



Credit Rating Announcement

GCR downgrades Grobank Limited's national scale issuer rating to BB_{-(ZA)}, with the Outlook placed on Rating Watch Evolving

Rating Action

Johannesburg, 10 November 2020 - GCR Ratings ("GCR") has downgraded the South African long and short-term issuer ratings of Grobank Limited to BB_{-(ZA)}/B_(ZA) with the outlook placed on Rating Watch evolving.

| Rated Entity / Issue | Rating class | Rating scale | Rating | Outlook / Watch |
|----------------------|-------------------|--------------|---------------------|-----------------|
| Grobank Limited | Long Term Issuer | National | BB _{-(ZA)} | Rating Watch |
| | Short Term Issuer | National | B _(ZA) | Evolving |

Rating Rationale

The downgrade of Grobank Limited's ('the bank') national scale ratings reflects increased risk to its balance sheet owing to deteriorating levels of capitalisation, less stable funding structure balanced with moderate levels of liquidity and compounded by the strained South African operating environment with the banking sector coming under pressure amidst the COVID-19 pandemic. The ratings watch evolving factors in the anticipated acquisition of the bank by Access Bank Nigeria, which in turn will bring in new capital and infrastructure to support its funding strategy and contain downside risk. Grobank's capital position is precarious and close to breaching the regulatory minimum capital adequacy requirements (as of September 2020). The transaction (valued at approximately R400m) is undergoing regulatory approvals and we expect to resolve the watch around the time the acquisition is finalised. Failure of concluding this transaction successfully may result in negative rating migration.

The competitive position of the bank constrains the rating given the lack of scale and product diversity in comparison to top tier banks. Under the current shareholders, the bank focuses on food and agri-business financing in SA, and given the size of the Agri-economy, strong capacity building of the bank and the owners'/ managers' strong links into the market, our expectation was that the market position of the bank would be bolstered quickly. However, the anticipated shareholder change brings uncertainty to the strategic direction for Grobank. Revenue stability has been weak over the past 3-5 years as the bank continues to post losses on the back of limited funding and capital for growth.

Capitalisation is ratings negative. The bank's GCR total capital ratio was c.14.6% at FY19, and we expect it to deteriorate 400bps to around 10.5% by year end. Losses doubled from prior year and we expect this trend to continue until new capital is injected to support top line growth. The bank is close to breaching the regulatory minimum capital adequacy ratio and a continued loss-making position makes this inevitable in the absence of capital support. Access Bank's acquisition of Grobank is expected to recapitalise the bank and alleviate regulatory risk. Positively, the current shareholders have agreed to subscribe to tier 2 capital instruments as part of the overall transaction which should see the bank complying with regulatory requirements. However, the GCR capital ratio (measured on a loss bearing tier 1 capital basis) would need to be maintained above 15% for a positive assessment.

The bank's risk position is a positive ratings factor, supported by cost of risk that is better than peers and the sector average. Credit losses were 0.5% at FY19 and we forecast an increase to around 1.2% by year end, given a number of borrowers downgraded to stage 2 and 3 loan classification. Over the next 12-18 months, cost of risk will likely remain

between a favourable range of 1.2%-1.5% compared with peers, given the level of collateral. Non performing loans ('NPLs') on the other hand are higher than peers but recovering towards more normalised levels (5.9% at FY19). Positively, loan concentrations are moderately low, with top 20 exposures accounting for 31% of total loans as of March 2020. Limited foreign currency lending also benefits the bank's risk position.

Funding and liquidity factors in some of the structural funding disadvantages of tier 2 banks in South Africa. This is reflected by the bank's relatively limited core transactional deposit franchise which increases the cost of funding. Furthermore, we consider the funding structure to be less stable given a large composition of the deposits are confidence sensitive and some funding contain rating-linked triggers. Liquidity is adequate for now, reflected in the regulatory coverage ratio of over 176% as of September 2020 vs. revised minimum of 80%. However, the bank's liquid assets reduced significantly due to large deposit out flows and we think liquidity may be pressured by a continued outflow of deposits, without meaningful additional funding. Nonetheless, we have factored in the potential liquidity line from Access Bank which will help ease liquidity pressure in the interim up to the time the transaction is approved.

Outlook Statement

The ratings watch evolving factors in the anticipated acquisition of Grobank by Access Bank Nigeria, which in turn is expected to recapitalise the bank and improve capitalisation metrics beyond the regulatory minimum. This is likely to support business growth. However, any deviations from current expectations for capital injections and/or the failure to conclude the transaction which could lead to any breaches in the bank's regulatory capital requirements could result in downward ratings pressure.

Rating Triggers

A national scale downgrade could be caused by a failure to successfully conclude the corporate transaction which could lead to continued losses and consequently a reduction in capital adequacy. We may also downgrade the ratings should liquidity deteriorate under the current funding structure. The upside to the ratings is limited, although increased business diversification, a stronger funding structure and stronger capitalisation beyond expectations could result in a rating improvement.

Analytical Contacts

| | | |
|--|---|--|
| Primary analyst Johannesburg, ZA | Simbarake Chimutanda SimbarakeC@GCRratings.com | Financial Institutions Analyst +27 11 784 1771 |
| Committee chair Johannesburg, ZA | Vinay Nagar Vinay@GCRratings.com | Senior Financial Institutions Analyst +27 11 784 1771 |

Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scale, Symbols & Definitions, May 2019
GCR Country Risk Scores, May 2020
GCR Financial Institutions Sector Risk Score, August 2020

Ratings History

| Grobank Limited | | | | | |
|-------------------|----------------|--------------|---------------------|----------|---------------|
| Rating class | Review | Rating scale | Rating class | Outlook | Date |
| Long Term issuer | Initial / last | National | BBB _(ZA) | Negative | November 2019 |
| Short Term issuer | Initial / last | National | A3 _(ZA) | N/a | November 2019 |

Risk score summary

| Rating Components & Factors | Risk scores |
|------------------------------|---------------|
| Operating environment | 14.50 |
| Country risk score | 7.00 |
| Sector risk score | 7.50 |
| Business profile | (4.00) |
| Competitive position | (4.00) |
| Management and governance | 0.0 |
| Financial profile | (2.00) |
| Capital and Leverage | (2.00) |
| Risk | 0.50 |
| Funding and Liquidity | (0.50) |
| Comparative profile | 0.00 |
| Group support | 0.00 |
| Government support | 0.00 |
| Peer analysis | 0.00 |
| Total Score | 8.50 |

Glossary

| | |
|-------------------|---|
| Balance Sheet | Also known as 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. |
| Capital | The sum of money that is invested to generate proceeds. |
| 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. |
| Diversification | Spreading risk by constructing a portfolio that contains different exposures 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. |
| 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. In insurance, it refers to an individual or company's vulnerability to various risks |
| 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. |
| Long Term Rating | See GCR Rating Scales, Symbols and Definitions. |
| Rating Outlook | See GCR Rating Scales, Symbols and Definitions. |
| Risk | The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives. |
| Short Term Rating | See GCR Rating Scales, Symbols and Definitions. |
| Short Term | Current; ordinarily less than one year. |

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the ratings were influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity.

The ratings were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Grobank Limited participated in the rating process via teleconference management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from the entities and other reliable third parties to accord the credit ratings included:

- Audited financial results as at 31 December 2019;
- Management accounts for 2020;
- Latest internal and/or external audit report to management;
- A breakdown of facilities available and related counterparties; and
- Industry comparative data.

ALL GCR CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS, TERMS OF USE OF SUCH RATINGS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS, TERMS OF USE AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://GCRRATINGS.COM](http://GCRRATINGS.COM). IN ADDITION, RATING SCALES AND DEFINITIONS ARE AVAILABLE ON GCR'S PUBLIC WEB SITE AT WWW.GCRRATINGS.COM/RATING_INFORMATION. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. GCR'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THIS SITE.

CREDIT RATINGS ISSUED AND RESEARCH PUBLICATIONS PUBLISHED BY GCR, ARE GCR'S OPINIONS, AS AT THE DATE OF ISSUE OR PUBLICATION THEREOF, OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. GCR DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL AND/OR FINANCIAL OBLIGATIONS AS THEY BECOME DUE. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: FRAUD, MARKET LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND GCR'S OPINIONS INCLUDED IN GCR'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND GCR'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND GCR'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL OR HOLD PARTICULAR SECURITIES. NEITHER GCR'S CREDIT RATINGS, NOR ITS PUBLICATIONS, COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. GCR ISSUES ITS CREDIT RATINGS AND PUBLISHES GCR'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING OR SALE.

Copyright © 2019 GCR INFORMATION PUBLISHED BY GCR MAY NOT BE COPIED OR OTHERWISE REPRODUCED OR DISCLOSED, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT GCR'S PRIOR WRITTEN CONSENT. Credit ratings are solicited by, or on behalf of, the issuer of the instrument in respect of which the rating is issued, and GCR is compensated for the provision of these ratings. Information sources used to prepare the ratings are set out in each credit rating report and/or rating notification and include the following: parties involved in the ratings and public information. All information used to prepare the ratings is obtained by GCR from sources reasonably believed by it to be accurate and reliable. Although GCR will at all times use its best efforts and practices to ensure that the information it relies on is accurate at the time, GCR does not provide any warranty in respect of, nor is it otherwise responsible for, the accurateness of such information. GCR adopts all reasonable measures to ensure that the information it uses in assigning a credit rating is of sufficient quality and that such information is obtained from sources that GCR, acting reasonably, considers to be reliable, including, when appropriate, independent third-party sources. However, GCR cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall GCR have any liability to any person or entity for (a) any loss or damage suffered by such person or entity caused by, resulting from, or relating to, any error made by GCR, whether negligently (including gross negligence) or otherwise, or other circumstance or contingency outside the control of GCR or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits) suffered by such person or entity, as a result of the use of or inability to use any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained in each credit rating report and/or rating notification are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained in each credit rating report and/or rating notification must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY GCR IN ANY FORM OR MANNER WHATSOEVER.