

Credit Rating Report Xceda Finance Limited

Credit Rating Report

Date: 27 April 2023

Prepared for: Xceda Finance Limited

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

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Currency used in this report:

This report is presented in New Zealand Dollars unless otherwise noted



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1 Executive Summary

Xceda Finance Limited ('XFL' or 'the Company')

XFL (formerly known as Asset Finance Ltd) is a New Zealand based Non-Bank Deposit Taking (NBDT) institution licensed by Reserve Bank of New Zealand ('RBNZ') to accept deposits and underwrite loans to public.

Equifax Credit Ratings Australasia Pty Ltd ('Equifax') has affirmed XFL's credit rating of 'B' at Sep22, which is a sub-prime classification with a moderate level of risk. The 'B' credit rating is placed on Credit Watch with positive implications, indicating that a rating upgrade is highly likely in the near-term.

The Credit Watch will be resolved following the closure of a legacy loan account that exposes the Company to disproportionately elevated asset quality risks due to its age, size and history of underperformance in prior periods. The closure of this loan is expected to occur soon and materially improve the Company's asset quality characteristics, which combined with the Company's recent performance supports a rating upgrade.

XFL's credit rating is supported by its incumbent market position in the New Zealand NBDT industry, continued healthy liquidity profile commensurate with its size, healthy capital adequacy levels and improving asset quality metrics. The risks to the XFL's credit rating arise from the current macroeconomic environment, relatively small scale, limited product offerings, its business model that focuses on upper quadrants of risk reward matrix and operating risks associated with a growing loan book.

Strengths

- XFL's competitive profile benefits from its niche offerings in the secured consumer lending market, thereby enabling the Company to repeatedly attract customers in a segment underserved by traditional banks and profitably manage that customer portfolio. Further, XFL's ability to maintain a high yield on loans enables it to continually raise consumer deposits by offering attractive returns.
- XFL's liquidity position is deemed adequate, supported by healthy retail deposits reinvestment rates, liquid assets to liabilities ratio of 20.4% at Sep22, 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 (88.8% of the loan book at Jan23).
- XFL's loan book has grown over the years and an improving trend is observed in its asset quality evidenced by declining NPLs and improved recovery 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. Furthermore, as aforementioned, the soon to be finalised closure of the legacy large loan that exposed the Company to disproportionately high asset quality risks is also a credit positive.
- The Company continues to maintain sound capital adequacy levels, with a capital ratio of 15.4% at Sep22 (Mar22:15.4%) which is above the minimum Trust Deed requirement of 10.0%. That said, the expected growth in the loan book over the next 12 months would also require increased deposits and/or the Company's shareholders to provide support for it to maintain adequate buffer under the Trust Deed's capital ratio requirements.
- RBNZ is in the process of aligning regulation of all deposit takers under one framework including increased regulatory oversight and extending the depositor compensation scheme to NBDTs. These developments, though evolving and protracted in nature, are nonetheless highly likely to promote public confidence in the sector and improve attractiveness of NBDTs deposits in our view.

Constraints

- Macro-economic headwinds remain tilted downside and may translate into asset quality or growth pressures over the near to medium term. Together with the wider economy, the NBDT sector, including XFL, are also likely to face the impact of inflation pressures stemming from evolving geo-political landscape, supply chain issues, tight labour markets and an increasing frequency and intensity of inclement weather events similar to Cyclone Gabrielle in part of North Island, New Zealand. Thus, households and businesses are likely to face reduced debt servicing and borrowing capacity due to rising cost of living, interest costs and decline in asset values including property holdings that secure the majority of the Company's loan book.
- XFL's business profile is limited by its relatively small size and franchise, its focus on upper quadrants of risk reward matrix and its retail depositor base. The bulk of the Company's loan book comprises short term non-amortizing loans that compared to amortizing loans are inherently riskier in nature and remain a source of risk to the Company's relatively small asset book notwithstanding the Company's healthy ALM, diversification and liquidity metrics. Furthermore, the Company's depositor base primarily includes individuals and mid-sized corporates, whose savings may reduce due to macro-economic headwinds and undermine the Company's capacity to maintain or grow its level of deposits.
- The limited product offering of the NBDT sector, and hence its relatively low systemic importance, compared to traditional banks, acts as a ceiling for the sector's (and by extension XFL's) credit rating. In addition, increased competition from fintech companies, non-traditional lenders and the Buy Now Pay Later sector represents an ongoing risk, in our view.
- XFL's loan book growth over the last few years and the growth anticipated over the next 12 months presents potential operating risks that the Company would be required to adequately manage to prevent downward pressure on quality and income generation capacity of its loan book and ability to meet trust covenants. Positively, the Company remains well cognizant of these risks and has taken several measures including hiring additional personnel in various senior roles and obtaining requisite exemptions under the Trust deed governing its deposits.

Risk Rating

B

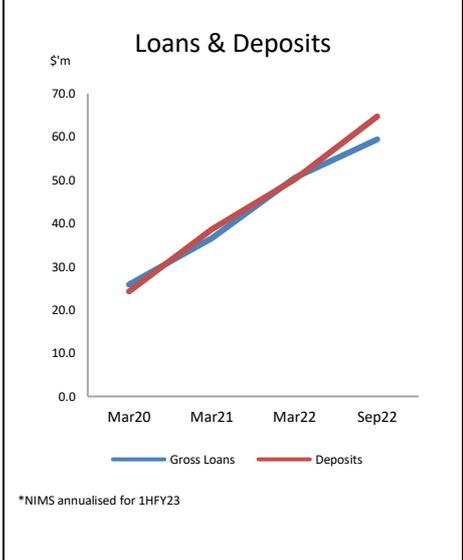
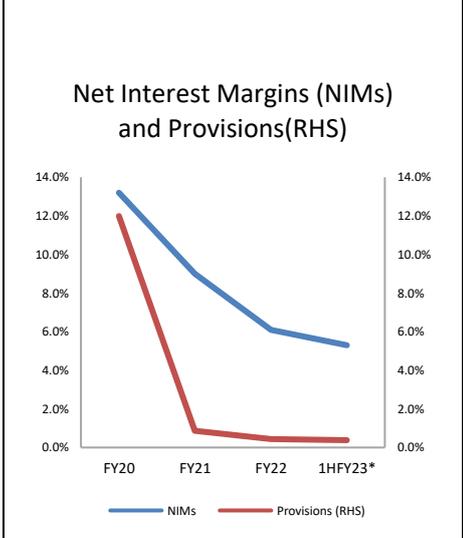
Credit Watch - Positive

Public, Under ongoing monitoring

Industry Percentiles

Scale:		
Total Assets	47%	●
Gross loans	53%	●
Profitability:		
NIM	67%	●
ROE	40%	●
ROA	47%	●
Efficiency Ratio	73%	●
Capitalisation:		
Leverage (Gross Loans to Equity)	20%	●
Capital Ratio	53%	●
Capital to Total Assets	27%	●
Funding and Liquidity:		
Deposits to Loan Ratio	40%	●
Liquid Assets to Total Assets	33%	●
Asset Quality:		
Net Charge-offs	27%	●
Impaired Loans	33%	●
Provision for Loan Losses	60%	●

Key Trends



2 Scope of Report

The report provides an overview of the credit rating and associated rationale of Xceda Finance Limited (“XFL”, “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:

Report Details	
Date of Report	27 April 2023
Request Type	Issuer
Assessment Type	Under ongoing monitoring
Rating Initiation	Issuer based (solicited)
Rating Distribution	Public Rating
Report Distribution	Unrestricted
Purchased by	Xceda Finance Limited
Report Fee	Fixed Price
Ancillary fees	Nil
Subject First Time Rated	No
Issuer Name	Xceda Finance Limited
Issue Name	Not Applicable
Issue First Time Rated	Not Applicable
Financial Scope	Standalone Entity
Structure	Limited Company
Industry	Financial Services
Sector	NZ Non-Bank Deposit Takers (Peer Group included on page 33)

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	<p>Audited Financial Statements for the years ended 31 March 2022 and 2021.</p> <p>Audited Financial Statements for the six months interim period ended Sep 2022.</p> <p>Management Accounts for the ten-month interim period to Jan 2023.</p>
Name of auditor	Grant Thornton New Zealand Audit Limited
Other Information Sources	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
Subject participation	Full
Material financial adjustments	None
Limitations of assessment	None noted
Outsourced rating activities	No
Confidentiality agreement	No
Material client	No
Rating amended post issuer disclosure	No
Potential conflict of interest	No
Rating methodology	Financial Institution Rating Criteria

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

3 General Background of the Subject

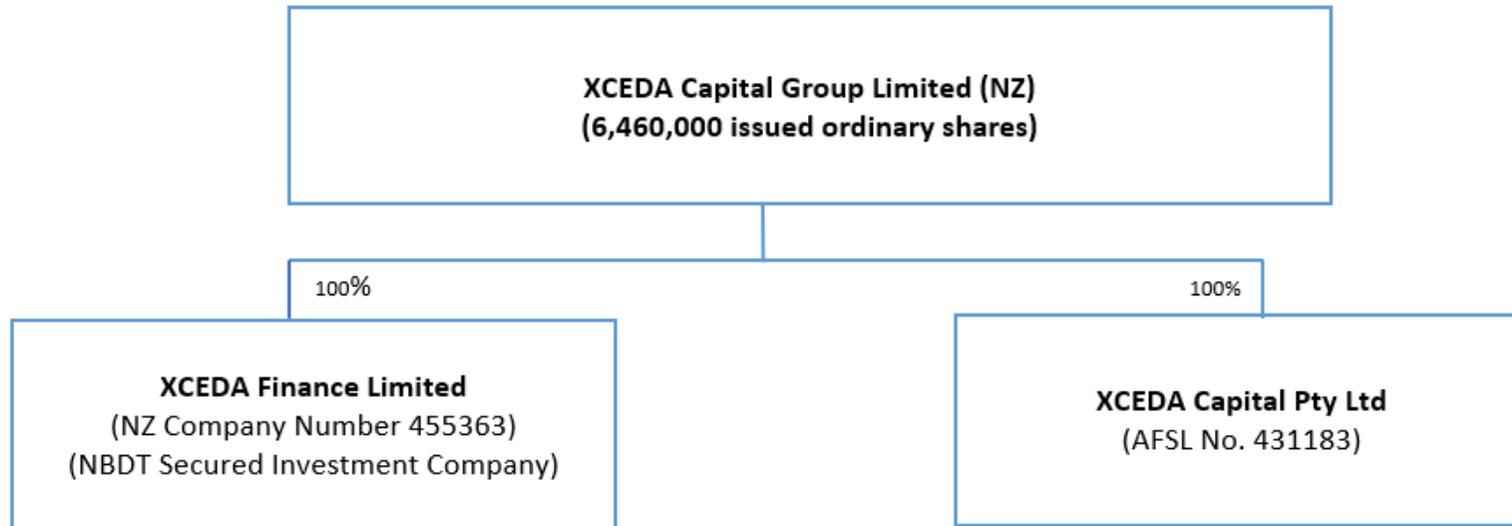
3.1 Subject Overview

Subject Name	Xceda Finance Limited
Previous Name	Asset Finance Limited
Type of Entity	Licensed Non-Bank Deposit Taker (NBDT)
Head Office Address	7 Windsor Street, Parnell Auckland NZ 1052
Date of Incorporation	15 December 1989
Principal Activities	XFL is licensed by the Reserve Bank of New Zealand (RBNZ) to operate as a non-bank deposit taker and raise money from and issue securities to the public. XFL raises funds from the public by offering debt securities (fixed term deposits) and provides property (residential and commercial) and business loans to qualified borrowers.
History	<p>Since 1997, the Company has been undertaking the business of lending money to generate yield in investor funds. In March 2015, the Company obtained a licence from the Reserve Bank of New Zealand (“RBNZ”) to operate as a Non-Bank Deposit Taker (“NBDT”).</p> <p>In September 2018, the majority ownership of the Company was acquired by Clare Investments NZ Limited (formerly named Blackstar Finance Limited), a company jointly controlled by Daniel McGrath (the current Chief Executive Officer of the Company).</p> <p>The RBNZ gave consent for the restructure on 17th December 2019 and Covenant Trustee Services Ltd (appointed Supervisor) also gave its consent on 17th February 2020.</p> <p>Further, on 25th April 2020, the Company underwent a reorganisation whereby the major shareholders (Clare Investments NZ Limited and other shareholders holding 98.98% of the total shares) transferred their shareholdings to a new holding company, Xceda Capital Group Limited (Refer 3.2 – Corporate Structure for ownership tree). Pursuant to the restructure, on 11th May 2020, the largest shareholder Clare</p>

Investments NZ Limited was wholly acquired by Clare Investment Management Pty Ltd, an Australian private company controlled by the current CEO Daniel McGrath.

In Oct21, the Company changed its trading name and style to Xceda Finance Limited.

3.2 Corporate Structure



4 Industry Risks

Systemic risks factors (GDP, unemployment, economic cycles interest rates etc), level of competition, market structure and the regulatory framework are key sources of industry risks that determine the operating environment of financial institutions (FIs). A summary¹ of the above risk factors and their outlook in the context of the New Zealand economy is included in paragraphs below.

Systemic Risk Factors

Employment remains above its maximum sustainable level

Employment as a share of the working-age population reached record levels in the second half of 2022. The unemployment rate remained at 3.4% in the December 2022 quarter and is one of many indicators that suggest employment remains above its maximum sustainable level. However, most of the labour market indicators show that pressures eased marginally over 2022, while still remaining strong. While businesses report labour as being the most significant factor holding back production, delays in shipping and production also continue to act as constraints on economic activity. Supply-chain bottlenecks are easing globally, but this has yet to translate meaningfully into improved supply conditions and lower costs for New Zealand firms. Discussions with businesses suggest that these pressures are likely to persist in New Zealand for some time.

The tight labour market has contributed to high CPI inflation

Although same-job wage inflation has not kept pace with higher CPI inflation, broader measures of average earnings and incomes have been more resilient. Ways in which workers have obtained higher wages in an environment of labour shortages have been through increased movement between employers and potentially asking for more frequent wage increases. If these behaviours continue, they will increase the risk of more persistent wage and CPI inflation. High wage inflation has contributed to broad-based strength in domestic inflation. Housing construction costs, rent, and domestic airfares and accommodation have been significant contributors to non-trades inflation.

Inflation is too high

The lagged impacts of high global commodity prices, in addition to worker shortages and difficult growing conditions in New Zealand, have translated into very high food price inflation. The recent increase in international visitors has also boosted inflation in tourism-related sectors. At 7.2%, annual CPI inflation remains well above RBNZ's desired levels. Measures of core inflation, which attempt to remove one-off or particularly volatile price movements, also remain elevated. High core inflation is particularly concerning for central banks

¹ RBNZ Financial Stability Report November 2022, RBNZ Monetary Policy Statement February 2023, RBNZ Website and various of Publications of RBNZ, QV House Price Index reports.

because it tends to be persistent. It is also the aspect of inflation on which monetary policy has the greatest influence, albeit with significant lags.

Actual and expected OCR increases have seen the interest rates faced by households and businesses increase quickly over the past 18 months. Although the New Zealand economy remained strong in 2022, there are signs that domestic demand may be slowing as expected at the time of the November Statement. In particular, areas of the economy more directly affected by changes in interest rates – such as household spending and construction – showed some early signs of easing in late 2022:

- While only a partial measure of household spending, the value of electronic card transactions declined in nominal terms in November and December, particularly for durable goods.
- New building consent numbers are also declining as the outlook for the residential construction sector has deteriorated.
- Although the labour market remains very tight, most indicators marginally eased over 2022. In particular, job vacancy numbers have started to decline across most regions and industries.

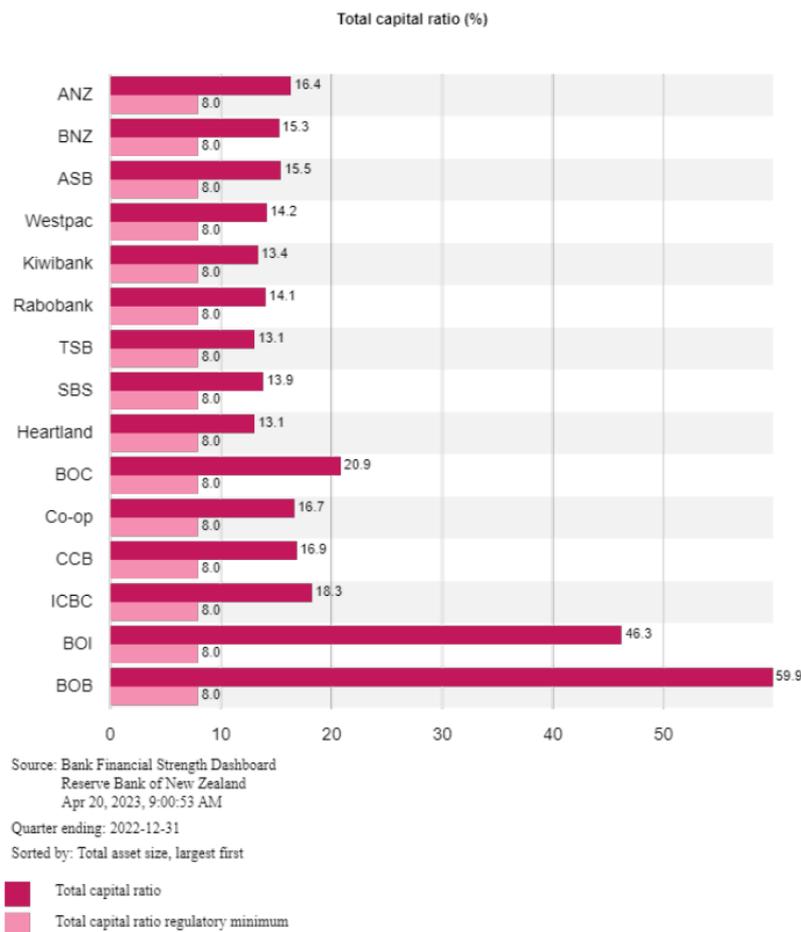
Asset prices continue to fall

Average house prices across New Zealand have continued to fall from their November 2021 peak, in response to higher interest rates, low population growth and increased housing supply. House prices have declined by around 15.0% to date and are expected to fall by about 23.0% in total from their peak by 2024. This decline is larger than that assumed in the November 2022 Monetary Policy Statement, in part due to RBNZ's continually evolving understanding of house price sustainability.

Financial systems remain sound and financial institutions robust

Recent banking stress in the United States and Europe has resulted in lower wholesale interest rates and an increase in credit spreads. This reflects, to some degree, the potential for tighter global credit conditions and a weaker outlook for global demand. New Zealand's financial system (including banks, other deposit takers and insurers) is well placed to keep supporting New Zealanders through a time of global financial market volatility and a slowdown in domestic economic activity. New Zealand's banks are well capitalised, profitable, and have strong liquidity positions, with plenty of cash on hand. They also have comparatively little exposure to interest rate risk on their balance sheets as firms remain adequately hedged or insured against such risks. New Zealand banks are also required to hold capital against this risk to the extent it exists, and are not as susceptible to a concentrated run on deposits, unlike in the US where some banks had very large deposits held by just a few savers.

Figure 1: Capital Ratio of Banks



Cyclicality

Due to strong linkage between economic activity and interest rates financial institutions remain vulnerable to vagaries of economic cycles. During recessionary times interest rates drop and business sentiment remains weak, thus undermining the ability of financial institutions to raise deposits and make loans. Similarly, during periods of inflation, interest rates usually rise and purchasing power of households dwindles thereby exposing financial institutions to asset quality risks. As a result, a study of economic cycles and its phases is vital to accurately assess the financial institutions exposure to various market risks.

Slowing credit growth

High levels of inflation and a rising interest rate environment has impacted annual household credit growth, which has slowed significantly in recent months. It was noted in the recent MPC meeting that this is consistent with declining house prices and the transmission of past monetary tightening.

Many mortgage borrowers are re-pricing to new interest rates that are higher than the ‘stress’ test rates used by banks in recent years to assess loan affordability. To date, the share of mortgages for which scheduled payments have fallen behind remains very low, likely reflecting that household incomes have also increased

during this time. However, this share is expected to increase as the economy contracts and employment declines from very current high levels.

Market Risk

Market risk refers to the impact on profitability due to adverse changes in interest rates, assets prices, commodity prices and exchange rates. Interest rates remain the key and most direct source of market risk to financial institutions due to the nature of their operations and the strong interplay between interest and currency rates and interest rates and asset prices.

NBDTs primarily faces interest rate risk given their limited appetite for transactions denominated in foreign currency and relatively small scale of operations. As a result, paragraphs below discuss the recent movements in the prevailing interest rates and asset prices in New Zealand.

Interest rate movements

On 5 April 2023, the Monetary Policy Committee ('MPC' or 'the Committee') increased the Official Cash Rate (OCR) to 5.25% (from 4.75%). The Committee agreed the OCR needs to increase, as previously indicated, to return inflation to the 1.0%-3.0% target range over the medium term. Inflation is still too high and persistent, and employment is beyond its maximum sustainable level. The level of economic activity over the December quarter was lower than anticipated in its February Monetary Policy Statement and there are emerging signs of capacity pressures in the economy easing. However, demand continues to significantly outpace the economy's supply capacity, thereby maintaining pressure on annual inflation. The recent severe weather events in the North Island have led to higher prices for some goods and services. This higher near-term CPI inflation increases the risk that inflation expectations will persist above target range.

Over the medium term, the Committee anticipates economic activity to be supported by rebuilding efforts in the aftermath of the weather events. The demand on resources is expected to add to inflation pressure by more than assumed in the February Monetary Policy Statement. Global growth is expected to be below average, contributing to lower demand for New Zealand's key commodity exports. Continued growth in New Zealand's service exports, in particular tourism, is assumed to provide some offset to this drop in export revenue. New Zealand's economic growth is expected to slow through 2023, given the slowing global economy, reduced residential building activity, and the ongoing effects of the monetary policy tightening to date.

Asset and Commodity Price Movements

Several commodity prices have increased on expectations of stronger Chinese demand, although levels remain below recent peaks. They include rises in industrial metals prices, with iron ore prices having increased by 21.0% and copper prices by 9.0% since the November Statement. Soft commodity prices such as those for dairy and meat – particularly relevant for New Zealand exporters – have not recovered as much. Petrol prices, which

accounted for some of the increase in inflation through 2022, have since declined from their peak as global oil prices have eased. House prices continue to remain on a declining trend, with current monetary policy settings expected to continue to put downward pressure on house prices.

The latest QV House Price Index for March shows property values have decreased across Aotearoa New Zealand by an average of 3.9% since the start of the year – weakening further from the 2.7% three-monthly decline witnessed in February, and the 1.7% three-monthly decline recorded back in January. The average home value is now \$907,737, which is 13.3% less than the same time last year. The rolling three-monthly rate of reduction increased last month in all but two of the country's 16 largest urban areas, with the most significant quarterly home value reductions occurring on average in Whangarei (-6.6%) and Rotorua (-5.7%). Of the largest cities, Auckland (-5.2%), Hamilton (-5.2%), and Wellington (-4.8%) led the decline. Christchurch (-1.2%) and Hastings (-2%) were the two exceptions – the former experiencing the smallest decline of the main centres.

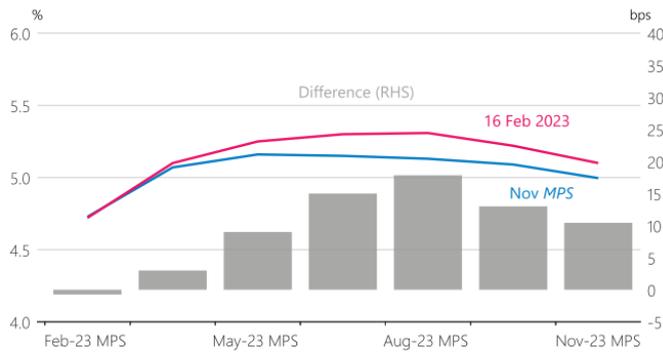
Foreign Currency Risks

The adverse movement in exchange rate poses direct and indirect risks to financial institutions depending on its balance sheet and contribution of foreign trade to overall economy. For economies highly reliant on foreign trade adverse changes in exchange rates can affect overall GDP levels and business profitability thus heightening the financial institutions vulnerability to asset quality risks. Further financial institutions may raise capital from or lend to foreign investors / borrowers and hence adverse movement in the exchange rates may impact the financial institutions borrowing costs / lending incomes.

New Zealand Exchange Rate

Improved financial market sentiment following lower global inflation outturns and the reopening of China has contributed to an increase in the New Zealand dollar Trade-Weighted Index (TWI) exchange rate relative to what had been assumed at the time of the November Statement. All else being equal, a higher exchange rate will dampen exporters' incomes and reduce the costs of our imported goods and services, reducing inflationary pressure in New Zealand.

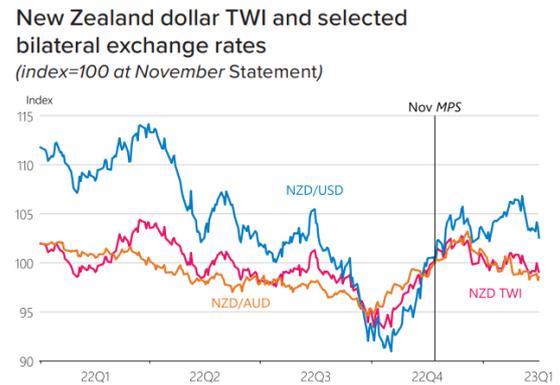
Figure 2: Market expectations for the OCR



Source: Bloomberg.

Note: Each data point represents market expectations of the level of the OCR at a given point in the future, as measured by overnight indexed swap pricing. For example, at the time of the November 2022 *Statement* market participants expected the OCR to reach 4.75 percent at the February 2023 *Statement*.

Figure 3: New Zealand dollar exchange rates



Source: RBNZ, NZFMA.

Level of Competition and Market Structure

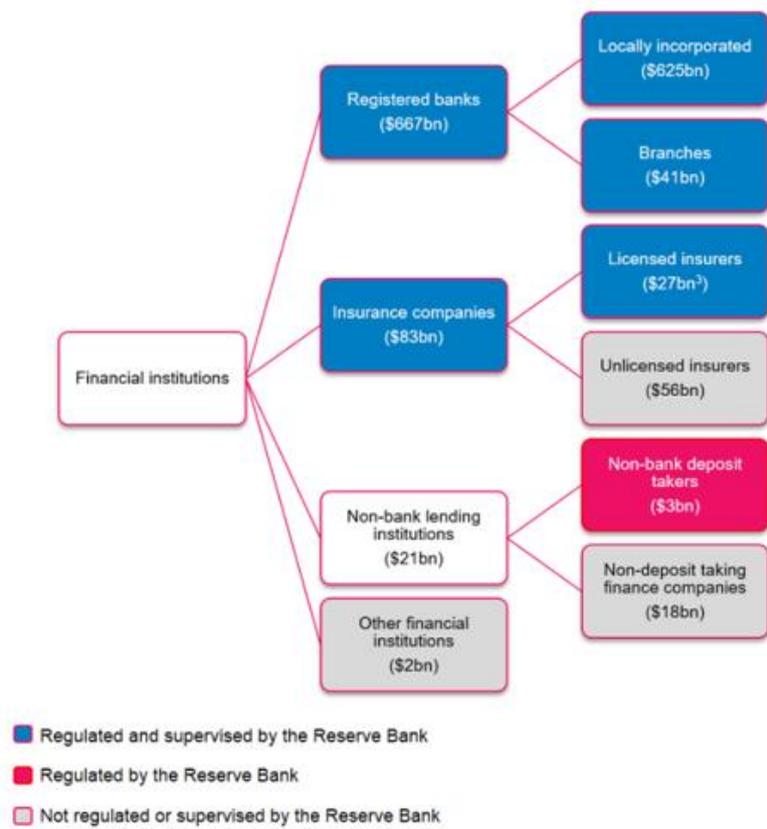
The financial institutions face stiff competition on an ongoing basis to attract capital and funding. In addition to peers, the financial institutions must compete with other finance intermediaries like managed funds, insurance companies and other intermediaries that offer alternative avenues for households and businesses to park savings or borrow funds. Further, the advent of fintech, payment banks and rise of buy now pay later sector has heightened competition in the short-term lending segment.

Overview of Competitive Landscape in New Zealand

The New Zealand financial system is dominated by the banking sector, with banking assets accounting for a very large share of overall financial system assets (Figure 4). Structural entry barriers benefit the systemically relevant banks and offer them a competitive advantage in attracting customers and pricing, lending and savings products. These advantages allow these large scale financial institutions to access a diversity of liquidity pools including retail deposits and wholesale funding. This diversity offers them the flexibility to absorb shocks to funding costs and to partly insulate their earnings from capital market volatility. Moreover, top tier banks offer a broad range of products like savings, deposit and transaction accounts, superannuation, trading accounts, financial advice, wealth management and a network of branch and ATM services providing a level of convenience, range and quality.

In contrast, equity and debt capital markets are relatively less developed in New Zealand, with the total market capitalisation of equities listed on the New Zealand Stock Exchange at ~\$167bn, while the domestic bond market is estimated at ~\$171bn (excluding government debt). The managed funds industry is also small compared to banks, with around \$200bn of assets under management.

Figure 4: Financials Institutions Total Asset as of 31 March 2022



Note: numbers may not sum due to rounding

Source: RBNZ Bank Balance Sheet (BBS), RBNZ Standard Statistical Return (SSR), RBNZ Non-Bank Deposit Taker Prudential Return (NBDTPR), individual insurer financial statements.

Direct capital market funding (issuance of corporate bonds) and non-bank lending institutions (NBLIs) together account for only 6% of non-financial private sector borrowing. NBLIs account for just over 3% of intermediated credit since they have a limited offering and specialise in raising deposits to lend to higher risk consumer and business segments underserved by the traditional banks. NBLIs include non-bank deposit-taking institutions (NBDTs) and non-deposit-taking finance companies. While the Reserve Bank of New Zealand regulates NBDTs it does not regulate or supervise non-deposit-taking finance companies.

There are currently 15 NBDTs actively operating in New Zealand, which include building societies, credit unions, and deposit taking finance companies. They have a diverse range of business models, with credit unions having a high share of their lending in a mix of residential and consumer loans to their members, while building societies and finance companies tend to focus on a range of types of property lending. Total net lending by NBDTs is around \$2.3bn, compared to \$540bn in lending by banks. While small relative to the rest of the financial system, the NBDT sector covers a diverse range of organisations that support financial inclusion by serving communities that may traditionally be under-served by the banking system.

There has been consolidation in the NBDT sector in recent years, particularly among credit unions. Overall, since 2018, the number of credit unions operating in New Zealand has fallen from 13 to 5. Many of the profitability challenges faced by the credit union sector are due to lack of scale, with high operating costs relative to income. Combined with a limited ability to raise external equity given their mutual structure, some institutions have had a limited capacity to build up the capital buffers that are needed to absorb unexpected shocks while maintaining credit growth. While attaining economies of scale has been challenging for some credit unions, net interest margins have moderately increased in recent years as interest rates have declined, supporting their financial sustainability.

Figure 5: Key Metrics for NBDTs (year ended June)

Metric	Segment	2018	2019	2020	2021	2022
Total assets (\$m)	Finance Companies ¹	220	270	218	296	357
	Credit Unions	1,149	1,131	1,152	1,126	1,106
	Building Societies and Other ²	1,084	1,217	1,303	1,400	1,553
Capital ratio (%)	Finance Companies	15.6	14.8	17.8	15.7	17.2
	Credit Unions	14.9	14.7	14.1	12.9	12.7
	Building Societies and Other	11.0	11.6	12.4	13.7	13.7
Non-performing loan ratio (%)	Finance Companies	5.6	7.3	10.3	1.9	1.9
	Credit Unions	2.6	2.5	3.3	2.9	3.1
	Building Societies and Other	0.3	0.1	0.2	0.1	0.3
Return on assets, before tax (%)	Finance Companies	2.5	1.7	1.9	1.8	2.4
	Credit Unions	0.1	-0.6	0.0	0.4	0.1
	Building Societies and Other	0.8	0.9	0.9	1.2	1.5
Number of operating entities	Finance Companies	7	7	6	6	6
	Credit Unions	13	9	9	8	7
	Building Societies and Other	4	4	4	4	4

Source: RBNZ Non-Bank Deposit Takers survey.

¹ Datas for finance companies exclude FE Investments Limited from March 2020, when it entered receivership.

² Other NBDT refers to Christian Savings Limited.

Legal and Regulatory Framework

The financial institutions are heavily regulated due to their vital role and high failure costs. The scope of regulations extends to various aspects of the FI's business including but not limited to capital and liquidity requirements, risk management and governance controls.

Regulatory landscape in New Zealand

Part 5 of the Reserve Bank of New Zealand Act 1989 (the Act) gives the Reserve Bank of New Zealand ('RBNZ' or 'the Reserve Bank') the powers to register and supervise banks for the purposes of promoting the maintenance of a sound and efficient financial system; and avoiding significant damage to the financial system that could result from the failure of a registered bank. The Reserve Bank has a responsibility to promote the integrity of the financial system as a whole, and, accordingly, also has responsibilities in relation to non-bank deposit takers, insurance companies and the payments system. While the Reserve Bank monitors registered

banks' compliance with banking supervision policies, neither it nor the government guarantees that a registered bank will not get into difficulty or fail.

Macro Prudential Policy

The purpose of macroprudential policy is to reduce the risk that the financial system amplifies a severe downturn in the real economy. An unsustainable boom in credit and asset prices can result in a bust that creates losses for banks, businesses and households, and hampers the ability of banks to continue lending to the economy. This is important because financial instability – a disruption to the supply of essential services provided by the financial system – can have significant and lasting economic and social costs. Macroprudential policy aims to reduce the likelihood and severity of these costs. To achieve objectives of its macro prudential policy the RBNZ uses tools like Countercyclical Capital Buffer, Sector Capital Requirement, Core Funding Ratio and Loan-to-value ratio (LVR) restrictions. The limits prescribed under above are revised from time to time.

LVR restrictions are the main tool currently used to address financial system risks related to the housing market. In May 2021, RBNZ tightened LVR restrictions on new lending to investors above 60%. In addition, the maximum share of new lending to owner-occupiers with LVRs over 80% was reduced from 20% to 10% from 1 November 2021. By limiting a build-up of homeowners at risk of a fall in house prices, these adjustments will further support financial stability.

Various other regulatory initiatives are continuing to future-proof the resilience of the financial system, including changes to the Credit Contracts and Consumer Finance Act (CCCFA) and Regulations, and the Proposed Deposit Takers Act (DTA) - aligning regulation of all deposit takers under one framework. Included within the DTA are proposals for a Depositor Compensation Scheme to cover bank depositors in the event of bank, or non-bank deposit taker such as a building society, failing. Depositors will be covered for a total of \$100,000 per institution per depositor.

Credit Contracts and Consumer Finance Act 2003 (CCCFA) changes: The CCCFA changes intended to address concerns about continued irresponsible lending that was harming some borrowers. Specifically, the CCCFA changes were intended to result in all consumer lenders implementing credit assessment processes that conformed to the lender responsibility principles around affordability and suitability, including performing 'minimum steps' prescribed in regulations. While the initial changes received some criticism, the negative impacts from the initial changes are likely to be reversed with the recent amendments and potentially improve borrowing capacity and lending processes. That said, given the current macroeconomic environment globally and locally in NZ on the back of high inflation rate, rising interest rates, high cost of living, declining asset prices and reduced repayment capacities, the intended benefits from the CCCFA changes could take longer to reap than originally anticipated, in our view.

Deposit Takers Bill (DTB) and Depositor Compensation Scheme (DCS): The Deposit Takers Bill (introduced to Parliament on 22 September 2022 and expected to come into force as law after receiving Royal Assent in mid-to-late 2023) intends to bring banks as well as non-bank deposit takers under one regulatory regime. The purpose of the DTB is to modernise New Zealand's monetary and financial stability policy frameworks and the Reserve Bank's governance and accountability settings. As part of the Bill, DCS will be prioritised ahead (to be operational by 2024) of the other changes from DTB. That said, the costs associated for deposit takers with the implementation of the DCS and maintaining compliance with the new regulatory requirements are likely to increase and anticipated to place downward pressure on the operating margins of deposit takers, particularly smaller entities. In our view, over the short-term these regulatory changes combined with adverse impacts from the current macroeconomic factors (inflation, rising interest rates, potentially deteriorating asset quality and weakening repayment capability of the borrowers) are likely to negatively affect the earnings and capitalisation for deposit takers.

Prudential Requirements applicable to NBDTs are discussed in the section 5 – Prudential Framework.

5 Prudential Framework

The Reserve Bank regulates non-bank deposit takers (NBDTs) in New Zealand for the purposes of promoting the maintenance of a sound and efficient financial system, and avoiding significant damage to the financial system that could result from the failure of an NBDT. NBDTs are entities that make an NBDT regulated offer (as defined in section 5 of the Non-bank Deposit Takers Act 2013) and carry on the business of borrowing and lending money, or providing financial services, or both. The prudential regulation of NBDTs is provided under the Non-bank Deposit Takers Act 2013 and associated regulations. Trustee companies also have obligations under the Act. These include ensuring certain prudential content is included in licensed NBDTs' trust deeds. Trustees must report to the Bank any non-compliance with the Act and regulations by the licensed NBDT. Trustees are licensed by the Financial Markets Authority under the Financial Markets Supervisors Act 2011. The table summarises certain key prudential requirements ²for NBDTs currently in force.

Credit Rating	Licensed NBDTs are required to have a local currency (New Zealand dollar), long-term, issuer rating given by approved rating agencies.
Governance	Licensed NBDTs that are companies or building societies must have a chairperson who is not an employee of either the licensed NBDT or a related party and must have at least two independent directors. Licensed NBDTs that are subsidiaries of another person are prohibited from including provisions in their constitutions that would allow directors to act otherwise than in the best interests of the NBDT.
Risk Management	Licensed NBDTs are required to have a risk management programme that outlines how the licensed NBDT identifies and manages its credit, liquidity, market and operational risks. This programme is to be submitted to, and approved by, the licensed NBDT's trustee.
Capital Ratio	A minimum capital ratio (the level of capital in relation to the credit exposures and other risks of the NBDT or its borrowing group) is required to be included in licensed NBDTs' trust deeds. This ratio must be at least 8% for licensed NBDTs with a credit rating from an approved credit rating agency. For licensed NBDTs without a credit rating from an approved rating agency, the minimum capital ratio specified in the trust deed must be at least 10%.
Related party exposure limits	The exposures to related party, as defined in the Act, shall not exceed a maximum limit of 15% of capital.
Liquidity	Liquidity regulations require every licensed NBDT and its trustee to ensure that the licensed NBDT's trust deed include one or more quantitative liquidity requirements that are appropriate to the characteristics of the licensed NBDT's business, and that take into account the liquidity of the licensed NBDT and the liquidity of any borrowing group.
Suitability assessment of certain directors and senior officers	Licensed NBDTs must notify the Reserve Bank when one of its directors or senior officers (or a person who is proposed to be appointed as a director or senior officer) raises a "suitability concern".
Change in ownership	An application must be made to the Reserve Bank to approve a transaction that will result in a person: <ol style="list-style-type: none"> 1. having the direct or indirect ability to appoint 25% or more of a licensed NBDT's governing body; or 2. having a qualifying interest in 20% or more of the voting securities issued by the licensed NBDT.

¹ RBNZ

6 Business risks

6.1 Market Risk Exposures and Controls

Interest Rate Risk

The Company's primary business is raising deposits and making loans denominated in New Zealand dollar. Thus, adverse interest rate movements remain the key source of market risk as XFL has no direct exposure to other components of market risks like foreign exchange rates and commodity prices. To mitigate this risk the Company only enters into fixed rate borrowing and lending agreements, and regularly monitors its Asset Liability Maturity Profile (ALM).

The tables and commentary below summarise the Company's ALM profile at Sep22.

Sep22 – Interest Rate Repricing Profile of Monetary Items

Non-derivative Financial Assets and Financial Liabilities (\$'000)	Weighted Average Interest Rate % p.a.	Total	Within 6 Months	Between 6 - 12 Months	Between 1 - 2 Years	Between 2 - 5 Years	Over 5 Years	Non-Interest Bearing
Cash and Cash Equivalents	1.00%	13,424	13,424	-	-	-	-	-
Loans and Advances	11.23%	59,200	36,322	18,183	3,825	845	26	-
Total Assets	-	72,624	49,745	18,183	3,825	845	26	-
Employee Entitlements	-	179	-	-	-	-	-	179
Secured Debenture Stock	5.18%	64,727	19,112	17,145	15,426	12,944	-	-
Accounts Payables	-	317	-	-	-	-	-	317
Total Liabilities	-	65,223	19,112	17,145	15,426	12,944	-	496
Total	-	7,401	30,633	1,038	(11,701)	(12,099)	26	(496)

Mar22 – Interest Rate Repricing Profile of Monetary Items

Non-derivative Financial Assets and Financial Liabilities (\$'000)	Weighted Average Interest Rate % p.a.	Total	Within 6 Months	Between 6 - 12 Months	Between 1 - 2 Years	Between 2 - 5 Years	Over 5 Years	Non-Interest Bearing
Cash and Cash Equivalents	0.30%	7,165	7,165	-	-	-	-	-
Loans and Advances	11.11%	50,282	21,389	21,395	5,867	1,604	28	-
Total Assets	-	57,447	28,554	21,395	5,867	1,604	28	-
Employee Entitlements	-	145	-	-	-	-	-	145
Secured Debenture Stock	4.96%	50,169	10,047	12,930	14,621	12,572	-	-
Accounts Payables	-	311	-	-	-	-	-	311
Total Liabilities	-	50,625	10,047	12,930	14,621	12,572	-	456
Total	-	6,822	18,507	8,465	(8,754)	(10,968)	28	(456)

The favourable balance in the near-term maturity buckets indicates that the Company's assets mature earlier and are repriced more frequently relative to its liabilities. In a rising interest rate environment, the above is positive as interest income from loans grows faster than cost of deposits. However, we note that the weighted average interest rate on loans increased by only 12bps, compared to a 22bps increase in the weighted average interest cost on deposits during the six months to Sep22. In addition to rising interest rates, this also reflects the strategic and conscious shift towards higher quality loans backed by residential mortgages and healthy LVRs that translating into lower yield on an absolute basis. Since the interest rates are expected to increase further to curb inflationary pressures as indicated by RBNZ, we expect the Company's net interest margins to benefit over the short term.

Liquidity Risk

To manage its liquidity risk, the Company monitors its forecasted and actual cash flows on an ongoing basis to ensure the maturity profiles of financial assets and liabilities remain favourably matched. The tables below summarise the maturity profile.

Sep22 – Maturity Profile

Non-derivative Financial Assets and Financial Liabilities (\$'000)	Total	Contractual Cash Flows	Within 6 Months	Between 6 - 12 Months	Between 1 - 2 Years	Between 2 - 5 Years	Over 5 Years
Cash and Cash Equivalents	13,424	13,424	13,424	-	-	-	-
Loans and Advances	59,200	63,328	39,060	19,097	4,198	947	26
Total Assets	72,624	76,752	52,483	19,097	4,198	947	26
Employee Entitlements	179	179	179	-	-	-	-
Secured Debenture Stock	64,727	69,270	20,548	18,175	16,676	13,872	-
Accounts Payables	317	317	317	-	-	-	-
Total Liabilities	65,222	69,766	21,043	18,175	16,676	13,872	-
Total	7,401	6,761	31,216	922	(12,478)	(12,924)	26

Mar22 - Maturity Profile

Non-derivative Financial Assets and Financial Liabilities (\$'000)	Total	Contractual Cash Flows	Within 6 Months	Between 6 - 12 Months	Between 1 - 2 Years	Between 2 - 5 Years	Over 5 Years
Cash and Cash Equivalents	7,165	7,165	7,165	-	-	-	-
Loans and Advances	50,282	55,243	24,269	22,723	6,406	1,816	28
Total Assets	57,447	62,408	31,434	22,723	6,406	1,816	28
Employee Entitlements	145	145	145	-	-	-	-
Secured Debenture Stock	50,169	453,890	11,179	13,769	15,585	13,358	-
Accounts Payables	311	311	311	-	-	-	-
Total Liabilities	50,625	54,346	11,635	13,769	15,585	13,358	-
Total	6,822	8,061	19,799	8,954	(9,178)	(11,541)	28

At Sep22, the Company's exposure to liquidity risks remains muted as ~57.7% of its deposits mature later than 12 months and XFL's near-term ALM profile remains favourably matched. As a result, at Sep22 the Company's liquid assets represented 20.4% of total liabilities which though marginally below the industry median, remain healthy in our view. Moreover, XFL's YTD reinvestment rate remains moderately healthy at close to 70.0% despite trending lower over the three months to Jan23 compared to past corresponding periods.

Thus, the Company's ALM profile suitably positions it to withstand liquidity shocks and benefit from increasing interest rates.

6.2 Credit Risk Exposures and Controls

The Company primarily faces credit risk on its loan portfolio and cash deposits held with other financial institutions. Regarding its cash and cash equivalents, XFL faces low credit risk given majority of its cash holdings are primarily held with tier I banks – Bank of New Zealand and ASB Bank. With regard to the loan portfolio, the Company manages counterparty risks on its loan portfolio through adherence to its credit policy, portfolio level underwriting standards and controls, and management of concentration risks and loan asset quality.

Credit Approval Process

The Company has a well-structured credit policy and approval process that includes conducting credit checks, obtaining security in the form of charges on residential property, commercial and industrial property, other assets (including but not limited to buildings, plant and motor vehicles) and debenture charges including personal guarantees. The Company also ensures its loans adhere to following LVR limits as outlined in its credit policy.

Particulars	Consumer Loans	Business Loans
Maximum Unsecured Loan	\$3,000	\$50,000
Maximum LVR Limits for Asset Classes:		
• Motor Vehicles	90.0%	90.0%
• Commercial Vehicles	80.0%	80.0%
• Trucks	80.0%	80.0%
• Machinery	70.0%	70.0%
• Residential Property	80.0%	80.0%
• Commercial Property	70.0%	70.0%
• Bare Land	70.0%	70.0%

The above LVR limits may be exceeded for small token loans or, for larger loans, by obtaining requisite approvals from the board or the trustee as prescribed in the credit policy. In addition to the above, XFL also obtains general

PPSR and personal guarantees depending on specific case circumstances and for its invoicing financing book – it obtains a charge on the entire trade receivables register of the borrower, irrespective of invoice purchased.

Concentration Risks

XFL's loan portfolio faces moderate concentration risks. At Jan23, XFL's exposure to a single borrower was 5.0% (Jan22: 7.4%). However, we note that the closure of this single largest loan account is expected to occur soon, which would materially improve the Company's asset quality characteristics, in our view. The legacy loan account closure combined with the improvement in the Company's recent performance would be a credit positive event for the Company, and in our view, would support a rating upgrade.

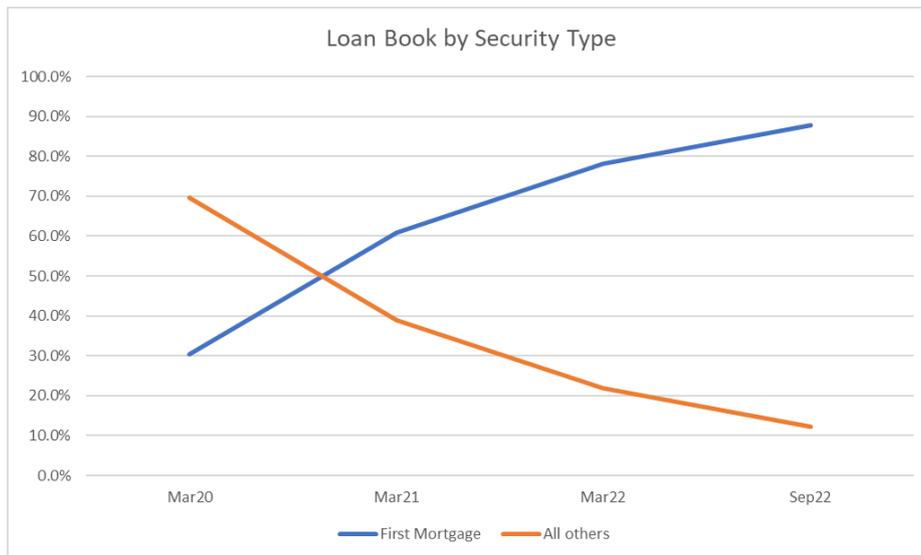
Excluding the aforementioned single largest loan, the remaining nine loan accounts individually represent more than 2.0% of the gross loan book at Jan23 and the Company's financial performance will thus remain susceptible to a deterioration in the credit profile of these few borrowers. A substantial portion of XFL's business loan book remains exposed to construction sector (~93.0% of loan book at Jan23), thereby increasing the vulnerability of its earnings to adverse changes in property market conditions. The above risks are partially offset by the skewness of the loans assets towards Auckland, which is the New Zealand's economic powerhouse.

Asset Quality

Only a low proportion of the Company's total loan book at Jan23 constituted of loans with monthly principal repayment obligations. While XFL's loan portfolio remains well collateralised, it remains vulnerable to adverse changes in property market conditions – asset price and liquidity risks. The above, coupled with relatively moderate degree of concentration risks alluded to previously, increase the likelihood of impairments on an ongoing basis, in our view.

That said, the Company's weighted average LVR across its total loan book was ~62.0% at Jan23, and is deemed to be conservative, in our view. Further, Company provided stress testing data (tested for a 15% decline over the NZ indexed property valuation for each property) reveals that the weighted average LVR would remain below 70%.

Positively, a more conservative approach to and a tightening in XFL's underwriting standards over the years is evident from an increase in the proportion of loans secured by first mortgages to 87.9% at Sep22 (Mar22: 78.2%, Mar21: 61.0%, Mar20: 30.3%) and a reduction in the proportion of loans secured against all other securities (such as second mortgages, motor vehicles and machinery assets, general charges over all assets, accounts receivables as well as unsecured loans). See chart below for details.



6.3 Structure and Service Delivery Platform

Structure

Xceda Finance Limited is governed by a four-member board consisting of two independent non-executive directors. In order to accept term deposits, the Company entered into a Trust Deed with Covenant Trustee Services Limited (“the Supervisor”) as per Debenture Trust Deed dated 15 March 2004 as amended and restated on 3 December 2018 (together referred to as the “Trust Deed”). Under the terms of the Trust Deed, term deposits are secured by a security interest over all of the Company’s present and future assets and undertakings, in favour of Covenant Trustee Services Limited, as the Supervisor. The security interest secures all amounts payable by the Company on the term deposits and all other moneys payable under the terms of the Trust Deed and prevents the Company from creating any higher ranking charge on assets in excess of 2.0% to total tangible assets.

The Supervisor reviews, on a monthly basis, the management reports of the Company to determine whether the total value of the assets subject to the security interest are in excess of the amount of the liability secured by the security interest. The Company is also required to provide the Supervisor, on a monthly basis, with a liquidity report, a capital adequacy report and a Trust Deed financial ratio compliance report.

Service Delivery Platform

The Company uses an inhouse software developed with assistance from Lentune Software Solutions (Lentune) to perform and manage custodian functions associated with term deposits. The inhouse software performs all the functions performed by other commonplace software like Finpower. Further, exclusive license rights of the software along with Lentune assures ongoing tech support.

The Company's lending services are primarily delivered through its network of branches, digital marketing initiatives and distribution partnerships. Recently XFL has also partnered with broker network and an accounting franchisee firms to widen its customer acquisition net. Loan origination is done by the Company's staff as part of the loan approval process, and to adhere with AML-CFT, identification for the client is sought and verified according to the Company's policy on combating fraud arising from identity theft.

6.4 Strategic Vision

XFL is committed to generating sustainable returns to investors by providing short- and medium-term lending products and services that help New Zealanders and their businesses achieve their respective goals. The Company's goal is to lead the way in providing loans in a manner which is easy, hassle free and well-aligned with responsible lending practises.

6.5 Execution of Strategy

The Company primarily specialises in providing short-to-medium term property (residential and commercial) and business loans backed by collateral. Over the last few months, the Company has stopped new lending in the personal loans segments and management has made a strategic decision to focus on property and business loans going forward.

The loan products offer a mixture of principal and interest (amortising) payment loans, interest only loans and capitalised interest loans. The lending policy of the Company imposes caps on the amount of interest only loans and capitalised interest loans to ensure optimal liquidity of the overall loan book. For funding, the Company sources investment term deposits from the public. The Company's acquisition strategy includes utilising its branch network and customer referrals together with digital marketing activities. Over the last couple of years, the Company has initiated a wider distribution strategy including partnerships with broker networks and accounting firms to source term deposits and loans.

6.6 Management

Board Member	Position	Date Appointed
Scott Weenink	Chairman	11 Dec 2018
Daniel McGrath	CEO	16 Aug 2018
Ross Verry	Independent Director	8 Dec 2022
Ian Hankins	Independent Director	8 Dec 2022

Scott Weenink (BA/LLB, Mstud (Oxon))

Independent Director, Chairman

Scott is an experienced M&A and corporate finance lawyer, with broad corporate governance experience. His current board roles include being a director of Generate KiwiSaver Funds Management (a KiwiSaver funds manager), Enable Networks (an Ultra-Fast Broadband provider) and the New Zealand Cricket Players Association. Scott has also previously held directorships in the telecommunications industry in Asia and was formerly the General Counsel at Auckland International Airport Limited. Scott is admitted to the Bar in NZ, UK and NSW, has a Master's degree in Law from Oxford University.

Daniel McGrath (BA/LLB,MA)

Executive Director & CEO

Daniel has extensive experience in senior management positions, having worked as a solicitor for major international law firms - Freshfields Bruckhaus Deringer LLP and Shearman & Sterling LLP, representing banks, private equity firms and global corporations. Daniel was also Senior Legal Counsel for ASX-listed Challenger Financial Services Group Ltd, advising on acquisitions and divestments for the Challenger's funds management group. Daniel holds a BA/LLB from Queensland University of Technology and an MA from Cambridge University.

Ross Verry

Independent Director

Ross is the Chief Executive of Syndex, a private markets investment management and trading platform. Ross's previous role was General Manager, Agriculture for ANZ where he had responsibility for the development and implementation of the bank's Agri business strategy. Prior to that, Ross held several senior Commercial Banking roles, including General Manager Corporate Banking and General Manager Specialist Businesses. Ross is a member of the New Zealand Institute of Directors and a former Chartered Accountant. He is currently also Chair of TH Enterprises, a large scale, family-owned dairy farming business and a Director of Gold Creek Farm Management and the NZ Cricket Players Association.

Ian Hankins

Independent Director

Ian currently leads the Wealth Management division at Forsyth Barr. Ian has 25 years of experience in financial services gained in senior leadership roles across Finance, Operations, Consumer, Business and Transformation areas. Prior to his current role at Forsyth Barr, Ian held various senior management roles at Westpac NZ including CFO, Chief Transformation Officer and GM Consumer Banking. Ian holds a Bachelor of Commerce and Administration from Victoria University, is Lean Six Sigma black belt accredited and was awarded a Fellow membership of CPA Australia in 2020.

In addition to the board, the Company's leadership team also includes the below key personnel.

Nicola Andresen

General Manager and Investor Relations

Nicola started at Xceda Finance in 1992 when the company was operating under its former name Asset Finance Limited. Nicola has worked in a wide variety of roles in the Company, and therefore has a comprehensive understanding of all aspects of operations. Nicola is primarily responsible for Investor Relations for secured term deposit products, as well as managing the general day-to-day running of the operations team in Whakatane.

Graeme O'Leary

Chief Financial Officer (CFO)

Graeme was appointed as Chief Financial Officer (CFO) in November 2020. Graeme started working with Xceda Finance in the 18 months prior to his appointment as one of our external accountants at Ernst & Young. Graeme holds a Bachelor of Commerce (BCom) in Accounting & Commercial Law from the University of Otago, a Graduate Diploma of Chartered Accounting (GradDipCA) and is a member of the Chartered Accountants Australia & New Zealand (CA ANZ). Graeme works in the Company's Auckland office alongside Daniel (the CEO), Darryl (the CCRO) and the commercial lending team.

Darryl French

Chief Credit Risk Officer (CCRO)

Darryl was appointed as Chief Credit Risk Officer (CCRO) in October 2021. He was previously Head of Consumer Credit and Head of Asset Management at Heartland Bank. Having worked in several senior management teams, Darryl has managed projects creating policy, procedures, loan assessment scorecards and has experience in business development, business analysis, staff management and establishing governance. Darryl works in XFL's Auckland office alongside Daniel (the CEO) and Graeme (the CFO).

Nicole Awhimate**Systems Manager**

Nicole started at Xceda Finance as a Loans Officer in 2012, fresh from completing her degree at Victoria University. She has worked in a wide variety of roles within the company and as such has a great depth of understanding of Xceda. Most recently Nicole has been working as Systems Manager, taking on the task of managing IT System upgrades. Nicole holds a BCA in Management and Commercial Law from Victoria University. Nicole works in XFL's Whakatane office alongside Nicola (General Manager) and the rest of the Loan Operations Team.

Amy Hanson**Senior Marketing Manager**

Amy was appointed as XFL's Senior Marketing Manager in December 2022. Amy has experience working in the Property, Finance and Tourism sector. Amy has a vast amount of experience in Marketing Strategy, Investor Marketing and Digital Marketing Strategies. Amy looks after XFL's marketing initiatives and strategy as well as strategic partnerships. Amy holds a BCom in Marketing Management from Otago University.

6.7 Governance and Oversight

Internal

XFL's risk management system uses principles and definitions included in AS/NZS ISO 31000:2009. The four key components of the Company's risks management system include the risk management program overview, the risk register, policy documents and operation manuals. The above documents serve as primer for its core risk management processes and are reviewed periodically. Changes, if any, to the processes mentioned in the above documents require the trustee's approval.

The Board of Directors is responsible for the overall risk oversight and approving the reporting requirements, policies, procedures and controls for XFL, monitoring XFL's risk exposure to ensure that it is consistent with established risk tolerances and ensuring that any exposures to, and transactions with, related parties are on arm's length terms and conditions. The CEO is responsible for risk oversight including conduct of the risk management process periodically, review of the risk management control results in the context of identified risks, determination of broad plans for action; and reporting to the Board of Directors. The management team is responsible for development and implementation of corporate risk management policies, controls and action plans; and the conduct and operation of risk management processes periodically for its area/s of responsibility. The team leaders are responsible for supporting the managing director and management team in carrying out their risk management role, identifying risk incidents/events that have or may occur and reporting them to the management team; and performance of periodic reviews of the risk management process as it pertains to their area of operation.

The components of the Company core's risks management process are identify, analyse, respond, monitor and report. Using the above core processes as template the Company has developed detailed and comprehensive policies and processes to manage credit risk, liquidity risk, operational risk, market risk and anti-money laundering and countering financing of terrorism risk.

Credit Risk Policy

Identification and analysis of credit risk is particularly relevant during the origination, evaluation, approval; and documentation & settlement phases of the credit process cycle. The identification is undertaken at the portfolio level as part of the annual strategic planning process; and at an individual borrower level at origination of a loan and periodically thereafter as an integral part of account monitoring, both for performing and non-performing loans. The outcome of the above process is a written strategy document to be approved by the board. Once approved, the above document serves as the primer for identification of acceptable and unacceptable level of risk exposures and development and implementation of risk management policies. The policies once formulated are reviewed quarterly and changes if any are ratified by the board prior to submitting to the Trustee for

approval. As part of ongoing monitoring, various reports as detailed below are produced and are kept on file for a period of twelve months.

Report Name	Freq.	Description	Report to
Management Accounts	Monthly	Financial accounts – Profit and Loss and Balance Sheet, shows bad debts written off.	Management, Board
Management Reporting to Directors	Monthly	Show loan book breakdown by impairment status, product type, payment type, geographical region, primary collateral type, top exposures, etc	Management, Board, Trustee
Account Collection Review Report	As required	Shows details about significant loans that are in default, so decisions can be made on future collection action.	Management
Trust deed reporting	Per Trustee Requirements	The monthly trustee reporting has information on loan quality and write offs.	Board, Trustee
Reserve bank spreadsheet	Per RBNZ requirements	The monthly template for the Reserve Bank that is submitted to the trustee contains loan quality and asset concentration information under the "Assets" heading.	Board, Trustee, RBNZ (via the trustee)
Annual Report and Half Year Financial Accounts	6 Monthly	The asset quality note shows information on loan overdue and impairment status	Public, Shareholders, Investors, Trustee

Breaches of the policies are reported to CEO and the Board of Directors, who may or may not ratify the breach in accordance with the Company's risks management policy. A risk register is also maintained to document adherence to above policies and is updated regularly.

Operation Risk Policy

The operational risks are reviewed on an ongoing basis and the Risk Register is updated accordingly. The Risk Register and Obligations Register are the primary means of monitoring / tracking operational risk exposures and regulatory compliance. The trigger for the identification and analysis of new or emerging operational risks can be any combination of management, board or staff meetings and discussion. The Company has policies in place to reduce the likelihood of fraudulent loans, money laundering, mistakes and business disruptions. To ensure compliance with relevant regulatory requirements, the Company has also sought legal advice while devising policies and processes to manage operational risks. Like its credit policy, various reports are produced to monitor compliance, operational risk policies and procedures and any incident involving internal fraud, workplace safety, action by a regulator, damage to physical assets and significant business disruption is reported to the board at the next meeting. The CEO is required to report to the Board of Directors on all matters which the board determines requires a reporting. The CEO shall report at each Board meeting on all instances of risk exposures identified as being outside of Company tolerances and shall advise the Board that no such instances exist where that is the case. These reporting requirements may be altered, as the board sees fit.

The Company's liquidity, market and AML-CFT policies are also developed on similar lines detailed above and include additional policies and procedure to manage special aspects associated with each of the above risks.

In our view, the Company's risk management system prima facies appear to be in line with widely accepted risks management practises and is deemed to be adequate in our view in absence of any information to suggest otherwise.

External

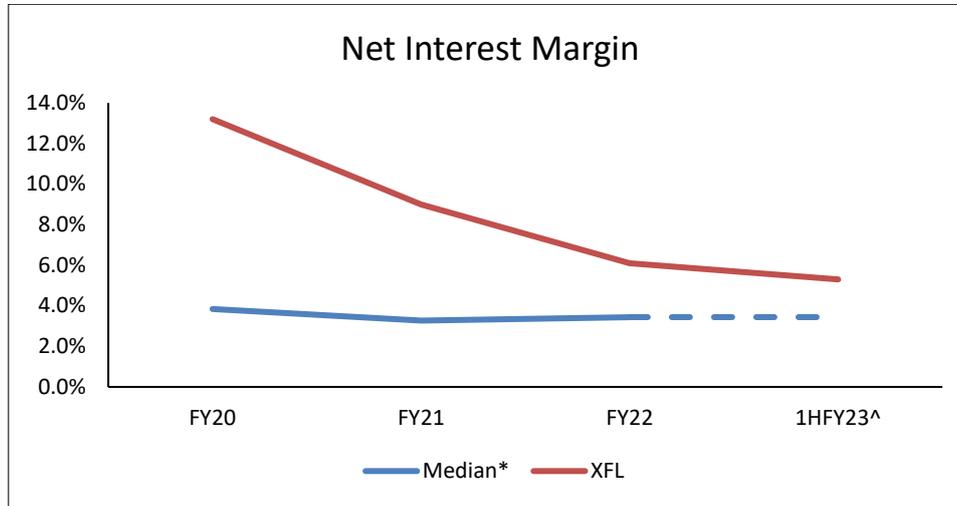
The Trust deed and the prudential norms prescribed by RBNZ are key source of external governance measures which XFL must comply with. The details of the RBNZ's prudential requirements are detailed in section 5 and the table below summarise the XFL's compliance with select requirements of the trust deed and RBNZ's prudential norms.

Ratio	Calculation	Sep-22	Mar-22	Mar-21	Mar-20	Trust deed	Regulatory
Risk weighted capital ratio	Tier 1 capital as a percentage of risk weighted assets	15.4%	15.4%	15.0%	14.3%	10.0% or more	8% or more if rated 10% or more if unrated
Related party ratio	Aggregate credit exposures to all the related parties as a percentage of tier 1 capital	0.0%	0.0%	0.0%	0.0%	<5.0%	<15%

7 Financial Indicators

7.1 Profitability

Net Interest Margin



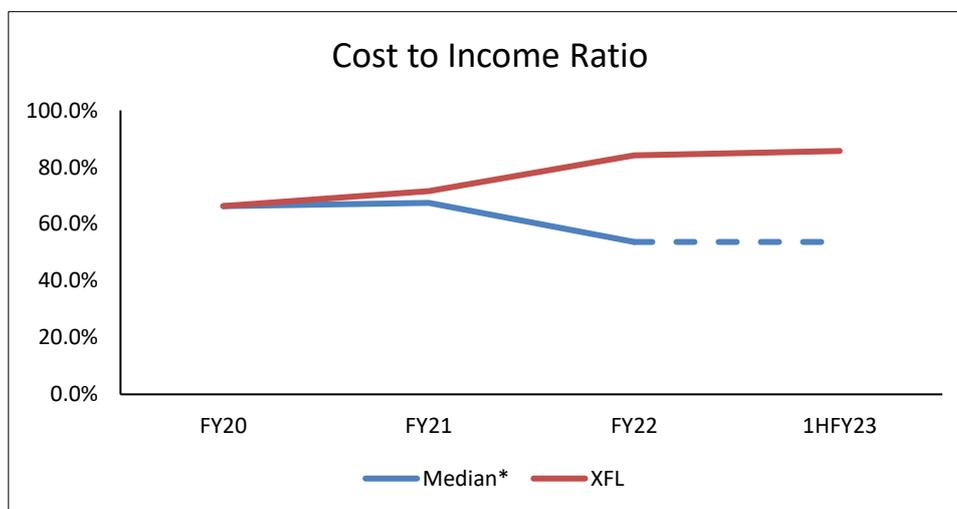
Source: Reported financial statements of Peer Group from FY20 to FY22.

*Median figure for FY22 is based on entities for which financial statements were available at Feb23

^ Annualised

For six months to Sep22, the Company's annualised net interest margin declined to 5.3% (FY22: 6.1%, FY21: 9.0%, FY20: 13.2%) driven by shifts in the Company's lending strategy and the potential lag associated with an increase in income following the Company's growing loan book. XFL's strategic and conscious shift towards higher quality loans backed by residential mortgages and healthy LVRs translates into lower yield on an absolute but potentially a higher yield on a risk adjusted basis. Moreover, going forward the Company's positive ALM profile suitably positions the Company to benefit from the increase in interest rates.

Operating Efficiency

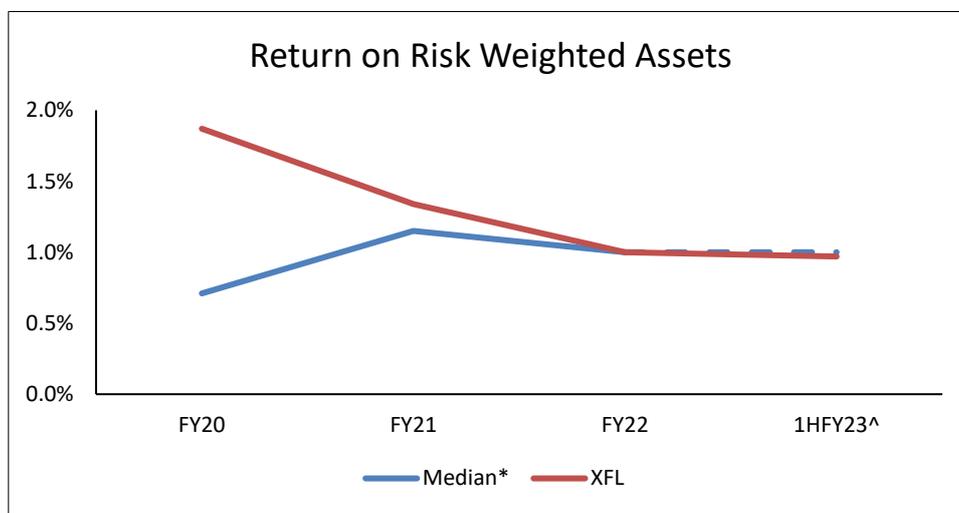


Source: Reported financial statements of Peer Group from FY20 to FY22.

*Median figure for FY22 is based on entities for which financial statements were available at Feb23

The Company's efficiency measured by its cost to income ratio lags the industry median. In the recent past, the Company undertook a strategic overhaul of its operations that included rebranding its business and hiring additional staff to support the growth in its lending operations. As a result, its operating expenses as a percentage of operating income have trended upwards to 85.7% in 1HFY23 (FY22: 84.2%, FY21: 71.6%, FY20: 66.3%) and combined with the decline in NIMs negatively impacted its cost-to-income ratio. The same however is not a material risk as the Company's income generating potential, measured by loan book growth and asset quality, remain on an improving trajectory.

Return on Assets (ROA)



Source: Reported financial statements of Peer Group from FY20 to FY22.

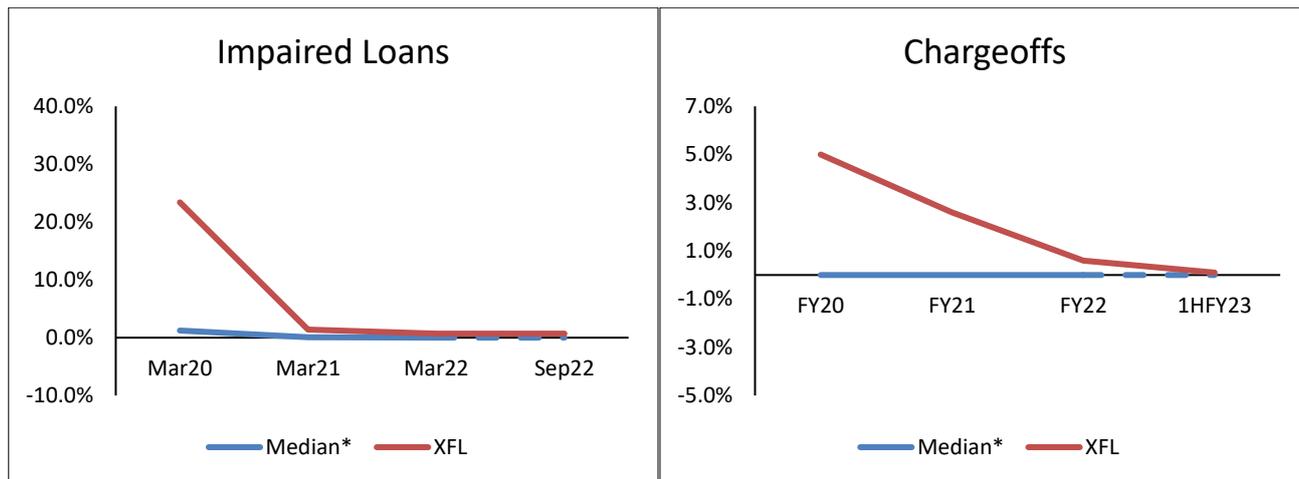
*Median figure for FY22 is based on entities for which financial statements were available at Feb23

^ Annualised

An increase in operating costs, downward pressure on NIMS and increasing asset size has led to a decrease in the Company's return on risk weighted assets (ROA) over the periods reviewed. The Company's total assets increased to \$74.2m at Sep22 (Mar22: \$59.1m) and its after tax profits remained largely steady (on an annualised basis) at \$0.6m for 1HFY23 (FY22: \$0.6m).

7.2 Asset Quality

Impaired Loans

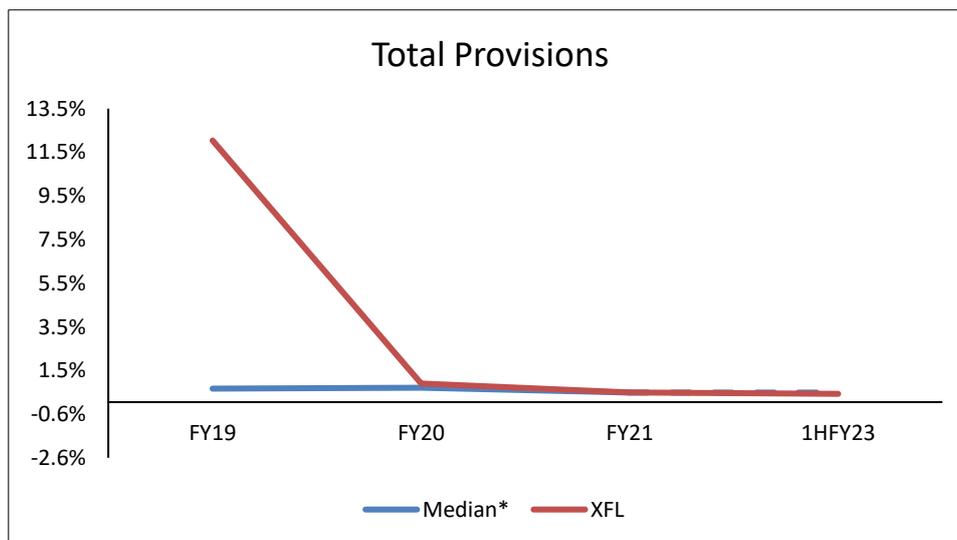


Source: Reported financial statements of Peer Group from FY20 to FY22.

*Median figure for FY22 is based on entities for which financial statements were available at Feb23

The Company's impaired loans and charge offs have been on an improving trend with the charge offs being <0.5% of its gross loans at Sep22 (Mar22: <1.0%) and impaired loans also being <1.0% of its gross loans at Sep22 (Mar22: <1.0%) supported by the management efforts to tighten underwriting standards. The elevated levels of impaired assets prior to FY21 were primarily due to relatively aggressive underwriting standards adopted by the then existing management, the risks from which crystallised in form of the underperformance of one big-ticket loan to a single borrower that represented more than three fourths of the impaired assets up to Sep20. Positively, since the change in ownership in 2018, XFL tightened its lending policies and subsequent to Sep20, the abovesaid underperforming loan was renegotiated into a performing loan and is expected to be closed soon, thereby further alleviating asset quality risks.

Total Provisions

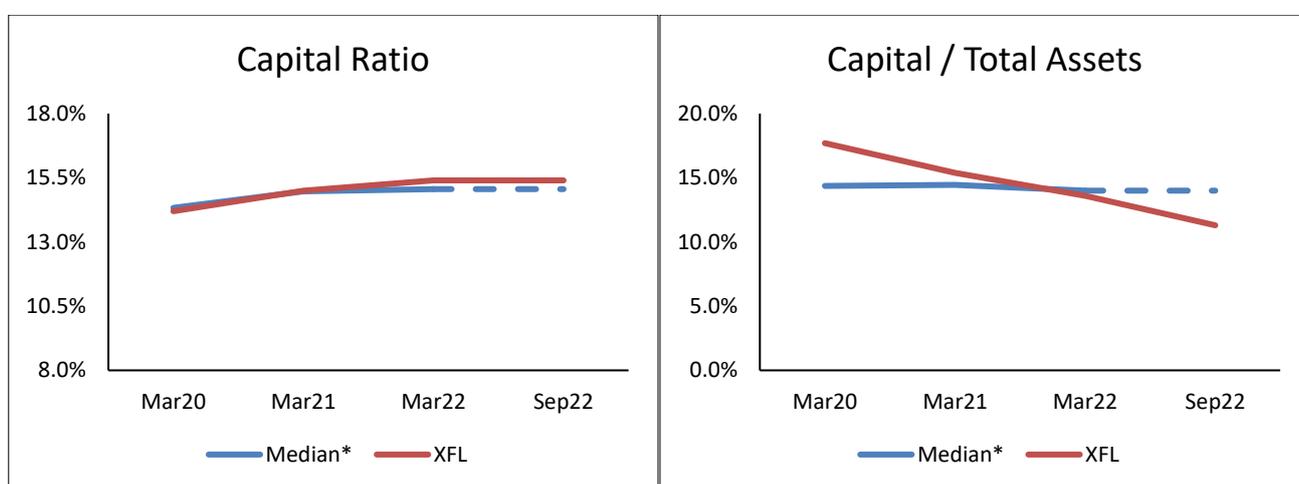


Source: Reported financial statements of Peer Group from FY20 to FY22.

*Median figure for FY22 is based on entities for which financial statements were available at Feb23

The Company's total provisions as a percentage of gross loans have been on an improving trend since FY20, currently being at <0.5% at Sep22 (Mar22: <0.5%). The Company's provision for loan impairments in FY20 represented more than a tenth of its gross loans and ~50.0% of impaired assets, largely on account of a single big-ticket underperforming loan, alluded to previously. After renegotiation of the aforementioned single big-ticket underperforming loan post Sep20, the provisions and corresponding interest accruals related thereto were reversed, thereby contributing to the decrease in the provision ratio. That said, XFL's asset quality metrics are expected to vary to a higher degree in general compared to traditional banks and finance intermediaries, reflecting the higher credit counterparty/repayment risks that inherently correspond to its product offering of bridging finance and other similar products.

7.3 Capitalisation



Source: Reported financial statements of Peer Group from FY20 to FY22.

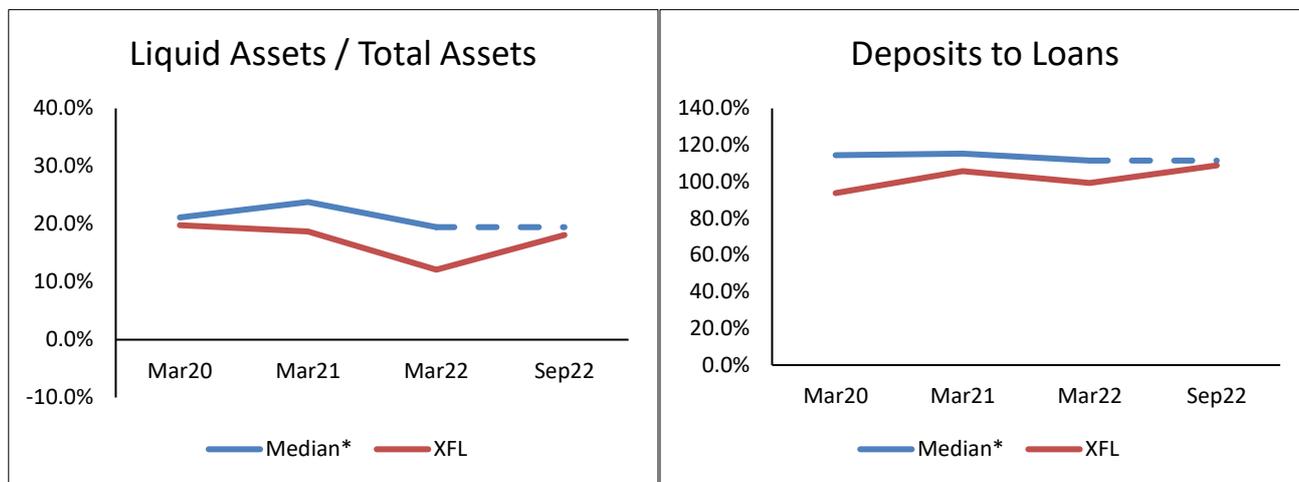
*Median figure for FY22 is based on entities for which financial statements were available at Feb23

The Company's capital ratio (being 15.4% at Sep22) offers a healthy headroom for further growth in the loan book, while maintaining an adequate buffer over the capital requirements stipulated by the Debenture Trust Deed (10.0%) and prudential requirements prescribed by RBNZ. That said, the expected growth in the loan book over the next 12 months would also require increased deposits and/or the Company's shareholders to provide support for it to maintain adequate buffer under the Trust Deed's capital ratio requirements.

The Company's gross loan book has increased to \$59.4m at Sep22 (Mar22: \$50.5m, Mar21: \$36.6m, Mar20: \$25.9m) and its equity has increased to \$8.4m (Mar22: \$8.0m, Mar21: \$7.2m, Mar20: \$6.1m). As a result, over the periods reviewed the Company's capital ratio has varied between 15.4% and 14.2% and remained marginally below the industry median. Reduced dividend payouts in FY21 and suspension of dividends in the recent two periods (1HFY23 and FY22) has supported the increased in capital and resulted in a marginal improvement in the Company's capital ratio compared FY20. The capital ratio has maintained an adequate

headroom (>500bps) over the minimum requirement of 10.0% stipulated by the Debenture Stock Trust Deed, thus providing it with healthy capacity to withstand shocks in the near to medium term.

7.4 Funding and Liquidity



Source: Reported financial statements of Peer Group from FY20 to FY22.

*Median figure for FY22 is based on entities for which financial statements were available at Feb23

Over the periods reviewed the Company has operated with a sound liquidity position. XFL’s liquid assets to total assets ratio has trended marginally below industry median. The increase in liquid assets during 1HFY23 was supported by an increase in deposits and the lagged growth in loan assets due to rising interest rates, inflationary environment and subsequent contraction in overall borrowing capacities of consumers as well as strategic shift towards conservative underwriting policies. As a result, the rate of growth in the Company’s deposits temporarily outpaced the rate of growth in loan assets and led to an increase in the Company’s liquid assets to \$13.4m at Sep22 (Mar22: \$7.2m), representing 18.1% (Mar22: 12.1%) of total assets.

The Company’s ability to offer attractive rates on its deposits so far has fared favourably and is evidenced in the growth in the total deposits from its customers which has supported the growth in its loan book. That said, given the recent rising interest rate environment, inflationary pressures and increased cost of living, there is a potential for a reduction in pace of growth of deposits from its customers in the near-term.

8 Financial Benchmarks

Description	Percentile	Liberty Financial Limited	General Finance Limited	Mutual Credit Finance Limited	GoldBand Finance Limited	Finance Direct Limited	Nelson Building Society	Unity Credit Union	First Credit Union Incorporated	Christian Savings Limited	Wairarapa Building Society	Police and Families Credit Union	Hertaunga Building Society	Credit Union Auckland	Xceda Finance Limited
Financial Year		2022	2022	2022	2022	2022	2022	2022	2022	2022	2022	2022	2022	2022	1HFY23
Scale:															
Operating income (\$ 000s)	 33%	1,961	4,032	3,442	2,717	3,045	29,793	43,513	22,203	6,187	5,558	3,903	1,599	2,358	2,840
Total Assets (\$ 000s)	 47%	72,818	99,354	44,876	44,004	14,663	1,091,865	447,125	445,131	285,805	152,771	155,486	42,914	29,527	74,192
Gross loans (\$ 000s)	 53%	58,523	80,230	42,399	38,660	12,375	865,908	320,038	301,057	211,169	125,080	31,195	27,538	20,619	59,424
Profitability:															
Net Interest Margin (%)*	 67%	2.7%	3.2%	6.3%	5.2%	6.5%	2.8%	8.1%	3.7%	2.3%	3.2%	2.7%	2.0%	5.9%	5.3%
Non Interest Income to total operating income (%)	 80%	0.0%	34.6%	22.7%	21.1%	69.9%	5.2%	18.4%	32.9%	4.9%	16.2%	1.9%	54.0%	37.4%	38.6%
ROE (%)*	 40%	9.6%	19.5%	15.4%	15.5%	-3.1%	12.9%	-0.2%	5.0%	11.5%	6.2%	2.5%	13.8%	-9.1%	5.7%
Return on assets (%)*	 47%	1.2%	1.9%	2.8%	2.9%	-0.5%	1.2%	0.0%	0.7%	1.4%	0.9%	0.4%	2.1%	-1.1%	1.0%
Cost to Income (%)	 73%	37.2%	47.4%	46.1%	44.0%	101.1%	45.6%	79.3%	83.1%	40.8%	59.9%	100.3%	40.4%	107.6%	85.7%
Capitalisation:															
Leverage (Gross loans to Equity) (x)	 20%	6.3	8.2	5.3	4.6	5.3	8.4	5.3	4.7	6.0	5.1	1.1	4.2	6.4	7.1
Capital ratio - risk adjusted (%)	 53%	22.8%	17.9%	14.5%	16.6%	13.6%	12.4%	9.9%	14.6%	14.7%	15.7%	19.4%	19.4%	11.8%	15.4%
Capital to total assets ratio (%)	 27%	12.8%	9.8%	17.8%	18.9%	15.9%	9.4%	13.6%	14.4%	12.2%	16.1%	17.8%	15.3%	11.0%	11.3%
Funding and Liquidity:															
Gross loans as a % of total assets (%)	 53%	80.4%	80.8%	94.5%	87.9%	84.4%	79.3%	71.6%	67.6%	73.9%	81.9%	20.1%	64.2%	69.8%	80.1%
Deposits to gross loans (%)	 40%	107.5%	109.7%	85.7%	90.2%	92.3%	113.3%	116.6%	124.3%	117.7%	101.2%	407.0%	130.7%	122.1%	108.9%
Liquid assets to total assets (%)	 33%	18.7%	19.0%	3.1%	11.9%	6.9%	19.9%	23.4%	27.1%	24.1%	12.3%	71.6%	25.9%	27.1%	18.1%
Asset Quality:															
Write-offs to gross loans (%)	 27%	0.0%	0.0%	0.6%	0.0%	0.1%	0.0%	2.2%	0.0%	0.1%	0.0%	0.0%	0.0%	0.2%	0.1%
Impaired loans to gross loans (%)	 33%	0.0%	0.0%	0.0%	0.0%	2.8%	0.0%	3.6%	2.3%	0.0%	0.2%	0.0%	0.0%	2.0%	0.7%
Impairment provision to gross loans (%)	 60%	0.6%	0.3%	0.0%	0.0%	2.7%	0.4%	2.2%	0.9%	0.0%	0.5%	0.4%	0.0%	1.6%	0.4%

*Annualised for reported periods not equal to 12 months

9 Summary Financial Data

Xceda Finance Limited					
\$'000s	Trend	FY20	FY21	FY22	1HFY23
Income Statement					
Net Interest Income		4,291	3,510	3,146	3,486
Non Interest Income		2,269	2,321	2,390	1,097
Operating Income		6,560	5,831	5,536	2,840
Operating Expense		4,347	4,174	4,662	2,434
Pre Provision Operating Profit		2,203	1,639	889	404
Credit Impairment Charge / (Reversal)		1,301	934	278	84
Operating Profit Before Tax		902	705	611	320
Other non Operating Income / (Expense)		- 10	- 18	15	- 2
Net Profit		640	503	435	233
Financial Position					
Total Assets		34,184	46,744	59,074	74,192
Customer Deposits		24,272	38,659	50,170	64,727
Gross Loans		25,867	36,587	50,503	59,424
Liquid Assets		6,754	8,736	7,165	13,424
Ratios					
Profit Before Tax to Operating Income Margin (%)		14%	12%	11%	11%
Net Interest Margin (%)*		13%	9%	6%	5%
Cost to Income (%)		66%	72%	84%	86%
Return on Asset (%)*		2%	1%	1%	1%
Return on Equity (%)*		16%	8%	6%	6%
Capital Ratio (%)		14%	15%	15%	15%
Capital to Total Asset Ratio (%)		18%	15%	14%	11%
Leverage Ratio - (Gross Loans / Equity) (x)		4.3	5.1	6.3	7.1
Charges-offs / Gross Loans (%)		5%	3%	1%	0%
Neither Impaired or Past Due to Gross Loans (%)		57%	92%	94%	92%
Non-Performing Loans to Gross Loans (%) **		26%	2%	1%	1%
Loan Loss Provision / Gross Loans (%)		12%	1%	0%	0%
Deposits to Gross Loans (%)		94%	106%	99%	109%
Liquid Assets to Total Assets (%)		20%	19%	12%	18%

*Annualised for reported periods not equal to 12 months

**Non-performing Loans = Impaired loans + Loans past due for more than 90 days,

10 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		CC	CC	52.87	Distressed	Extremely High
		C	C	55.00		
C	D	D	D	100.00		

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/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

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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>

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