent be offset by higher initiation and services fees. Specifically, for unsecured credit transactions and short-term transactions, the proposed initiation fees are R165 per credit agreement, plus 10% of the amount in excess of R1,000, but never to exceed R1,050 (compared to the current initiation fees of R150 per credit agreement, plus 10% of the amount in excess of R1,000, but never to exceed R1,000). Nevertheless, calculations performed by Finbond indicate that its annual profits could be reduced by as much as 4% should the NCR's draft proposed changes in interest rates and fees be accepted in their current form.

While this overview has highlighted broad trends in the market, the uncertain strategy/role of ABIL and vastly different areas of focus and lending practices of market players over the preceding years, has resulted in the market average being a poor reflection of any one credit provider's actual experience post 2012. As such, while the industry overview provides historical and aggregate context, and the negative consumer environment affect all market players, unsecured lenders' performances are more likely to reflect the product of their own strategic choices and risk appetites, than the trends in the sector as a whole.

Competitive landscape

Finbond's main competitors in the short-term credit market are c.1,750 independent cash lenders, companies/groups with less than 10 branches (approximately 1,750 branches in total) and Capitec Bank (691 branches). As increasing regulation and unfavourable market conditions place strain on smaller consumer finance institutions, Finbond's competitive environment is easing and existing branch network/client bases are regularly available for acquisition. Finbond added 86 branches to its network in F15, and a further 35 during 1H F16, primarily by acquiring several existing short-term lending franchises, making Finbond the largest South African unsecured short term credit provider by branch footprint.

Finbond also benchmarks itself against a selection of larger, broader-based unsecured credit providers. In the past two years, several unsecured credit providers of significant size have either scaled back their general short-term lending products (Real People), or entered a period of severe financial stress (African Bank, Blue Financial Services) creating further opportunities for Finbond to grow its market share. As such, relevant financial comparatives are scarce. The group's focus on shorter term loans and ability to disburse cash over the counter differentiates Finbond from longer term lenders such as Capitec Bank, Real People, Blue Financial Services and RCS. Capitec Bank – which is used as a benchmark by Finbond with regards to growth and development in its journey from niche microlender to retail bank – has established itself as the new leader in the unsecured credit space, and at 31 August 2015 had 691 branches, R45.0bn in deposits and R33.6bn in unsecured loans.

Financial profile

Likelihood of support

Finbond's last capital contribution (in 2008) was backed by investment property. High capitalisation levels combined with earnings retention have negated the need for subsequent equity raising. While a mix of strategic and institutional shareholders is viewed as positive, the large stake of the founder/CEO implies that shareholder support, should it be required, is most likely to come from institutional or new shareholders, who have provided some financial support to Finbond in the past.

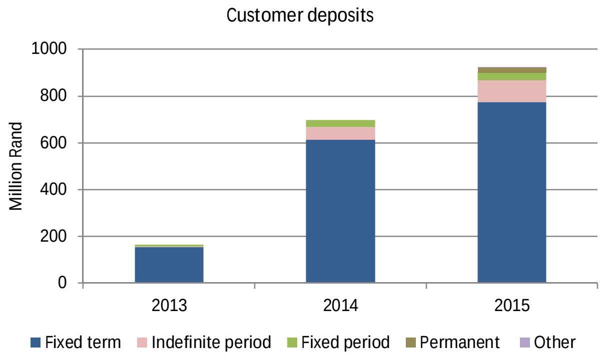
Funding structure

Finbond's funding structure has continued to focus on retail term deposit funding as its primary source, and the deposit base grew 32.5% to R922.0m at FYE15.

Table 3: Funding base	F14		F15	
	Rm	%	Rm	%
Long-term funding	484.1	69.6	654.6	69.9
Customer deposits	*484.1*	*69.6*	*654.6*	*69.9*
Short-term funding*	211.8	30.4	282.4	30.1
Customer deposits	*211.8*	*30.4*	*267.4*	*28.5*
*Shareholder loan***	*-*	*-*	*15.0*	*1.6*
Total	**695.9**	**100.0**	**937.0**	**100.0**

* Most of the underlying facilities are provided on a secured basis.
** Short term unsecured loan issued to the group by the shareholders.
Source: Finbond.

Finbond's savings/investment products are mainly taken up by retirees in the LSM 8-10 bracket, who are looking for low-risk, high yield investments.



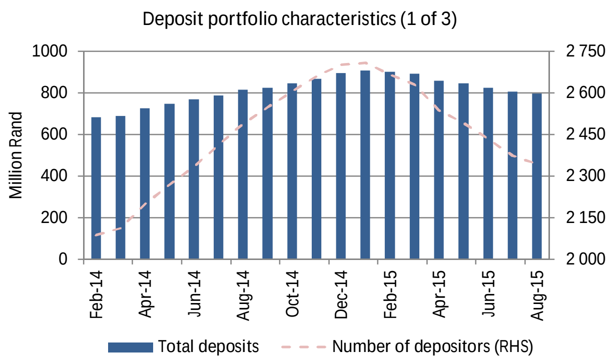
Salient features of the key savings and investment products follow:

Product (as at 31 August 2015)	Tenor (months)	Effective interest rate	Minimum deposit
Savings – Fixed term			
Fixed term	6-72	7.0-10.5%	R100 000
Indefinite period	18-notice	9.0%	R100 000
Fixed period	60	10.25%	R100 000
Permanent	*	11.0%	R100 000

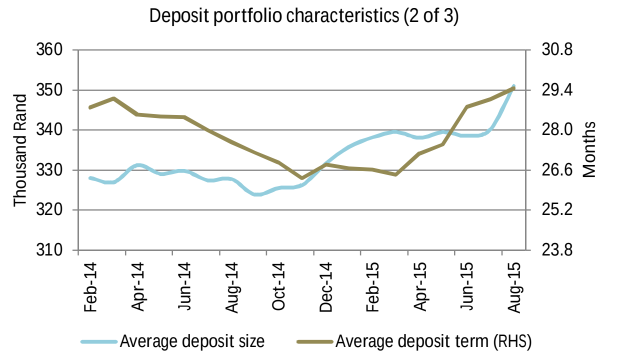
* Permanent, but transferable after 72 months. Source: Finbond

Given current limited opportunities for profitable funding deployment, Finbond's conservative credit appetite, and the risk of negative carry associated with excess interest-bearing liabilities, the group implemented measures to help reduce the value of its deposit portfolio. In particular, deposit rates were adjusted downwards in March and August 2015, and marketing efforts were scaled back. This resulted in a steady decline of the deposit portfolio since January 2015.

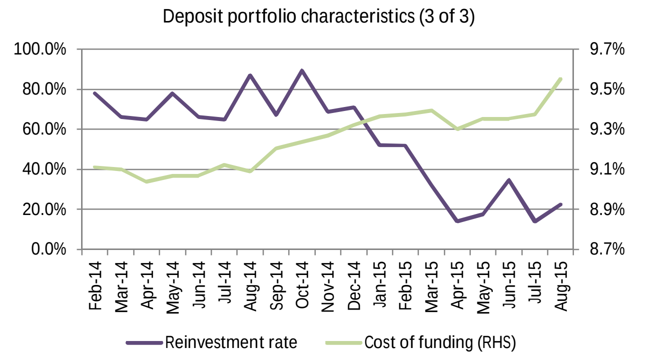
Deposit portfolio trends for F15 and 1H F16 are shown/explained below:



- At 1H F16, there were 2,344 depositors (1H F15: 2,489), with the top 10 comprising a slightly higher 10.3% (1H F15: 7.3%) of the deposit book. Despite the decrease in the number of depositors, the depositor base remains well diversified, and with low concentration risk.



- Average deposit size increased by 7.1% to R351,026 over the 12 months to 1H F16.
- Since the downward adjustment of deposit rates by Finbond in March 2015, average deposit term has been increasing, as depositors now favour the highest interest bearing deposit products (ie, those with the longest term).



- As a result of lower deposit rates, in line with the group's strategy to lower the cost of surplus funds, reinvestment rates on maturity have declined from an average of 71.6% over the 12 months to 31 August 2014 to an average of 44.6% over the 12 months to 31 August 2015.
- Following a c.25 basis point hike of deposit rates in August 2014, Finbond's funding cost has been on an upward trajectory, rising to 9.6% at 1H F16 (1H F15: 9.1%). Despite the downward adjustment of deposit rates in March 2015, which resulted in a slight reduction in the group's cost of funding, funding costs continue to rise gradually, as depositors now favour longer term higher interest bearing deposits.

Liquidity

As Finbond's weighted average deposit term at 1H F16 was 29.5 months, and weighted average loan term was 4.3 months, the contractual asset/liability mismatch is positive in the critical "0-6 month" bucket. The ratio of cash and liquid funds to total assets was 14.6% at FYE15 (FYE14: 8.0%). Excess funds (FYE15: R372.8m) are invested in highly-rated money-market and income funds. As a result, Finbond's ratio of cash, liquid funds and financial investments to total assets was 42.3% at FYE15 (FYE14: 46.1%). Following Finbond's strategy to reduce the intake of deposits, surplus funds have decreased since January 2015. Consequently, Finbond's ratio of cash, liquid funds and financial investments to total assets declined to 29.4% at 1H F16.

It is noted that Finbond already complies with the stringent liquidity and funding ratios, which will be introduced step-wise, as part of the move towards full Basel III implementation (which began from 1 January 2013). Per these rules, banks will be required to comply with two key liquidity measures:

- Liquidity Coverage Ratio ("LCR") – this is a 30-day stress test which requires sufficient high-quality liquid assets to cover envisaged net outflows. Ultimately, Basel III requires an LCR of at least 100% by 2019. Finbond's LCR was 204% (FYE15) and 314% (1H F16).
- Net Stable Funding Ratio ("NSFR") – this requires long-term asset cash flows to exceed long-term funding cash flows. Basel III requires an NSFR of at least 100% by 2018. At FYE15 and 1H F16, Finbond's NSFR was 579% and 517% respectively.

Interest rate risk
As loans and deposits are all at fixed rates, an element of natural hedge exists in the book. However, excess liquid balances are exposed to some interest rate and basis risk, which is not hedged. Per the Risk Management Framework, the management of liquidity risk takes precedence over the optimisation of interest rate risk.

Capital structure

Group level
Table 4 represents a comparative snapshot of the group's equity (vs. combined assets). As a result of organic earnings growth and the approval of Tier 2 capital (comprising long-term debt instruments) by SARB, the group's capital to total unweighted assets ratio improved to 28.8% at 1H F16 (FYE14: 27.4%), which is considered adequate given the relatively high level of credit risk associated with unsecured lending.

Table 4: Capitalisation	F14 Rm	F15 Rm	1H F16 Rm
Total reported capital	**339.3**	**381.5**	**389.6**
Paid up common shares	*239.7*	*239.7*	*239.7*
Retained earnings	*99.6*	*141.8*	*149.9*
Add: Qualifying reserves	4.0	2.6	3.8
Add: Approved Tier 2 capital	-	69.7	61.3
Less: Goodwill	(62.6)	(120.0)	(139.8)
Eligible capital	**280.7**	**333.8**	**314.9**
Total balance sheet assets†	**1 023.3**	**1 229.2**	**1 095.3**
Selected ratios:			
Adjusted capital : Total assets	27.4%	27.2%	28.8%

† Asset exposures not risk-weighted. Source: Finbond.

Finbond Mutual Bank level
The previous analysis covers group capital (which is lower than that of FMB, as part of the group's capital is funded by an intercompany loan from FMB). FMB, the SARB-regulated entity in which regulatory capital is measured, has a substantially higher capital base than the group (R449.8m vs. R345.9m at FYE15) and a CAR of 35.1% at FYE15 (1H F16: 35.9%). FMB's capitalisation is seen as adequate given current risk levels, management CAR targets, and the 25% regulatory minimum.

From a capital adequacy perspective, loan growth is expected to be supported by earnings retention, and increasing qualifying Tier 2 capital levels linked to the issue of certain long-term deposit products.

Operational profile

Strategic focus
Finbond is committed to its five-year strategic plan, for which detailed annual action plans/financial targets are available. The group strategy includes:

- Growing the distribution network, client base and market share, partly by pursuing 'micro-acquisitions' of competitors in the short-term loan market and larger acquisitions to diversifying income and enhance brand profile;
- Converting to a commercial bank;
- Introducing new products (including SME and vehicle finance) at a rate of approximately one per year;
- Accessing the capital markets and diversifying the capital base;
- The sale of investment properties; and
- Increasing support of social initiatives.

Evidence indicates that attainment of key strategic objectives is on track. During F15, Finbond completed the development and testing of its debit card (which was launched to qualifying customers in early 2015), internet banking and transactional banking products. Furthermore, Finbond was granted full membership to participate in key national payments/clearing/settlement systems, and expanded its branch network by 43% to 286 branches nationwide. In June 2015, the group introduced mortgage finance, which is nascent.

Operational focus
From an operational point of view, Finbond's key business propositions include the provision of micro-credit (target clients, LSM 1–5), and investment/ savings products (deposit-taking). At FYE15, 21.5% of the group's balance sheet is allocated to lending, c.42% to liquidity management, and 18.4% to investment property. Deposit-taking and liquidity management has been covered in the previous section. The properties are legacy capital contributions. An assessment of the lending business, and associated performance and risks, follows.

Risk focus

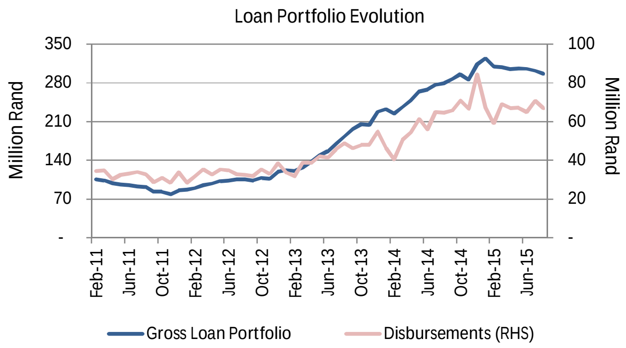
Key risks inherent in Finbond's business are credit risk, liquidity risk and operational risk. These risks are constantly monitored at executive management and board level, supported by rigorous reporting and periodic review of processes.

Micro-finance operations

Portfolio evolution

Finbond's micro credit loan product offering remained unchanged in F15 and 1H F16, consisting of 1-month to 24-month micro loans, ranging from R100 to R20,000.

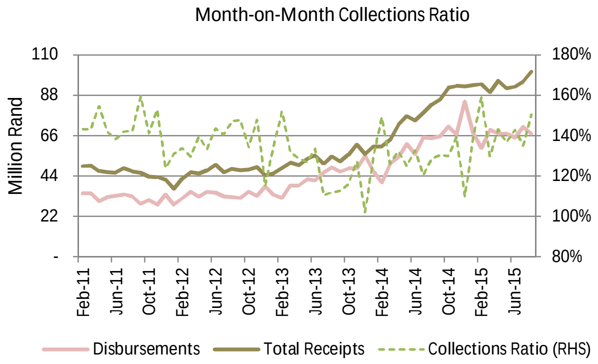
At FYE13, the group offered loans with a maximum 6-month tenor. In F14, the group introduced 12- 18- and 24-month loan products. The effect of the introduction of longer-term loan products is evident in the acceleration of gross loan portfolio growth, which is outstripping growth in disbursements.



Although medium term loans constituted 16.4% (1H F15: 19.7%) of the loan portfolio at 1H F16, loans with a tenor of 6 months or less still comprise over 90% of monthly sales. Medium term loans have a longer term to maturity, causing them to remain in the portfolio for longer.

Average loan term of monthly sales decreased to 3.6 months at 1H F16 (from 3.9 months at 1H F15), with whole loan turn remaining unchanged at 3.5 times. Given the short-term nature of Finbond's products, its loan portfolio is cash flow generative and a good source of internally generated liquidity.

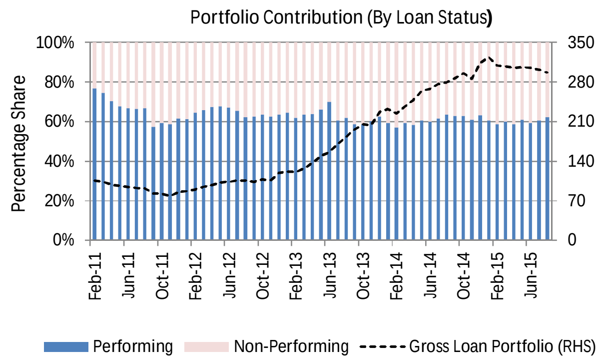
While the cash collection rate continues to experience some seasonality, aggregate loan collections of R1.1bn in F15 averaged 83% of anticipated receipts, an improvement from 80% in F14. Finbond's loan portfolio has remained highly cash generative in F15 and 1H F16, with receipts far outstripping disbursements. This is evidence that short-term loans continue to be the group's primary offering, and loan growth and performance should be viewed in the context of the short-term nature of the book.



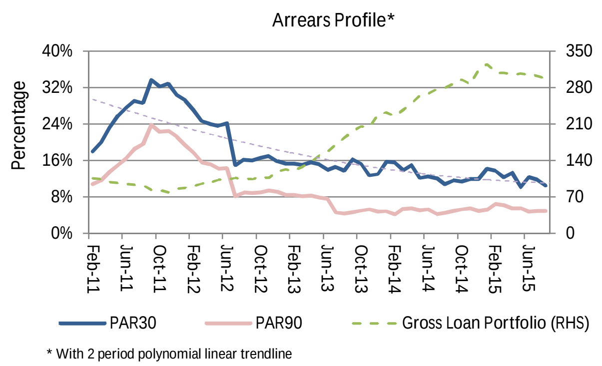
Finbond introduced a mortgage finance product in June 2015, which is targeted at individuals in the LSM 6/7-10 bracket. The offering focusses on debt consolidation mortgages where a client already has an existing home loan, and would like to consolidate their debt by refinancing the existing loan and repaying other creditors, using the equity in the property as collateral. At 1H F16, the mortgage finance portfolio comprised 12 fully performing home loans, out of a total of 148 applications (reflecting a decline rate of 91.9%), with an average loan size of R733,418.

Portfolio quality

Finbond has had success in pricing for risk, and maintaining consistently conservative credit scoring and rejection rates. Rejection rates stood at 93% on 24-month loans, 61% on 6-month loans, and between 6% and 13% on 1-month loans at 1H F16, compared to 94%; 58% and 7-14% respectively at 1H F15.



Despite negative trends in consumer finances and broader unsecured lending, the proportion of the portfolio in arrears remains stable (note that the previous chart shows the loan balance for which one or more instalments are in arrears).



Considering the arrears profile (above) in which portfolio at risk ("PAR") is measured relative to instalments in arrears (not the whole related loan) shows declining PAR percentages, partly due to the extension of book term and rising book size from F14 onwards.

Statistics on the rate at which loan arrears transition through the ageing buckets after a failed payment/s have slightly ticked up over the review period, where NPL formation rates of many MFIs have accelerated substantially.

Loan behaviour statistics†	F14	F15	1H F16
Current to 30 days	60.8%	63.8%	64.1%
31-days to 60 days	86.2%	87.2%	88.7%
61-days to 90 days	88.7%	91.0%	90.3%

† Gross forward roll rates, based on days past contractual due date.
Source: Finbond.

Table 5 illustrates the group's asset quality landscape. Instalment-basis metrics are used by Finbond's management to measure financial performance, and classify NPLs as instalments due and not paid (which is a fair measure given the short-term nature of the book). The outstanding balance basis metrics present NPLs on the assumption that the entire loan balance relating to an instalment not paid is non-performing (to enable direct comparison with typical NPL definitions in the market).

Table 5: Asset quality	F14	F15	1H F16
	Rm	Rm	Rm
Gross advances	**230.1**	**317.6**	**328.4**
Total balance (per board pack)	*298.7*	*374.6*	*386.4*
Less: Deferred future income	*(68.6)*	*(57.0)*	*(58.0)*
Performing	181.3	256.0	265.6
Non-performing	48.8	61.6	62.8
Less: Provisions	(19.1)	(26.9)	(28.2)
Net advances	**211.0**	**290.7**	**300.2**
Instalment basis metrics			
Gross impairment ratio	21.2%	19.4%	19.1%
Net impairment ratio	14.1%	11.9%	11.5%
Net impairment/Instalments due	6.3%	6.9%	7.3%
Outstanding balance basis metrics			
Gross impairment ratio	43.1%	41.4%	37.6%
Net impairment ratio	38.0%	35.9%	31.8%

Source: Finbond.

Irrespective of the absolute measure used, the trends in NPL experience are encouraging on almost all measures, indicating broadly improving asset quality in the book, despite the negative operating environment.

The loan loss reserve, or the risk coverage ratio (impairment provision/PAR >90 days in arrears), remained stable at 103% in FYE14/15. Furthermore, the 30-day arrears coverage ratio improved from 51.5% at FYE14 to 56.5% at FYE15. As such, provisioning levels appear modest, but given that impaired loans are likely to stop performing, be provided for and be written off (either against provisions or directly) within a one year period, provisioning levels relative to outstanding balances provide little information by themselves. It is more important to consider whether cash flow and revenue is sufficiently generous to accommodate a high level of NPLs, which appears to be the case based on several portfolio views. GCR does, however, note that net impairment as a percentage of cash received has shown negative experience (F13: 5.8%; F14: 7.3%; F15: 8.2%), illustrating some consumer strain.

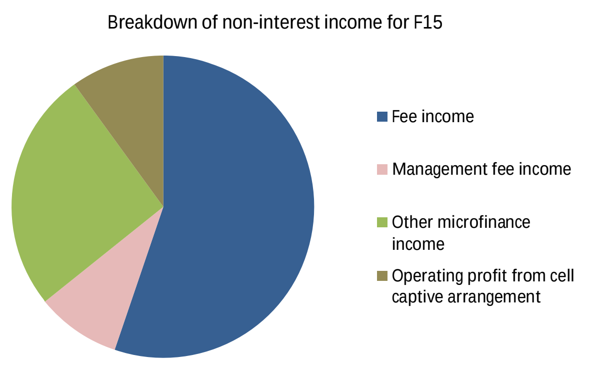
According to Finbond's write-off policy, which remained unchanged in F15/1H F16, any instalments that have reached 150 days in arrears where no payment has been received for at least 90 days are written off. Bad debts written off increased by 80% to R75.9m at FYE15. In particular, longer term loan products continue to reflect higher write-offs. Recoveries as a percentage of bed debts written off were negatively impacted by the increase in impairments in F15, dropping to 35.2% (FYE15) from 54.3% (FYE14).

Financial performance

A five year financial synopsis is shown at the back of this report, supplemented by the commentary below.

Net interest income grew 42.3% to R69.3m in F15, driven by gross advances growth of 38.0% and improved collections rates (up 4%). The net interest margin contracted from 20.2% (F14) to 17.6% (F15) as a result of an upward adjustment (by c.25 basis points) of deposit rates in August 2014, which ultimately increased the group's cost of funding.

In F15, Finbond granted R765.7m in loans (42.0% greater than F14), serviced 105,304 new clients (41.1% more than in F14) and granted 474,109 new contracts (an increase of 52.2% from F14). As a result, fee income (comprising initiation and service fees) increased by 50.9% to R170m, and comprised the majority (c.55%) of non-interest income, in F15. Total non-interest income increased by 67.1% to R304.8m, and contributed a higher 81.1% (F14: 77.3%) of total operating income in F15.



Operating profit from the cell captive arrangement, which made up c.9.9% of non-interest revenue in F15, is revenue received from insurance premiums written less related costs. Other microfinance income of R79.7m in F15, comprised profit on the disposal of insurance cell (R31.3m), insurance commission revenue (R21.5m), net legal subscriptions received (R20.0m), and other revenue (R6.9m).

Of concern is the significant growth in impairments (provisions and bad debt write-offs). In F15, impairments rose 141.4% (compared to advances growth of 38.0%) to R60.1m (F14: R24.9m). Resultantly, impairment charges as a percentage of operating income increased from 10.6% (F14) to 16.0% (F15). At 1H F16, impairments were R47.9m (1H F15: R23.7m). While this partly illustrates Finbond's exposure to the beleaguered consumer, it also highlights a lagged effect of loan book term extension (into higher risk-return products, which are beginning to season).

Operating costs increased by 47.5% in F15, mainly related to increasing capacity and improving risk management functions and processes, as well as infrastructure development. Although its operating cost to income ratio improved to 64.5% (F14: 69.6%), Finbond's cost base remains high, reflecting its early development stage, low-value high-volume proposition, retail client focus, and bricks-and-mortar distribution model.

Table 6: Interim result comparison (Rm)*	1H F15 Actual	1H F16 Actual	1H F16 Budget
Net interest income	34.9	29.1	24.5
Other income	160.1	216.3	207.0
Total operating income	**195.0**	**245.4**	**231.5**
Bad debt charge	(23.7)	(47.9)	(19.9)
Operating expenses	(139.3)	(155.4)	(173.0)
Profit before tax	**30.0**	**42.1**	**38.6**

* Based on management information. Source: Finbond.

The group's results vs. budget for 1H F16 illustrate significantly higher than expected impairments, compensated for by above-budget operating income and strong cost control. While the group appears on track to meet its full year earnings targets, the elevated impairment levels are concerning.

Prospects and conclusion

The group is focused on maintaining its conservative approach to risk management, and comfortable capital and liquidity buffers, in order to manage challenges currently being presented by South Africa's economic and regulatory environments.

Should the DTI's proposals on fee and interest rate caps gain approval, the group's revenue is unlikely to be significantly affected, based on the additional fee income Finbond should receive given the short term/ repetitive nature of its products. However, a ruling in favour of the NCR's application, relating to Finbond allegedly charging excessive and unreasonable credit life insurance to consumers, could have damaging financial and reputational implications for the group.

Finbond Group Limited

(South African Rand in millions except as noted)

For the year ended 28 February	2011	2012	2013	2014	2015
Income Statement					
Interest income	58.4	47.4	51.2	93.0	145.5
Interest expense	(15.9)	(16.8)	(20.7)	(44.3)	(76.1)
Net interest income	**42.5**	**30.6**	**30.5**	**48.7**	**69.3**
Asset related gains / (losses)[n]	(19.4)	22.4	3.1	5.0	1.8
Other income	119.2	126.0	142.2	182.4	304.8
Total operating income	**142.3**	**179.0**	**175.7**	**236.1**	**375.9**
Net impairment charge	(23.5)	(23.7)	(19.8)	(24.9)	(60.1)
Operating expenditure	(145.3)	(127.0)	(134.7)	(164.3)	(242.4)
Net profit / (loss) before tax	**(26.5)**	**28.2**	**21.2**	**46.9**	**73.4**
Tax	6.1	(14.8)	(0.7)	(9.9)	(22.5)
Net profit / (loss) after tax	**(20.3)**	**13.4**	**20.5**	**36.9**	**50.9**
Other after-tax income / (expenses)	0.3	0.1	0.3	-	-
Net attributable income / (loss)	**(20.0)**	**13.6**	**20.7**	**36.9**	**50.9**
Balance Sheet					
Ordinary share capital and reserves	235.5	247.6	305.8	330.4	346.7
Minority interest	(0.4)	(0.6)	(0.8)	(0.8)	(0.8)
Total capital and reserves	**235.1**	**247.1**	**304.9**	**329.6**	**345.9**
Long-term borrowings	159.1	159.2	111.4	484.1	654.6
Short-term borrowings	19.4	35.2	76.1	211.8	282.4
Other liabilities	30.5	35.6	65.0	60.3	66.3
Total capital and liabilities	**444.1**	**477.1**	**557.5**	**1 085.8**	**1 349.3**
Cash and liquid assets	36.9	53.2	63.0	86.8	197.5
Net customer loans	95.6	89.5	122.3	211.0	290.7
Other loans	0.1	0.1	0.1	-	-
Investments - Financial assets	6.3	8.6	24.8	413.7	372.8
Investments - Property	207.0	229.6	233.0	242.6	248.8
Other assets	98.1	96.1	114.2	131.8	239.4
Total assets	**444.1**	**477.1**	**557.5**	**1 085.8**	**1 349.3**
Contingencies	**33.8**	**26.6**	**31.2**	**32.8**	**49.0**
Key ratios (%)					
Financial management					
Interest expenses / Average gross advances	15.2	16.3	15.3	19.2	24.0
Interest expenses / Average funding liabilities	8.9	9.0	11.0	6.4	8.1
Interest bearing debt / Total capital (:1)	0.8	0.8	0.6	2.1	2.7
Total capital / Total assets	52.9	51.8	54.7	30.4	25.6
Internal capital generation	(4.6)	2.8	3.7	3.4	3.8
Loans / Deposits	53.6	46.0	65.2	30.3	31.0
Cash and liquid assets / Total assets	8.3	11.2	11.3	8.0	14.6
Cash, liquid funds and financial investments / Total assets	9.7	13.0	15.8	46.1	42.3
Asset quality					
Portfolio at risk‡ / Gross advances	17.7	24.2	24.4	21.3	19.4
Loan loss reserves / Average gross advances	10.2	10.4	11.3	10.5	9.8
Loan loss reserves / Portfolio at risk‡	56.8	44.4	40.2	39.1	43.6
Net impairment charge / Average gross advances	22.4	22.9	16.8	13.6	22.0
Net inpairment charge / Total operating income	16.5	13.3	11.3	10.6	16.0
Efficiency and Productivity					
Operating expenses / Average gross advances	138.8	122.9	99.3	71.4	76.3
Cost per loan (Rand value)	3.3	3.3	2.8	2.1	2.1
Operating expenses / Operating income	102.1	71.0	76.7	69.6	64.5
Profitability					
Net interest margin	29.6	22.2	18.6	20.2	17.6
Net interest income / Average gross advances	40.6	29.6	22.5	21.2	21.8
Non interest income / Total operating income	83.8	70.4	80.9	77.3	81.1
Net profit margin	(18.6)	15.8	12.0	19.8	19.5
Portfolio yield	0.2	0.2	0.2	0.2	0.2
ROaE	(8.2)	5.6	7.5	11.6	15.1
ROaA	(4.3)	2.9	4.0	4.5	4.2
Nominal growth indicators					
Total assets	(8.0)	7.4	16.8	94.8	24.3
Net customer loans	(0.1)	(6.4)	36.7	72.5	37.8
Shareholders equity	(6.7)	5.1	23.5	8.1	4.9
Attributable income	(134.4)	(167.7)	53.0	78.1	37.8

[n] Relates to revaluations, recognition of goodwill, net profit on sale/purchase and impairment losses on intangibles.
‡Refers to loans past due for more than 30 days.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S FINANCIAL INSTITUTIONS GLOSSARY

Arrears	An overdue debt, liability or obligation. An account is said to be 'in arrears' if one or more payments have been missed in transactions where regular payments are contractually required.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Asset Quality	Asset quality refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (i.e. being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Audit Report	An audit report is a written opinion of an auditor (attesting to the financial statements' fairness and compliance with generally accepted accounting principles).
Bad Debt	A bad debt is an amount owed by a debtor that is unlikely to be paid due, for example, to a company going into liquidation. There are various technical definitions of what constitutes a bad debt, depending on accounting conventions, regulatory treatment and the individual entity's own provisioning and write-off policies.
Balance Sheet	Also known as a 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.
Basel	Basel Committee on Banking Supervision housed at the Bank for International Settlements.
Basel I	Basel Committee regulations, which set out the minimum capital requirements of financial institutions with the goal of minimising credit risk.
Basel II	Basel Committee regulations, which attempt to integrate Basel capital standards with national regulations, by setting the minimum capital requirements of financial institutions with the goal of ensuring institutional liquidity.
Basel III	A comprehensive set of reform measures designed to improve the regulation, supervision and risk management within the banking sector. Largely in response to the credit crisis, banks are required to maintain prescribed leverage ratios and meet certain capital requirements.
Basis Point	A basis point is 1/100th of a percentage point.
Basis Risk	Basis risk is the imperfect correlation in the adjustment of the rates earned and paid on different instruments with otherwise similar repricing characteristics.
Bond	A long term debt instrument issued by either: a company, institution or the government to raise funds.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
Capital	The sum of money that is invested to generate proceeds.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent.
Capital Base	The issued capital of a company, plus reserves and retained profits.
Cash	Funds that can be readily spent or used to meet current obligations.
Cash Equivalent	An asset that is easily and quickly convertible to cash such that holding it is equivalent to holding cash.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Collateral	Asset provided to a creditor as security for a loan.
Consolidated Balance Sheet	A balance sheet in which the assets and liabilities of a parent company and its subsidiaries are presented as a single entity.
Consumer Price Index	CPI is an index of inflation. It is calculated by collecting and comparing the prices of a set basket of goods and services bought by a typical consumer at regular intervals over time.
Corporate Governance	Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Correlation	A term that describes the degree to which two variables move together. A correlation of 1 means that they move together exactly, while a correlation of minus 1 means that they move in exactly the opposite direction from each other.
Cost of Funds	The rate that a bank pays to borrow funds.
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.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Rating Agency	An entity that provides credit rating services.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and/or interest when due.
Creditworthiness	An assessment of a debtor's ability to meet debt obligations.
Customer Deposit	Cash received in exchange for a service, including safekeeping, savings, investment, etc. Customer deposits are a liability in a bank's books.
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.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.

Diversification	Spreading risk by constructing a portfolio that contains different investments, 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.
Dividend	The portion of a company's after-tax earnings that is distributed to shareholders.
Downgrade	The assignment of a lower credit rating to a company or sovereign borrower's debt by a credit rating agency. Opposite of upgrade.
Economies of Scale	Economies of scale are the cost advantages of an increase in output if the fixed costs of doing so, such as those for plant and equipment, remain the same. The marginal cost, or the cost of the last unit of production, falls as output is raised.
Equity	Equity (or shareholders' funds) is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Exchange	A standardised marketplace in which different assets are traded.
Exchange Rate	The value of one country's currency expressed in terms of another.
Expected Loss	Losses that a bank expects to bear over a certain period (generally a year). These losses are a consequence of doing business, namely the bank's role as financial intermediary.
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.
Facility	The grant of availability of money at some future date in return for a fee.
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Financial Statements	Presentation of financial data including balance sheets, income statements and statements of cash flow, or any supporting statement that is intended to communicate an entity's financial position at a point in time.
Franchise	Business or banking franchise; a bank's business.
Fraud	The unlawful and intentional making of a misrepresentation which causes actual and or potential prejudice to another.
Gearing	With regard to corporate analysis, gearing (or leverage) refers to the extent to which a company is funded by debt.
Goodwill	Arises upon the sale/acquisition of a business and is defined as an established entity's reputation, which may be regarded as a quantifiable asset and calculated as the price paid for a company over and above the net value of its assets. Negative goodwill refers to a situation when the price paid for a company is lower than the value of its assets.
Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.
Hedge	A risk management technique used to reduce the possibility of loss resulting from adverse movements in commodity prices, equity prices, interest rates or exchange rates arising from normal banking operations. Most often, the hedge involves the use of a financial instrument or derivative such as a forward, future, option or swap. Hedging may prove to be ineffective in reducing the possibility of loss as a result of, inter alia, breakdowns in observed correlations between instruments, or markets or currencies and other market rates.
Hedging	A financial risk management process or function to take a market position to protect against an eventuality. Taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
IFRS	IFRS is designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
Impairment	Reduction in the value of an asset because the asset is no longer expected to generate the same benefits, as determined by the company through periodic assessments.
Income Statement	A summary of all the expenditure and income of a company over a set 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.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Interest Rate Risk	The potential for losses or reduced income arising from adverse movements in interest rates. Interest rate risk in the banking book is the risk that earnings or economic value will decline as a result of changes in interest rates. The sources of interest rate risk in the banking book are repricing/mismatch, basis and yield curve risk.
JSE	Johannesburg Stock Exchange.
King III	King Code of Governance Principles and the King Report on Governance (King III) is a corporate governance code determining standards of conduct for public, private and non-profit organisations.
Lease	Conveyance of land, buildings, equipment or other assets from one person (lessor) to another (lessee) for a specific period of time for monetary or other consideration, usually in the form of rent.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquid Assets	Assets, generally of a short term, that can be converted into cash.
Liquidation	Liquidation is the process by which a company is wound up and its assets distributed. It can be either compulsory or voluntary. It can also refer to the selling of securities or the closing out of a long or short market position.
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.

Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Long term	Not current; ordinarily more than one year.
Margin	The rate taken by the lender over the cost of funds, which effectively represents the entity's profit and remuneration for taking the risk of the loan; also known as spread.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Mortgage Loan	A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan.
National Credit Act	The National Credit Act 34 of 2005 (South Africa).
Net Interest Margin	Net interest margin is the net interest income divided by average interest earning assets.
NPL Ratio	The ratio of non-performing loans and advances to total gross loans and advances, expressed as a percentage.
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This includes legal risk, but excludes strategic risk and reputational risk.
Option	An option gives the buyer or holder the right, but not the obligation, to buy or sell an underlying financial asset at a pre-determined price.
Over The Counter	An OTC market or trade is one conducted directly between dealers and principals rather than via an exchange.
Past Due	Any note or other time instrument of indebtedness that has not been paid on the due date.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Pledge	An asset or right delivered as security for the payment of a debt or fulfilment of a promise, and subject to forfeiture on failure to pay or fulfil the promise.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Outlook	A Rating outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Refinancing	The issue of new debt/loan to replace maturing debt/loan. New debt may be provided by existing or new lenders, with a new set of terms in place.
Regulatory Capital	The total of primary, secondary and tertiary capital.
Repurchase Agreement	In a REPO one party sells assets or securities to another and agrees to repurchase them later at a set price on a specified date.
Reputational Risk	The risk of impairment of an entity's image in the community or the long-term trust placed in it by its shareholders as a result of a variety of factors, such as performance, strategy execution, the ability to create shareholder value, or an activity, action or stance taken by the entity.
Retained Earnings	Earnings not paid out as dividends by a company. Retained earnings are typically reinvested back into the business and are an important component of shareholders' equity.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Secured Loan	A loan which is backed by a pledging of real or personal property (collateral) by the borrower to the lender. Unlike unsecured loans, which are backed by a promise by the borrower that he will repay the loan, in case of a secured loan, the lender can initiate legal action against the borrower to reclaim and sell the collateral (pledged property).
Securities	Various instruments used in the capital market to raise funds.
Security	An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default.
Settlement	Full repayment of an obligation.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Solvent	The state of a company where its assets exceed its liabilities and it is able to service its debt and meet its other obligations, especially in the long-term.
Stock Exchange	A market with a trading-floor or a screen-based system where members buy and sell securities.
Strategic Risk	The risk of an adverse impact on capital and earnings due to business policy decisions (made or not made), changes in the economic environment, deficient or insufficient implementation of decisions, or failure to adapt to changes in the environment. Strategic risk is either the failure to do the right thing, doing the right thing poorly, or doing the wrong thing.
Swap	An exchange of payment streams between two parties for their mutual benefit. Swaps can involve an exchange of debt obligations, interest payments or currencies, with a commitment to re-exchange them at a specified time.
Tenor	The time from the value date until the expiry date of an instrument, typically a loan or option.
Term Deposit	A savings account held for a fixed term. Also called a time deposit. Generally, there are penalties for early withdrawal.
Write-off	The total reduction in the value of an asset.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

Finbond Group Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have been disclosed to Finbond Group Limited with no contestation of the rating.

The information received from Finbond Group Limited and other reliable third parties to accord the credit ratings included:

- Audited financial results of Finbond Group Limited to 28 February 2015 (plus four years of comparative numbers);
- Interim financial results of Finbond Group Limited to 31 August 2015;
- Latest internal and/or external audit reports to management;
- A breakdown of facilities available and related counterparties;
- Reserving methodologies and capital management policy;
- Industry comparative data and regulatory framework; and
- Corporate governance and enterprise risk frameworks.

The ratings above were solicited by, or on behalf of, Finbond Group Limited, and therefore, GCR has been compensated for the provision of the ratings.