



Credit Ratings & Research

# Credit Rating Synopsis Xceda Finance Limited

## Credit Rating Synopsis

**Date:** 26 September 2022

**Prepared for:** Xceda Finance Limited

**Report prepared by:** Equifax Australasia Credit Ratings Pty Ltd ("Equifax")

**Primary Analyst:** Girish Jethani, CFA

**Secondary Analyst:** Emmanuel Machapaza

**Job Number:** 367049

### Currency used in this report:

This report is presented in New Zealand Dollars unless otherwise noted



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# 1 Credit Rating Synopsis

Xceda Finance Limited ('Xceda' or 'the Company')	Risk Rating																												
<p>Xceda is a New Zealand based Non-Bank Deposit Taking (NBDT) institution licensed by the Reserve Bank of New Zealand ('RBNZ') to accept retail deposits and underwrite loans to the public.</p>	<b>B</b>																												
<p>Equifax Credit Ratings Australasia Pty Ltd ('Equifax') has affirmed Xceda's credit rating of 'B' at Mar22, which is a sub-prime classification with a moderate level of risk. The outlook for the rating is 'Stable'.</p>	<b>Outlook: Stable</b>																												
<p>Xceda's credit rating reflects its incumbent market position in the New Zealand NBDT sector, adequate liquidity position appropriate for its size, improving asset quality underpinned by good collateral coverage ratio, healthy capital adequacy levels, and the expected benefit to its ability to attract deposits by recent proposed regulatory reforms. The risks to the rating arise from the current macroeconomic environment, Xceda's relatively small scale, its business model that focuses on upper quadrants of risk reward matrix and operating risks associated with a growing loan book.</p>	<b>Public, Under ongoing monitoring</b>																												
<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>- Xceda has carved a niche for itself in the specialised market sub-segment of asset-backed lending, thereby enabling the Company to repeatedly attract customers in a segment underserved by traditional banks and manage that portfolio profitably. Further, the Company's ability to maintain a high yield on loans enables it to continually raise consumer deposits by offering attractive returns.</li> <li>- Xceda's liquidity position is considered adequate, supported by high retail deposits reinvestment rates, liquid assets to liabilities ratio of 14.8% at Jun22, and a well-matched asset-liability maturity profile. Together they suitably position the Company to withstand liquidity shocks and partially offset risks associated with a high proportion of non-amortising loans (88% of the loan book at Jun22).</li> <li>- Xceda's asset quality is improving, evidenced by declining NPLs and high monthly loan receipts collection rates. This improvement has been attributed to the strategic overhaul of its operations, which included a tightening of lending criteria and underwriting standards, reducing concentration risk, and increasing the share of first mortgages. Moreover, a large &amp; performing legacy loan account, which had disproportionately impacted asset quality metrics in periods prior to FY21, is expected to be closed soon and poses relatively lower levels of risks owing to the increase in the Company's loan book.</li> </ul>	<p style="text-align: center;"><b>Industry Percentiles</b></p> <p><b>Scale:</b></p> <table border="0"> <tr> <td>Total Assets</td> <td style="text-align: right;">46%</td> </tr> <tr> <td>Gross loans</td> <td style="text-align: right;">62%</td> </tr> </table> <p><b>Profitability:</b></p> <table border="0"> <tr> <td>NIM</td> <td style="text-align: right;">85%</td> </tr> <tr> <td>ROE</td> <td style="text-align: right;">62%</td> </tr> <tr> <td>ROA</td> <td style="text-align: right;">62%</td> </tr> <tr> <td>Efficiency Ratio</td> <td style="text-align: right;">62%</td> </tr> </table> <p><b>Capitalisation:</b></p> <table border="0"> <tr> <td>Leverage (Gross Loans to Equity)</td> <td style="text-align: right;">15%</td> </tr> <tr> <td>Capital Ratio</td> <td style="text-align: right;">46%</td> </tr> <tr> <td>Capital to Total Assets</td> <td style="text-align: right;">38%</td> </tr> </table> <p><b>Funding and Liquidity:</b></p> <table border="0"> <tr> <td>Deposits to Loan Ratio</td> <td style="text-align: right;">23%</td> </tr> <tr> <td>Liquid Assets to Total Assets</td> <td style="text-align: right;">31%</td> </tr> </table> <p><b>Asset Quality:</b></p> <table border="0"> <tr> <td>Net Charge-offs</td> <td style="text-align: right;">39%</td> </tr> <tr> <td>Impaired Loans</td> <td style="text-align: right;">39%</td> </tr> <tr> <td>Provision for Loan Losses</td> <td style="text-align: right;">62%</td> </tr> </table>	Total Assets	46%	Gross loans	62%	NIM	85%	ROE	62%	ROA	62%	Efficiency Ratio	62%	Leverage (Gross Loans to Equity)	15%	Capital Ratio	46%	Capital to Total Assets	38%	Deposits to Loan Ratio	23%	Liquid Assets to Total Assets	31%	Net Charge-offs	39%	Impaired Loans	39%	Provision for Loan Losses	62%
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<ul style="list-style-type: none"> <li>- The Company has sound capital adequacy levels, with a capital ratio of 16.1% at Jun22 (Mar22:15.4%) which is above the minimum Trust Deed requirement of 10.0%. While the expected growth in the loan book over the next 12 months is expected to reduce the capital ratio to between 13%-14%, it is healthy in our view, subject to no material deterioration in the quality and/or income generation capability of the loan assets. Moreover, similar to FY22, the Company's shareholders expect to continue supporting the Company in FY23 providing further comfort.</li> </ul>	<b>Key Trends</b>																												
<ul style="list-style-type: none"> <li>- RBNZ is in the process of aligning the regulation of all deposit takers under one framework and introducing a depositor compensation scheme. More stringent regulatory oversight of NBDTs will promote public confidence in the sector, and in turn, enhance Xceda's capacity to obtain funding from depositors, in our view. Whilst we acknowledge that the related compliance cost burden could weigh on Xceda's profitability, the Company's healthy capitalisation supports its ability to absorb any material impact.</li> </ul>	<p style="text-align: center;"><b>Net Interest Margins (NIMs) and Provisions(RHS)</b></p> <table border="1"> <caption>Net Interest Margins (NIMs) and Provisions (RHS)</caption> <thead> <tr> <th>Fiscal Year</th> <th>NIMs (%)</th> <th>Provisions (RHS) (%)</th> </tr> </thead> <tbody> <tr> <td>FY19</td> <td>13.5</td> <td>14.0</td> </tr> <tr> <td>FY20</td> <td>15.0</td> <td>12.0</td> </tr> <tr> <td>FY21</td> <td>9.0</td> <td>1.0</td> </tr> <tr> <td>FY22</td> <td>6.0</td> <td>1.0</td> </tr> </tbody> </table>	Fiscal Year	NIMs (%)	Provisions (RHS) (%)	FY19	13.5	14.0	FY20	15.0	12.0	FY21	9.0	1.0	FY22	6.0	1.0													
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<p><b>Constraints</b></p> <ul style="list-style-type: none"> <li>- The NBDT sector players including Xceda face significant macroeconomic headwinds characterized by rising inflation, increasing borrowing costs, and weakening economic growth, with a slowing down housing market. As a result, like its global peers, to rein in rising inflation the RBNZ has adopted a contractionary monetary policy stance, which is also highly likely to result in an economic recession over the short to medium term. In our view, these risks are affecting already high-levered households and may result in reduced debt serviceability, increased financial stress on consumers consequently weakening asset quality, and increased impairments.</li> <li>- Xceda's rating is constrained by its small size and franchise, its focus on upper quadrants of risk reward matrix and its retail deposit funding base. Its customers' debt serviceability is highly susceptible and sensitive to the macroeconomic environment. However, in our view, Xceda mitigates these risks by using good quality collateral on its loan book, with an average LVR of 56% at Jun22.</li> <li>- Xceda's strong loan book growth presents operating risks that the Company would be required to adequately manage to sustain the long-term health of the business. Whilst the recent recruitment of the Chief Credit Officer (CRO) has strengthened the Company's operational resource capacity, continued growth is likely to require the Company to attract and retain well-qualified and experienced personnel to manage larger operations and reduce its reliance on key executives' expertise, going forward.</li> </ul>	<p style="text-align: center;"><b>Loans &amp; Deposits</b></p> <table border="1"> <caption>Loans &amp; Deposits (\$'m)</caption> <thead> <tr> <th>Month</th> <th>Loans (\$'m)</th> <th>Deposits (\$'m)</th> </tr> </thead> <tbody> <tr> <td>Mar19</td> <td>25</td> <td>20</td> </tr> <tr> <td>Mar20</td> <td>28</td> <td>25</td> </tr> <tr> <td>Mar21</td> <td>38</td> <td>35</td> </tr> <tr> <td>Mar22</td> <td>50</td> <td>45</td> </tr> </tbody> </table>	Month	Loans (\$'m)	Deposits (\$'m)	Mar19	25	20	Mar20	28	25	Mar21	38	35	Mar22	50	45													
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<p>The near-term outlook for the rating is stable. A rating upgrade would require a sustainable improvement in scale, while maintaining profitability and asset quality. There may be downward pressure on the rating if the Company's asset quality, capital ratio or liquidity positions materially deteriorate, on an individual or a collective basis.</p>																													

## 2 Scope of Report

The report provides an overview of the credit rating and associated rationale of Xceda Finance Limited (“Xceda”, “the Company”).

We have complied with our rating services guidelines in order to derive the credit rating on Xceda Finance Limited. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold or sell any securities or make any other investment decisions. The details pertaining to this report are outlined below:

<b>Report Details</b>	
Date of Report	<b>26 September 2022</b>
Request Type	<b>Issuer</b>
Assessment Type	<b>Under ongoing monitoring</b>
Rating Initiation	<b>Issuer-based (solicited)</b>
Rating Distribution	<b>Public Rating</b>
Report Distribution	<b>Unrestricted</b>
Purchased by	<b>Xceda Finance Limited</b>
Report Fee	<b>Fixed Price</b>
Ancillary fees	<b>Nil</b>
Subject First Time Rated	<b>No</b>
Issuer Name	<b>Xceda Finance Limited</b>
Issue Name	<b>Not Applicable</b>
Issue First Time Rated	<b>Not Applicable</b>
Financial Scope	<b>Standalone Entity</b>
Structure	<b>Limited Company</b>
Industry	<b>Financial Services</b>
Sector	<b>NZ Non-Bank Deposit Takers</b>

This report should be read within the context of Equifax’s Rating Services Guide. This report should be taken as a whole and cannot be abridged or excerpted for any reason.

We have conducted this assessment on the basis of the information provided to us by Xceda Finance Limited, publicly available information and from our own enquiries. We have derived a credit rating on the Company based on the understanding that Xceda Finance Limited has no contingent liabilities, cross guarantees or other liabilities to any other entity other than as disclosed to us or as detailed in the financial statements. Our duty does not include auditing the financial statements.

## Information Sources

Financial statements	<b>Audited Financial Statements for the years ended 31 March 2022, 2021, and 2019. Management Accounts for three months interim period to Jun22.</b>
Name of auditor	<b>Grant Thornton New Zealand Audit Limited</b>
Other Information Sources	<b>The Company's response to our Request for Information, the Company website, industry and regulatory websites, management interviews, media articles, adverse searches and internet searches</b>
Subject participation	<b>Full</b>
Material financial adjustments	<b>None</b>
Limitations of assessment	<b>None noted</b>
Outsourced rating activities	<b>No</b>
Confidentiality agreement	<b>No</b>
Material client	<b>No</b>
Rating amended post issuer disclosure	<b>No</b>
Potential conflict of interest	<b>No</b>
Rating methodology	<b>Financial Institution Rating Criteria</b>

This report should be read within the context of Equifax's Ratings Services Guide.

### 3 APPENDICES

#### 1. Explanation of the Equifax's credit rating

##### 1.1 What is a rating?

Credit ratings provide an Agency's opinion as to the capacity, viability and willingness of an entity, issuer, or counterparty to meet their respective financial commitments. As such, Equifax assigns ratings based on the credit worthiness of an entity, commitment or product, and provides probabilistic assessments of default over the short, medium and long-term.

Credit ratings are a critical measure used extensively in commercial, financial and capital markets to support key business decisions. Equifax's credit ratings are used to support debt and bonding decisions, loan origination and recovery, insurance and warranty, funds management, portfolio management, tendering and procurement, counterparty risk assessments and other commercial contracts.

Equifax provides credit ratings on government and commercial agencies, international conglomerates, infrastructure consortia, financial institutions, publicly listed entities, private corporations and small-to-medium sized enterprises across a range of industry sectors both domestically and internationally. As such, Equifax is also able to provide detailed industry intelligence, benchmarking reports and analysis across a wide range of sectors.

##### 1.2 Equifax's credit rating

Equifax and other credit rating agencies all attempt to measure the probability of an entity being able to honour its financial commitments as and when they fall due. The most recognised credit rating is that based on Bond Rating Equivalent (BRE) used over the past eighty years to determine the proximity of an entity's securities to default (non-payment of interest or principal). The accuracy of this method has been extensively tested and is accepted worldwide.

The Equifax's database contains more than 100,000 financial years of information spanning more than twenty-five years. As such Equifax is in a unique position, having developed a large and empirical data source on entities across various industry sectors with long data histories covering a range of economic conditions and one or more complete business cycles. Equifax has therefore been able to use a variety of quantitative validation tools and comparisons using this information to adequately verify the stability, accuracy and consistency of its rating models.

Equifax's rating models have been designed to assess the proximity of an entity to defaulting on its financial commitments and obligations. Proprietary risk analytics are used to evaluate the multivariate interrelationship of key risk indicators using scientifically based and empirically derived risk metrics. These models evaluate the financial performance, position and profile of an entity in the context of its industry, size and structure. They have been validated on Australian and international data with the assistance of Professor Edward Altman, an internationally recognised leader in the field of credit risk analysis and bankruptcy prediction.

Equifax uses its comprehensive benchmarking database to evaluate the financial position, performance and credit quality of an agency, institution, corporation or entity relative to an industry and its peers. This enables the identification of key sensitivities, trends, cautionary alerts and exception reports based on identified anomalies and/or outliers across key credit indicators of a select benchmarking group.

While there is no single method to discriminate unambiguously between firms that will default and those that will not, Equifax can make probabilistic assessments of default. This requires a large database of actual defaults to enable an assessment of default probabilities and actual default rates from empirical evidence. The Australasian market has a comparatively small number of corporate bond issues and a relatively benign credit climate over recent decades, and as such empirical data on Australian default rates is limited. Therefore, Equifax considers it is more appropriate to apply default probabilities using empirical data from international markets over several economic cycles.

Equifax's default statistics have been derived from nearly twenty years' experience analysing mainly US non-financial, non-utility corporate bond issuers. The analysis covered a relatively large number of companies (approximately 1,000 rated each year) and follows the well-established static pool approach used by Credit Rating Agencies to report their default experience. Static pools were created for bond issuers each year by both notch and grade, and the history of these bond issuers was then analysed over the period. The pools were then combined so that long-term average default experience by duration could be calculated, and both annual and cumulative default experience was calculated from the pools.

Equifax's risk analytics enable analysts to evaluate the most critical and sensitive financial and risk items through the Risk Assessment Platform by analysing key indicators to derive a definitive credit risk score and Bond Rating Equivalent (BRE), providing Probabilities of Default (PoD) over the short-, medium- and long-term horizon.

### 1.3 Rating Definitions

Credit ratings provide an Agency's opinion as to the capacity, viability and willingness of an entity to meet their respective financial and contractual commitments. As such credit ratings are assigned in accordance with the entity, commitment or product's proximity to default. Equifax adheres to internationally recognised grades and are similar to other agency classifications, providing ratings across twenty-two credit notches from 'D' (in default) to 'AAA' (extremely strong).

Moody's	Fitch	S&P	Rating	Default rates (5 years)	Classification	Risk Level
Aaa	AAA	AAA	AAA	0.17	High Grade	Negligible
Aa1	AA+	AA+	AA+	0.31		
Aa2	AA	AA	AA	0.44		
Aa3	AA-	AA-	AA-	0.55		
A1	A+	A+	A+	0.76	Investment Grade	Very Low
A2	A	A	A	0.81		
A3	A-	A-	A-	1.47		
Baa1	BBB+	BBB+	BBB+	2.08	Investment Grade	Low
Baa2	BBB	BBB	BBB	3.19		
Baa3	BBB-	BBB-	BBB-	4.37		
Ba1	BB+	BB+	BB+	7.13	Near Prime	Low to Moderate
Ba2	BB	BB	BB	7.49		
Ba3	BB-	BB-	BB-	10.52		
B1	B+	B+	B+	16.34	Sub Prime	Moderate
B2	B	B	B	22.21		
B3	B-	B-	B-	24.16		
Caa1	CCC	CCC+	CCC+	28.16	Credit Watch	Very High
Caa2		CCC	CCC	29.90		
Caa3		CCC-	CCC-	39.16		
Ca	D	CC	CC	52.87	Distressed	Extremely High
		C	C	55.00		
C	D	D	D	100.00	Distressed	Extremely High

Equifax assigns ratings based on the credit worthiness of an entity or a specific financial commitment, and provides probabilistic assessments of default over the short, medium and long-term. Every entity or commitment has some probability of default over a period of time, even those assigned with the strongest of ratings. An Investment Grade classification is attributed to credits that exhibit a lower probability of default, while a Sub-Prime classification has a greater expectancy of default.

An Equifax's credit rating may also be assigned additional clarification markers (symbols) to qualify the credit risk assessment. These may include:

**Conditional Rating (#)**

A Conditional Rating is used where Equifax has rated an entity on the basis of significant risk factors and/or report qualifications, with recommendations providing one or more conditions precedent and/or mitigation action(s) to reduce identified uncertainty and risk.

**Provisional Rating (\*)**

A Provisional Rating is used when the most recent financial figures are based on draft management accounts or are deemed out-of-date. Entities with a provisional rating should be re-evaluated as soon as finalised financial statements become available.

**Indicative Rating (^)**

An Indicative Rating is used where Equifax is engaged to conduct preliminary analysis only, and as such an official rating assignment would require a more detailed and comprehensive investigation and due diligence assessment prior to the provision of our professional opinion.

## 1.4 Rating Outlooks

Equifax's forward estimates help ascertain the trajectory of ratings as well as the risks to ratings. Ratings with a positive trajectory are assigned 'Positive Outlooks'. Ratings with a negative trajectory are assigned 'Negative Outlooks'. Where Ratings are expected to remain unchanged, a 'Stable Outlook' assigned.

Rating trajectories are closely related to the outlook for the corporate's earnings. Earnings growth that is within sustainable growth parameters together with an attenuation of earnings volatility provide upward rating pressure and so may warrant the assignment of a Positive Outlook.

### Credit Concepts measured

The main credit concepts measured against Australian and New Zealand Standard Industry Classifications (ANZSIC) and specific Peer Groups based on entity size are available in Corporate Scorecard's Rating methodology, which can be found at the below-mentioned links

[https://www.corporatescorecard.co.nz/services\\_credit\\_ratings.php](https://www.corporatescorecard.co.nz/services_credit_ratings.php)

<https://www.corporatescorecard.co.nz/docs/RatingMethodologyFinancial.pdf>

Additional indicators used are computed as follows:

Operating Income	Net Interest Income + Non-interest income from operations
Operating profit	Operating income – operating expenses – provisions
Non-performing Loans	Impaired loans + Loans past due for more than 90 days

## 2. Regulatory Disclosures and Disclaimer

Equifax Australasia Credit Ratings Pty Ltd (Equifax Credit Ratings) is a credit rating agency regulated by the Reserve Bank of New Zealand. The licensing regime addresses a range of matters including the quality and integrity of the ratings process, independence and avoidance of conflict of interest, and responsibilities to the public, clients and assessed entities. The regime also covers confidentiality, communication and disclosure, professional development, document management, and a range of governance related matters. Financial, operational and compliance audits are conducted by external, independent auditors each year.

Equifax Credit Ratings also holds an Australian Financial Services License (AFS License no. 341391) which licenses it to provide credit ratings to wholesale clients in Australia.

The credit rating issued by Equifax Credit Ratings reflects our current opinion of the relative credit risk of the institution. This opinion has been formed in accordance with Equifax's published credit ratings methodology - financial institution rating criteria (version 6, 2019).

<https://www.corporatescorecard.com.au/docs/RatingMethodologyFinancial.pdf>

The credit rating and associated assessments, opinions and observations are solely statements of opinion. They are not statements of fact. They do not constitute advice or a recommendation. The credit rating does not guarantee the performance of the rated issuer or relevant security, and should not be relied on for the purposes of making an investment decision. All information used in the credit rating process is obtained by Equifax from sources believed by it to be accurate and reliable. Equifax adopts all necessary measures so the information used in assigning a credit rating is of sufficient quality and from sources believed to be reliable including, when appropriate, independent third-party sources. However, because of the existence of human or system error, or other factors, all information contained herein is provided 'as is' without warranty of any kind. Equifax is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Use of information contained in this report is at the recipients own risk. To the extent permitted by law, Equifax, its directors, officers, employees and any persons associated with the preparation of the release and our full report are not liable to any person in respect of anything (or the consequences of anything) done or omitted to be done by any person in reliance on any of the contents of the release or our full report; and are not responsible for any errors or omissions in the release or our full report resulting from any inaccuracy, mis-description or incompleteness of the information provided or from assumptions made or opinions reached by the parties providing the Information. All information contained herein is protected by law, including but not limited to copyright law, and this information may not be copied or otherwise reproduced, repackaged, further transmitted,

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