Credit Ratings & Research

Credit Rating Report
Asset Finance Limited

Credit Rating Report

Date: 25 March 2021

Prepared for: Asset Finance Limited

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

Primary Analyst: Anuj Kindra, CFA

Secondary Analyst: Girish Jethani, CFA

Currency used in this report:

This report is presented in New Zealand Dollars unless otherwise noted

Contents

1 Executive Summary

Asset Finance Limited ('AFL' or 'the Company')

AFL 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 assigned AFL a credit rating of 'B' at Jan21, which is a sub-prime classification with a moderate level of risk. The outlook for the rating is 'Stable'.

AFL's credit rating is supported by its incumbent market position in the New Zealand NBDT industry, an improving scale and healthy liquidity profile. Notwithstanding the visible improvements in the characteristics of the loan book following management's efforts to de-risk the portfolio, the Company's credit rating is constrained by its industry trailing asset quality, limited headroom under capital metrics to support further high growth in operations, earnings pressure from the low interest rate environment and intensifying competition from inter and intra industry sources.

Strengths

- AFL 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 profitably manage that customer portfolio. Further, AFL's ability to maintain a high yield on loans enables it to continually raise consumer deposits by offering attractive returns.
- A steady growth in Company's loan-book and deposits evidences the continued relevance of its product offering and a strengthening of its incumbent market position. Over the review period, the Company's loan portfolio has increased at Compounded Annual Growth Rate of 14.4% to $29.9m at Jan21 (Mar20: $25.9m, Mar19: $23.1m, Mar18: $17.9m), while deposits from consumers have experienced a similar growth.
- The shareholders' plan to infuse additional capital to support the ongoing growth in the loan book, combined with the management's efforts to de-risk the loan portfolio, augurs well for Company's key financial indicators going forward.
- AFL's sound liquidity profile is underpinned by its consistently favourable asset liability maturity (ALM) profile, reflective of a strategy to extend short term loans and raise long term deposits. The same, together with a sound 30.0% liquid assets to total assets ratio as at Jan21, is demonstrative of a moderate degree of inbuilt conservatism, which suitably positions AFL to manage the relatively higher business risk inherently associated with operating in the upper quadrants of the risk-reward matrix.

Constraints

- AFL's asset quality is weaker than the industry average and is the key constraint to its rating. In recent periods, a single major underperforming loan (that represented more than 3/4th of the impaired assets) has disproportionately impacted asset quality metrics. Moreover, compared to some of its NBDT peers, AFL's asset quality faces higher downward pressure on an ongoing basis, on account of a significant presence of personal loans, which inherently experience a higher rate of impairment than residential mortgages and/or collateral-backed business loans. As a result, AFL has had to operate with a high level of impaired assets and provision levels. Favourably, the Company's new management has undertaken several measures including tightening lending criteria and underwriting standards, reducing concentration risks, increasing the share of first mortgages, which though has led to a strategic contraction in NIMs, it is expected to bode well for AFL's asset quality on a forward looking basis. However, despite the NZ economy's resilience to COVID-19 headwinds, traditional and non-traditional lenders may face increased pressure on asset quality as downside risks to household incomes and asset quality remain accentuated due to the uncertain impact of unwinding of the government subsidy schemes.
- AFL's asset quality also weighs on its capacity to fund growth by putting upward pressure on Risk Weighted Assets (RWA). The recent growth in AFL's portfolio, a contraction in NIMs and persistently high credit and impairment costs, together with a steady dividend payout means that while the Company's RWA requirements have increased significantly, its equity capital has remained largely stagnant. While the sizeable reduction in headroom (to the trust deed requirement of 10.0%) historically available under AFL's capital ratio (Jan21: 14.7%, Mar18: 20.1%), due to aforementioned factors aligns with the management's strategy - to improve utilisation of capital employed, it offers limited capacity to support further growth without increased retention of earnings or additional capital injection.
- The global interest rates are near zero and are expected to remain low for foreseeable future as governments battle adverse economic impacts of COVID19. These low interest rates are expected to continue exerting pressure on profitability of industry participants like AFL, which may also be amplified by their positive ALM profile.
- The limited product offering of the NBDT sector, and hence its low systemic importance, compared to traditional banks, acts as a ceiling for the sector's (and by extension AFL's) credit rating. In addition to peers, traditional banks and financial intermediaries (FI), NDBTs also face stiff competition from fintech and the rapidly growing Buy Now Pay Later sector. In our view, competitive pressures are likely to remain high and inhibit growth in profitability and scale. Positively, the Company's diverse loan offerings suitably position it to withstand intra competitive pressures.

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.

Risk Rating

B

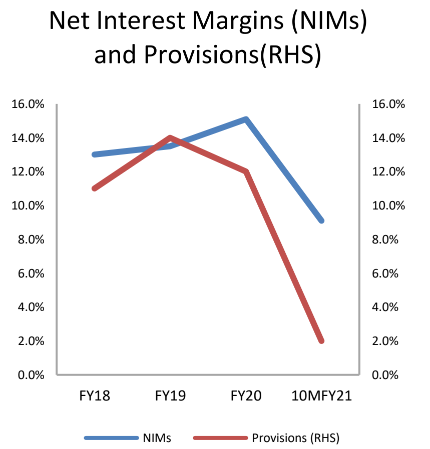
Outlook: Stable

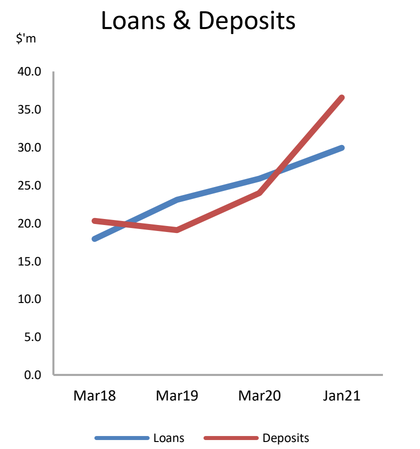
Public, Under ongoing monitoring

Industry Percentiles

Scale:	
Total Assets	43%
Gross loans	29%
Profitability:	
NIM	93%
ROE	86%
ROA	93%
Efficienty Ratio	36%
Capitalisation:	
Leverage (Gross Loans to Equity)	57%
Capital Ratio	21%
Capital to Total Assets	64%
Funding and Liquidity:	
Deposits to Loan Ratio	21%
Liquid Assets to Total Assets	36%
Asset Quality:	
Net Charge-offs	7%
Impaired Loans	7%
Provision for Loan Losses	7%

Key Trends





2 Scope of Report

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

We have complied with our rating services guidelines in order to derive the credit rating on Asset 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	**25 March 2021**
Request Type	**Issuer**
Assessment Type	**Under ongoing monitoring**
Rating Initiation	**Issuer based (solicited)**
Rating Distribution	**Public Rating**
Report Distribution	**Unrestricted**
Purchased by	**Asset Finance Limited**
Report Fee	**Fixed Price**
Ancillary fees	**Nil**
Subject First Time Rated	**No**
Issuer Name	**Asset 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 35)**

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 Asset Finance Limited, publicly available information and from our own enquiries. We have derived a credit rating on the Company based on the understanding that Asset 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	**Audited Financial Statements for the years ended 31 March 2020, 2019 and 2018.** **Audited Financial Statements for six months interim period ended Sep 2020.** **Management Accounts for ten months interim period to Jan2021.**
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	**Yes**
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**

*In the preceding twelve months Equifax was engaged to assess the credit profile of the Company, expressed in the form of point in time credit rating. The engagement has since been completed and this information is being shared to remove any perceived conflict of interest.

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

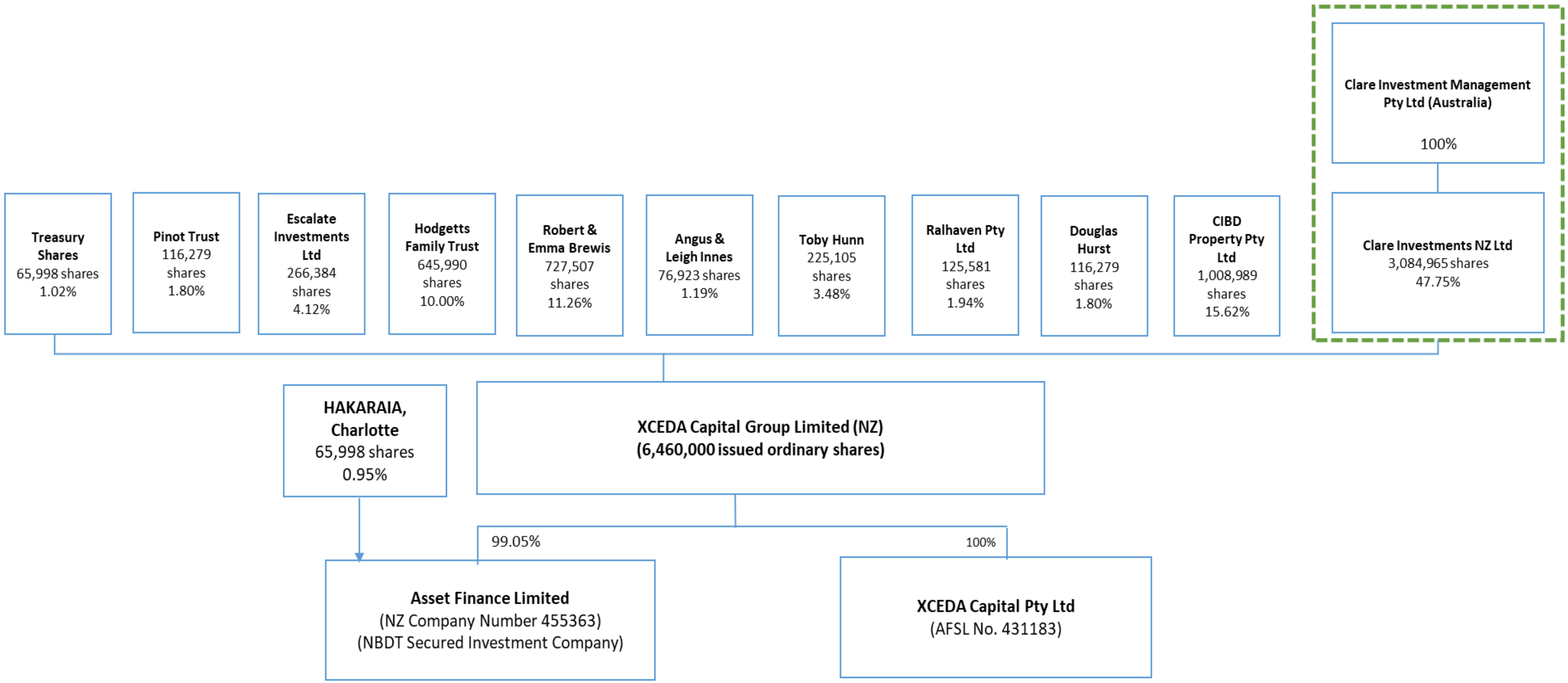
3 General Background of the Subject

3.1 Subject Overview

Subject Name	Asset Finance Limited
Type of Entity	Licensed Non-Bank Deposit Taker (NBDT)
Head Office Address	38 Richardson Street Whakatane 3120 New Zealand
Date of Incorporation	15 December 1989
Principal Activities	AFL 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. AFL raises funds from the public by offering debt securities (fixed term deposits) and provides business and personal loans to qualified borrowers.
History	Since 1997, Asset Finance Limited 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"). 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). 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. 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 Investments NZ Limited was wholly acquired by Clare Investment Management Pty Ltd, an Australian private company controlled by the current CEO Daniel McGrath.

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 summary [1] of the above risk factors and their outlook in the context of the New Zealand economy is included in paragraphs below.

Systemic Risk Factors

COVID-19

Economy showed resilience to initial outbreak.

The COVID-19 pandemic, and associated containment measures put in place to eliminate the transmission of COVID-19, have led to a significant downturn in the Global and the New Zealand economy. New Zealand GDP in the June quarter fell by 12.2% with industry breakdowns showing that construction, transport, trade, and accommodation and food service were among the sectors worst impacted (Figure 1).

Figure 1 – Impact of COVID19 on revenue and expenses by Industry

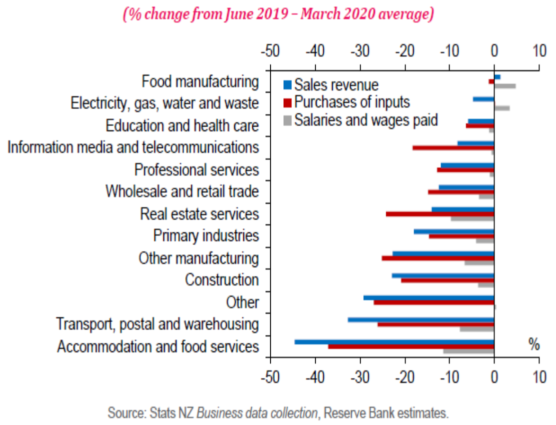
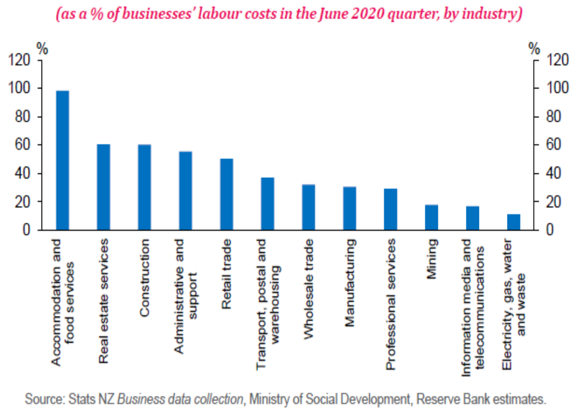


Figure 2 – Utilisation of Wage subsidy by various Industries

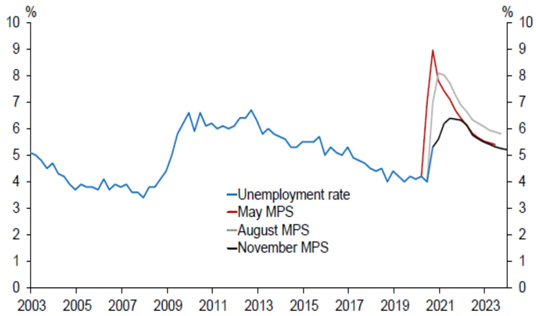


Despite this large decline in overall activity, businesses in most industries demonstrated a flexibility to the change in trading and operating conditions they faced and their ability to maintain stable salary and wages was aided by the Government's wage subsidy scheme (Figure 2) and monetary stimulus measures announced by the Reserve Bank of New Zealand (RBNZ), that included reducing the Official Cash Rate (OCR) to 0.25%, initiating a Large Scale Asset Program (LSAP) and directing banks to implement Funding for Lending Programme (FLP) starting Dec20. As a result, the unemployment is not expected to spike to levels originally feared (Figure 3).

---

[1] RBNZ Financial Stability Report November 2020, RNBZ Monetary Policy Statement November 2020, RBNZ Website and various of Publications of RBNZ.

Figure 3 – Actual and forecasted unemployment levels.

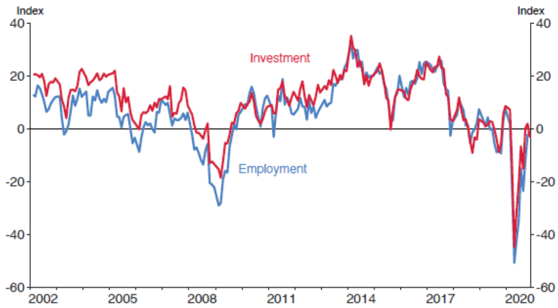


Source: Stats NZ *Household Labour Force Survey*, Reserve Bank estimates.
Note: Baseline scenarios from the Reserve Bank's May, August and November 2020 *Monetary Policy Statements*.

<u>Downside Risks remains</u>

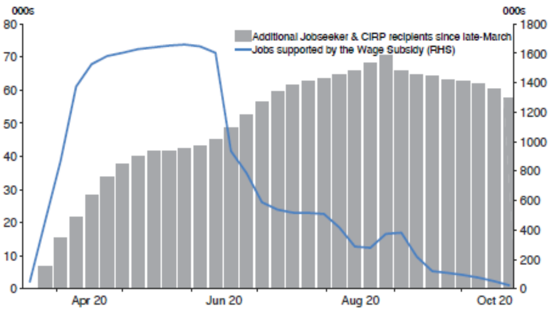
However, uncertainty surrounding the economic recovery remains high and the possibility of repeat COVID-19 outbreaks continues to weigh on the business confidence as reflected by dropping investment intentions (Figure 4). As a result, business lending has fallen considerably over the past six months as businesses have scaled back their expansion plans and are also hesitant to take on debt over and above what is necessary to remain operational. While the labour market has performed well in the circumstances, an increasing proportion of the workforce is experiencing underemployment due to the impacts of COVID-19, and this trend is likely to continue with the wage subsidy that supported majority of the jobs (Figure 5) having expired now.

Figure 4 – Investment Sentiment



Source: ANZ.
Note: The specific question asked to firms is "With regard to your business, how do you expect [employment/investment] to have changed in 12 months time?".

Figure 5 – Recipient of Income Support



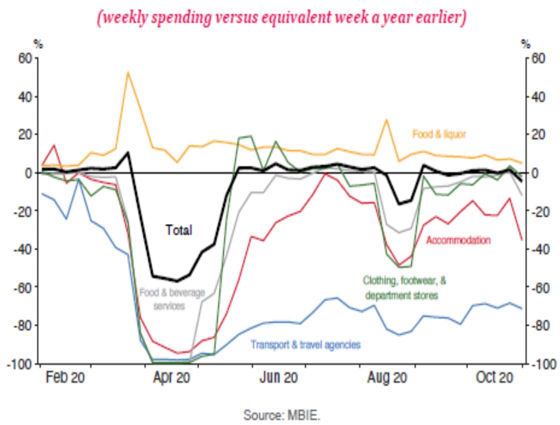
Source: Ministry of Social Development.
Note: Grey bars show the cumulative change in the number of income support recipients since late March 2020. CIRP stands for COVID-19 Income Relief Payment. Only Work Ready recipients have been included in the Jobseeker data.

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.

Despite the impacts of COVID-19 and restrictions on businesses and households, aggregate spending in the New Zealand Economy rebounded more than expected after the initial lockdown (Figure 6). The recovery was pronounced in some sectors, while spending in other sectors remained weak. For example, spending recovered for food and beverage services, as well as clothing, footwear, and department stores. Conversely, spending remained soft for accommodation and travel-related services. The Auckland outbreak in August 2020 caused a second decline in spending. Aggregate spending has mostly recovered again, although several sectors have remained soft.

Figure 6 – Electronic Spending



Low business sentiment and conclusion of wage subsidy pose risks to unemployment and GDP

Despite recovering the investment and employment intentions remains low. Further the economic package of $62.1bn announced earlier in 2020 carried frontloaded benefits, in form of Wage Subsidy which limited ongoing adverse impacts from the pandemic. However, in Oct20 the Wage Subsidy has largely been exhausted and the subsidy now only supports limited number of jobs. The impact of the subsidy unwinding remains unclear at this stage.

Market Risk

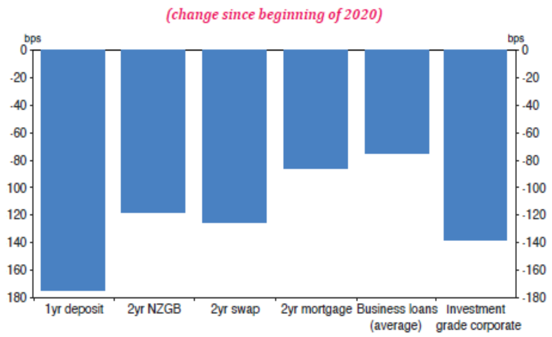
Market risk refers to the impact on profitability due to adverse changes in interest rates, assets prices, commodity prices and exchange rates. Interest rates remain the key and most direct source of market risk to financial institutions due to the nature of their operations and the strong interplay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

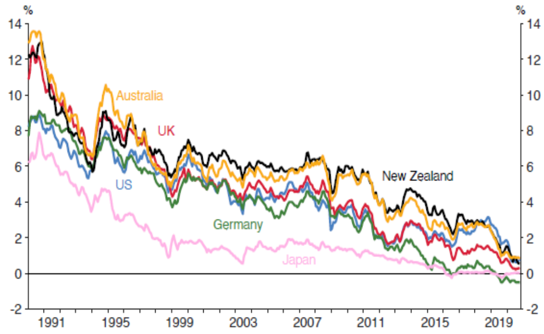
In March 2020, at the outset of COVID-19, the Monetary Policy Committee (MPC) reduced the Official Cash Rate (OCR) and implemented a Large-Scale Asset Purchase (LSAP) programme to support the economy. In the August 2020 Statement, the Committee announced an expansion of the LSAP programme to up to $100bn of New Zealand government bonds and Local Government Funding Agency bonds. These purchases lowered interest rates on bonds (Figure 7) and exerted a downward pressure on the New Zealand dollar exchange rate. The LSAP programme has worked primarily by reducing government bond yields (Figure 8), which are key benchmark interest rates that influence many other interest rates.

Figure 7 – Change in New Zealand Interest Rates



Source: Bloomberg, interest.co.nz, RBNZ.
Note: Data for business loans reflects the change in the average interest rate on outstanding business loans. Other rates are based on advertised and market rates.

Figure 8 – Global 10-Year Bond Yields



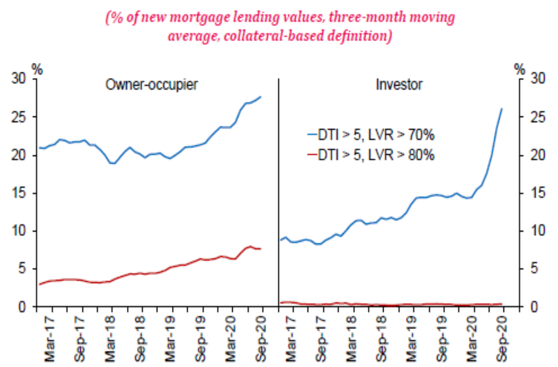
Source: Haver Analytics.

Monetary policy stimulus is helping to make credit cheaper and more accessible for households and businesses. While credit conditions have tightened for those hardest hits by the COVID-19 outbreak, the overall price of credit has fallen. Mortgage rates and business lending rates reduced by around 75 basis points over the first half of this year.

<u>Asset Price Movements</u>

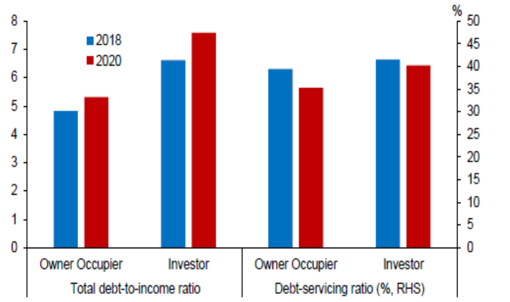
Following the lockdown-related decline in housing market activity, strong house price appreciation in recent months has supported household wealth and consumer confidence, mitigating the near-term effects of COVID-19-related uncertainty. Nationwide, average house prices in New Zealand grew 14% in the year to October 2020, accelerating from 4% a year prior. Strong momentum evident in the housing market prior to COVID-19 has continued, supported in part by the continued decline in mortgage servicing costs. House price growth continues to outpace the growth in household incomes and rents. The nationwide house price-to-income ratio rose to 7.7 times in October from 6.8 times (Figure 10) a year earlier, driven by strong growth in the Auckland house price-to-income ratio, which currently sits around 10.3 times. LVR restrictions were removed in May 2020 to remove any impediments to loan restructure or payment deferrals to existing borrowers. Circumstances have changed since then, and there has been an increase in the riskier categories of mortgage lending in recent months. The proportions of new mortgages originated to borrowers with high LVRs, and to those with debt – to - income (DTI) ratios of greater than 5 times, have increased from a year ago (Figure 9). The proportion of lending to investors has also increased in recent months. As a result, the recent growth in house prices increases the risk of a sharp correction in the medium term, if the current demand and supply imbalance changes.

Figure 9 - Higher Risk Lending by buyer Type



Source: Reserve Bank *LVR New commitments survey*, *DTI New commitments survey*, Reserve Bank estimates.
Note: DTI>5 refers to new lending at debt-to-income ratios greater than five.

Figure 10 - Key Debt Serviceability Metrics



Source: Reserve Bank.
Note: Figure shows total debt-to-income and debt-servicing ratios for 12 hypothetical borrowers, based on the maximum amount banks would be willing to lend and the borrowers' assumed incomes. Responses are weighted by banks' share of total new mortgage lending between September 2019 and September 2020. The debt-servicing ratio is calculated as the estimated annual principal and interest repayments as a fraction of borrowers' post-tax incomes.

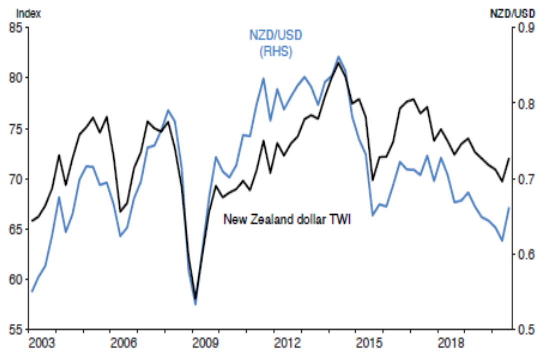
Foreign Currency Risks

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

International border restrictions will continue to curtail international trade and migration, with variable impacts across industries and regions. International prices for New Zealand's exports have remained resilient, although export returns continue to be partly offset by the New Zealand dollar exchange rate. The New Zealand dollar exchange rate (Figure 11) is broadly unchanged since August 2020 and is only slightly below where it started the year. Lower interest rates mean the returns available in New Zealand dollars have declined and this has put downward pressure on the exchange rate. However, central banks in NZ's trading-partner economies have also reduced interest rates to support their economies, countering the impact of lower domestic interest rates on the exchange rate.

Figure 11 - New Zealand Dollar Exchange Rate



Source: Reuters, RBNZ estimates.

Level of Competition and Market Structure

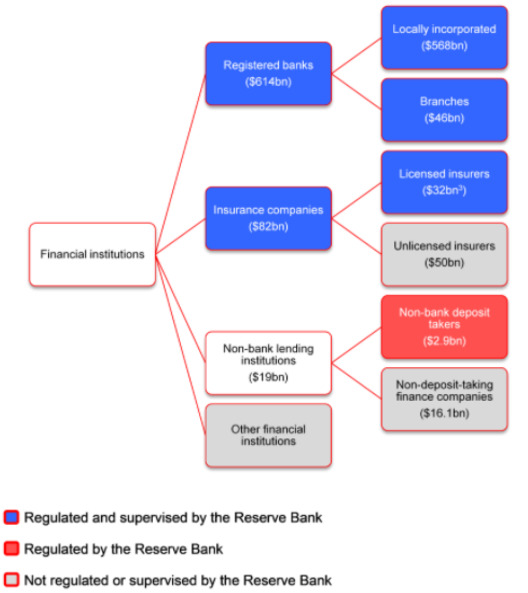
The financial institutions face stiff competition on an ongoing basis to attract capital and funding. In addition to peers, the financial institutions must compete with other finance intermediaries like managed funds, insurance companies and other intermediaries that offer alternative avenues for households 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.

<u>Overview of Competitive Landscape in New Zealand</u>

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 12). 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 ~$169bn, while the domestic bond market is estimated at ~$145bn(excluding government debt). The managed funds industry is also small compared to banks, with around $160bn of assets under management.

Figure 12 - Market Overview New Zealand Financial Services Industry



Source: 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 high 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.

Legal and Regulatory Framework

The financial institutions are highly 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.

<u>Regulatory landscape in New Zealand</u>

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.

<u>Macro Prudential Policy</u>

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.

<u>Regulatory Actions in Response to COVID-19</u>

Recognising the impacts of COVID-19 on the economy and financial institutions, the Reserve Bank, in addition to reducing the OCR and initiating LSAP, also took a number of steps to support the ongoing provision of credit to the economy and promote financial stability. These included relaxing a range of regulatory requirements, restricting dividend payments, and placing external-facing regulatory initiatives on hold, to allow entities to dedicate their resources to responding to the pandemic.

Figure 13 - Regulatory Action for Banks in Response to COVID-19

Action	Description	Current status
Dividend restrictions	No dividend payments permitted.	In place until at least 31 March 2021.
Capital instrument repayment	Optional repayment of capital instruments not exercisable.	In place until at least 31 March 2021, although banks may apply to replace instruments with ones of equal or higher value.
Payment deferrals	Concessionary capital treatment for loans on payment deferral.	In place until 31 March 2021.
Core Funding Ratio (CFR)	Minimum reduced from 75 to 50 percent.	Will remain at 50 percent until at least 31 March 2021.
Loan-to-Value Ratio (LVR) limits	Removed on all residential mortgage lending.	Reserve Bank will consult in December on reinstating high-LVR limits from March 2021.
Capital Review	Implementation delayed by one year, to start in July 2021.	Consultation on new framework began in November 2020. Increases to capital levels delayed one further year, to begin in July 2022.

In February 2021, RBNZ reinstated the high LVR limits on residential mortgage lending effective from March 2021, as were applicable prior to their suspension in April 2020.

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 [2]for 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: 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.

The above regulations remain unmodified amidst the outbreak of COVID19.

---

[2] 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 remains the key source of market risk as AFL 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 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 Sep20. The Company's ALM profile at Jan21 remains materially unchanged since Sep20.

Sep20 – 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	Non-Interest Bearing
Cash and Cash Equivalents	1.22%	9,458	9,458	-	-	-	-
Loans and Advances	16.68%	24,405	10,764	7,042	3,562	3,037	-
Total Assets	**12.35%**	**33,863**	**20,223**	**7,042**	**3,562**	**3,037**	**-**
Employee Entitlements	-	107	-	-	-	-	107
Secured Debenture Stock	-	28,577	3,665	4,242	9,017	11,652	-
Accounts Payables	-	246	-	-	-	-	246
Total Liabilities	**5.85%**	**28,930**	**3,665**	**4,242**	**9,017**	**11,652**	**353**
Total	**6.50%**	**4,933**	**16,557**	**2,800**	**(5,456)**	**(8,616)**	**(353)**

Mar20 – 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	Non-Interest Bearing
Cash and Cash Equivalents	1.30%	6,754	6,754	-	-	-	-
Loans and Advances	17.89%	22,766	11,636	4,592	3,816	2,723	-
Total Assets	**14.09%**	**29,520**	**18,390**	**4,592**	**3,816**	**2,723**	**-**
Employee Entitlements	-	119	-	-	-	-	119
Secured Debenture Stock	-	24,272	2,701	3,647	7,104	10,820	-
Accounts Payables	-	242	-	-	-	-	242
Total Liabilities	**6.23%**	**24,633**	**2,701**	**3,647**	**7,104**	**10,820**	**361**
Total	**7.86%**	**4,887**	**15,689**	**944**	**(3,288)**	**(8,097)**	**(361)**

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 falling interest rate environment, the above is negative as interest income from loans falls faster than cost of deposits. The same is also partly evidenced from a 121bps decrease in the weighted average interest rate on loans, compared to only a 38bps decrease in the weighted average interest cost on deposits during 6 months to Sep20. As a result, the net weighted average interest margin contracted to 6.50% (Mar20: 7.86%) at Sep20.

Since the interest rates are expected to remain low for foreseeable future as indicated by RBNZ, we expect the Company's net interest margins to remain under pressure until a major portion of liabilities is repriced to reflect prevailing market rates. Positively, the Company has excess liquidity which was shored up during the 6 months to Sep20, as AFL significantly reduced its lending operations in response to COVID-19. As the above funds get converted into loan assets, we expect it to offset some of the downward pressure on the Company's NIMs.

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.

Sep20 – 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	9,458	9,458	9,458	-	-	-	-
Loans and Advances	24,405	31,894	15,631	8.122	4.549	3,591	-
Total Assets	**33,863**	**41,353**	**25,089**	**8,122**	**4,549**	**3,591**	**-**
Employee Entitlements	107	107	107	-	-	-	-
Secured Debenture Stock	28,577	31,705	4,443	4,911	9,965	12,384	-
Accounts Payables	246	246	246	-	-	-	-
Total Liabilities	**28,930**	**32,058**	**4,796**	**4,911**	**9,965**	**12,384**	**-**
Total	**4,933**	**9,294**	**20,293**	**3,211**	**(5,416)**	**(8,794)**	**-**

Mar20 - 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	6,753	6,753	6,753	-	-	-	-
Loans and Advances	22,766	29,799	16,039	5,663	4,887	3,209	-
Total Assets	**29,523**	**36,553**	**22,793**	**5,663**	**4,887**	**3,209**	**-**
Employee Entitlements	119	119	119	-	-	-	-
Secured Debenture Stock	24,272	27,233	3,418	4,247	8,001	11,566	-
Accounts Payables	242	242	242	-	-	-	-
Total Liabilities	**24,633**	**27,595**	**3,779**	**4,247**	**8,001**	**11,566**	**-**
Total	**4,887**	**8,958**	**19,013**	**1,415**	**(3,113)**	**(8,356)**	**-**

At Sep20, the Company's exposure to liquidity risks remains muted as ~70.0% of its deposits mature later than 12 months and AFL's near-term ALM profile remains favourably matched. As a result, the Company's liquid assets represented 28.0% of total liabilities which was in line with industry median and reflective of AFL's healthy liquidity profile.

Thus, while the Company's ALM profile suitably positions it to withstand liquidity shocks, it can magnify the impact of falling interest rates on its NIMs.

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. With regard to its cash and cash equivalents, AFL 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	$5,000	$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	65.0%	65.0%

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, AFL 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.

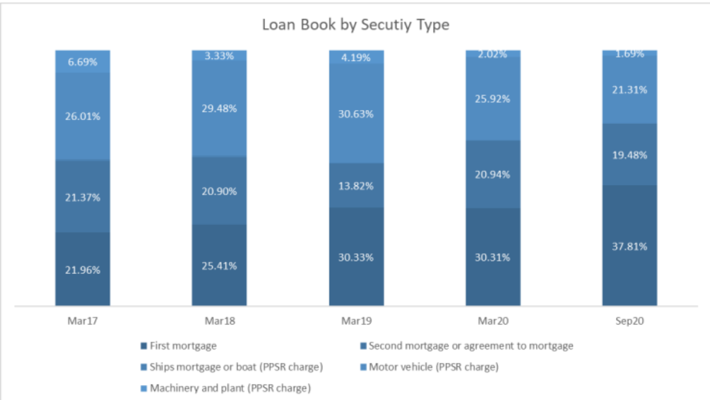
Concentration Risks

AFL's loan portfolio faces moderate concentration risks. At Jan21, AFL's exposure to single borrower was 9.5% (Mar20: 8.5%). Further at Jan21, the top 40 loans represented 58.0% of the total loan book with 20 of them individually representing more than 1.0% of the loan book, thereby making the Company's financial performance susceptible to a deterioration in credit profile of a few borrowers. A substantial portion of AFL's business loan book remains exposed to property and ancillary sectors (approx. one third of the loan-book at Sep20), thereby increasing the vulnerability of its earnings to property market risks. The above risks are partially offset by the skewness of the loans assets towards Auckland, which continues to be New Zealand's economic powerhouse and low exposure of its business book to sectors worst impacted by COVID-19 like hospitality and commercial property. Furthermore, the lending policy of the Company requires all property exposures to be secured by registered caveats or mortgages and the Company advised that LVR on majority of such loans does not exceed 70.0%.

Asset Quality

The Company's loan book at Jan21 comprised a high proportion of asset-backed interest only and capitalising interest short-to-medium term loans. While AFL'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. As a result, the Company's exposure to under-performing and/or non-performing loans has consistently been higher than the industry average over the periods reviewed.

Positively, the change in the ownership during 2018 has prompted a more conservative approach to and an improvement in AFL's underwriting standards. This is evident from an increase in the proportion of loans secured by first and second mortgages to 57.3% at Sep20 (Mar20: 51.2%, Mar19: 44.15% Mar18: 46.31%) and a reduction in the proportion of loans secured against motor vehicles and machinery assets (that generally depreciate faster than the loan amortisation rate) to 23.3% (Mar20: 25.9%, Mar19: 30.3%, Mar18: 29.5%).



Further, post Sep20, the Company has also successfully renegotiated its single major underperforming loan, which is expected to reduce the proportion of impaired loans and provision requirements going forward. The above actions in our view underscore the commitment of the management towards de-risking its loan portfolio while continuing to deliver on its business and growth strategy.

6.3 Structure and Service Delivery Platform

Structure

Asset 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 AFL has 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

AFL 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 business and personal loans backed by collateral. 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 12 months 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
Bryan Heapy	Independent Director	10 May 2005
John Whittfield	Independent Director	1 Feb 2015

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 also 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 Masters 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 Technolgy and an MA from Cambridge University.

Bryan Heapy

Independent Director

Bryan has 25 years' experience in the finance and business banking industry and has held several senior positions in a number of leading financial institutions. These positions have covered a spectrum of roles, including client relationship management, lending, credit, and regional management. These roles have exposed Bryan to a broad range of industry sectors including finance, manufacturing, fishing, tourism, commercial property, vehicle retailing, heavy equipment and civil engineering. In recent years Bryan has been an executive of one of NZ's largest private companies. More recently he has been CEO of Admark Visual Imaging Ltd, a significant printing company; and Manager of Precision Component Machining Ltd, an engineering company based in Hamilton.

John Whittfield

Independent Director

John is currently Managing Director of Corporate Solutions and Management Limited, a company that primarily operates in the field of business recovery. Prior to the formation of this company he was managing partner of McDonald Vague (Auckland) from 2005 -2010 where he had been a partner since 2002. Before taking up the position at McDonald Vague, John had held a significant number of directorships in the dairy industry and had been involved in mergers and acquisitions that lead to the formation of Fonterra. John has also taken directorships to assist and facilitate the sale of assets or amalgamation of trading entities.

6.7 Governance and Oversight

Internal

AFL'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 AFL, monitoring AFL'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 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.

<u>Credit Risk Policy</u>

Identification and analysis of credit risk are 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 polices once formulated are reviewed quarterly and changes if any are ratified by 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 operation 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, 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

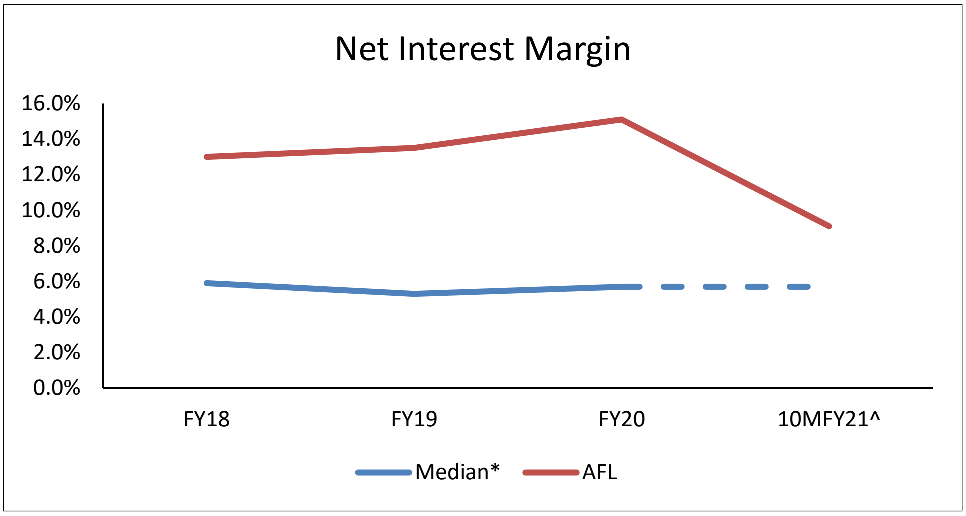
The Trust deed and the prudential norms prescribed by RBNZ are key source of external governance measures which AFL must comply with. The details of the RBNZ's prudential requirements is detailed in section 5 and the table below summarise the AFL's compliance with select requirements of the trust deed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

Ratio	Calculation	Jan-21	Mar-20	Mar-19	Mar-18	Trust deed	Regulatory
Risk weighted capital ratio	Tier 1 capital as a percentage of risk weighted assets	14.7%	14.3%	16.4%	20.0%	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



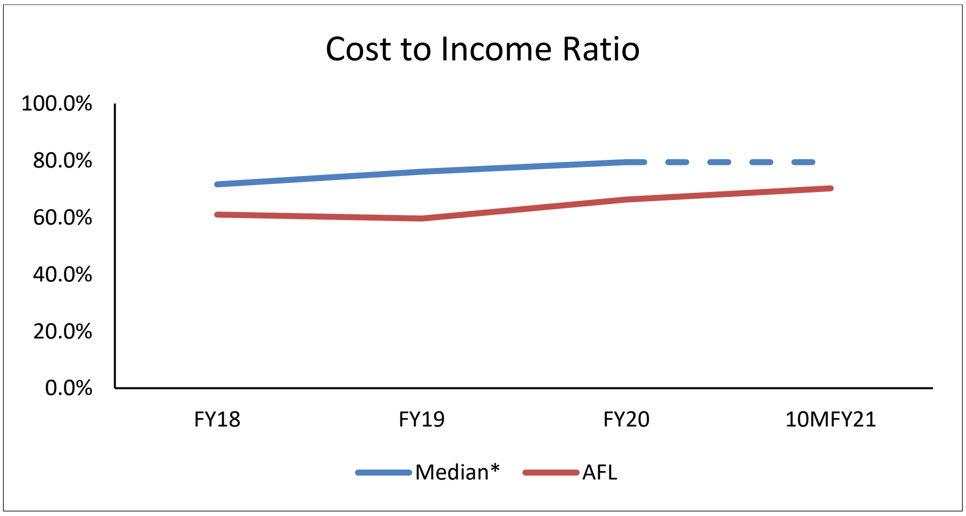
Source: Reported financial statements of Peer Group from FY18 to FY20.

*Median figure for FY20 is based on entities for which financial statements were available at Jan21

^ Annualised

Over the periods to 10MFY21, the Company's annualised net interest margin declined to 9.1% (FY20: 15.1%, FY19: 13.1%). The above decline was due to the recent growth in the loan-book (as income growth generally lags the growth in loans), downward pressure on interest rates and conservative lending policies adopted by AFL in response to COVID-19. The above may also reflect AFL's preference to lend to higher quality borrowers for shorter periods relative to the tenure of its deposits. As a result, the increase in the Company's holding of relative low yielding liquid assets and frequent repricing of its loan portfolio relative to its deposits, magnified the impact of falling interest rates. In comparison to its peers, the Company's NIMs have consistently outperformed, as AFL specialises in offering tailored and customised loans, which unlike traditional forms of loans offered by majority of its peers, carry higher interest rates.

Operating Efficiency

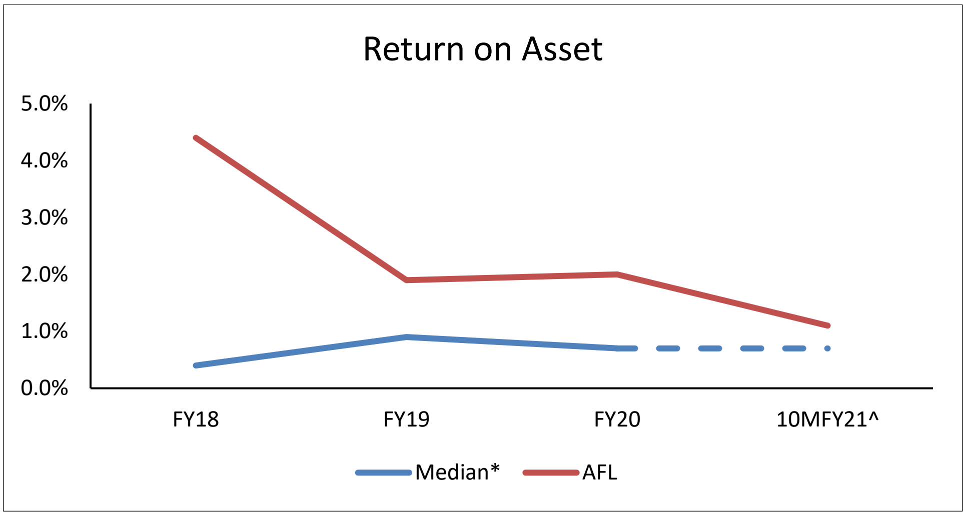


Source: Reported financial statements of Peer Group from FY18 to FY20.

*Median figure for FY20 is based on entities for which financial statements were available at Jan21

The Company's efficiency measured by its cost to income ratio is better than the industry median. AFL's primary operating expense is personnel costs which relates to its team of 19 staff, followed by administrative expenses. Due to the recent increase in scale, AFL's operating expenses have trended upwards, which combined with a downward trend in NIMs described earlier, has led to a slight deterioration in its efficiency ratio over the periods reviewed.

Return on Assets (ROA)



Source: Reported financial statements of Peer Group from FY18 to FY20.

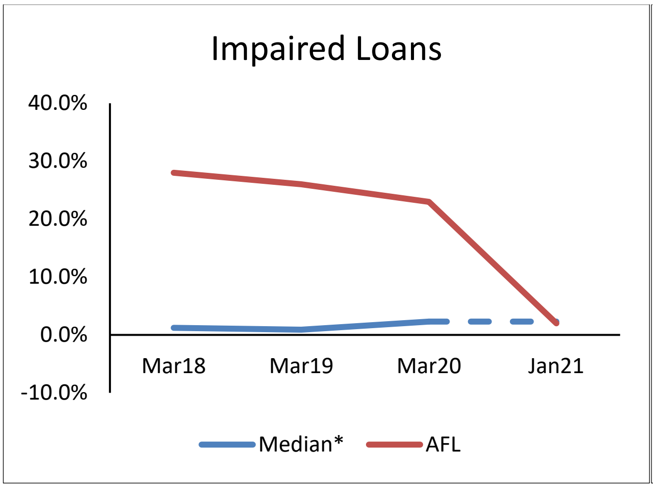
*Median figure for FY20 is based on entities for which financial statements were available at Jan21

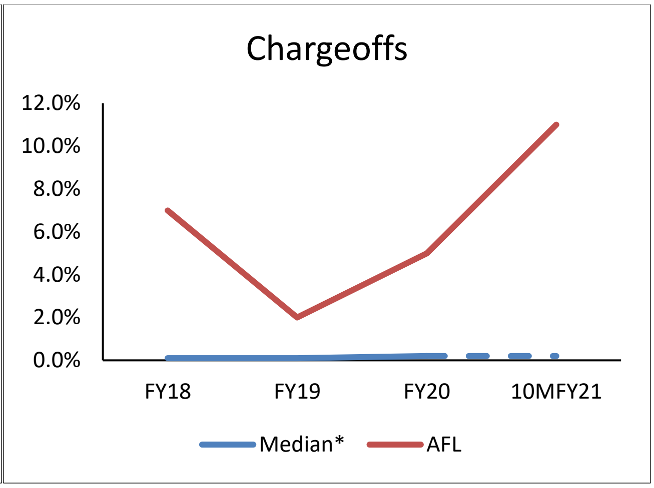
^ Annualised

An increase in credit costs (provisions), downward pressure on NIMS and increasing asset size has led to a decrease in the Company's return on assets (ROA) over the periods reviewed. The Company's total assets increased to $44.7m at Jan21 (Mar19: $29.1m) and its after tax profits remained largely steady (on an annualised basis) at $0.4m for 10MFY21 from $0.5m in FY19. The decline in profit is primarily attributable to declining NIMs for reasons highlighted above. The above worsened the impact of credit costs, which consistently remained elevated over the period under review.

7.2 Asset Quality

Impaired Loans





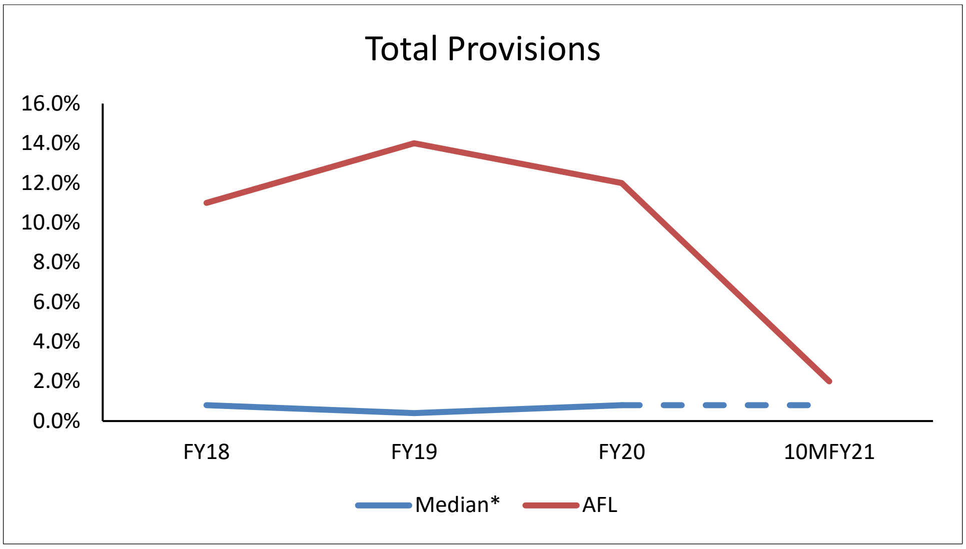
Source: Reported financial statements of Peer Group from FY18 to FY20.

*Median figure for FY20 is based on entities for which financial statements were available at Jan21.

The Company's impaired loans have historically represented more than a fifth of its gross loans over the periods reviewed. AFL indicated that elevated levels of impaired assets were primarily due to relatively aggressive underwriting standards adopted in past by the old 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, AFL has tightened its lending policies and subsequent to Sep20, the abovesaid underperforming loan has been renegotiated into a performing loan with a new counterparty. As a result, barring external shocks and other contingencies, the Company's level of impaired assets is expected to improve going forward and remain in line with levels seen at Jan21.

Due to the impairments as highlighted above, the Company's charge offs also remain elevated relative to its peers. The reversal of accrued interest on the single underperforming loan, upon its renegotiation, contributed to the spike in charge offs during 10MFY21. Positively, adequate provisions made against above interest accruals cushioned the impact on profitability. However, excluding above, we note that recoveries of impaired loans has historically ranged from 1.6% of opening balance to more than 50.0%, indicating average success of recovery measures.

Total Provisions



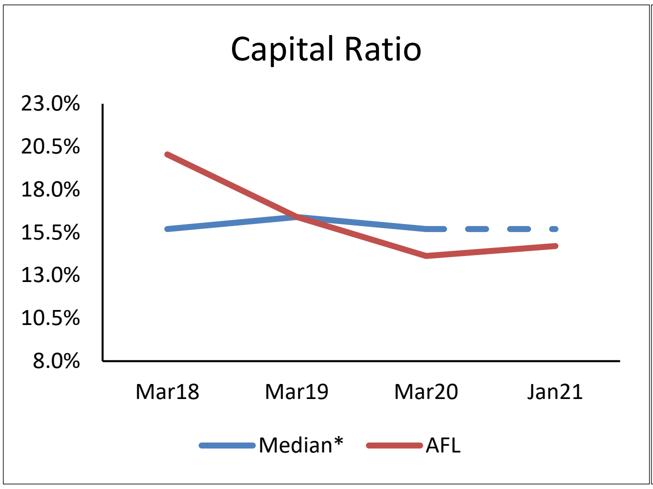
Source: Reported financial statements of Peer Group from FY18 to FY20.

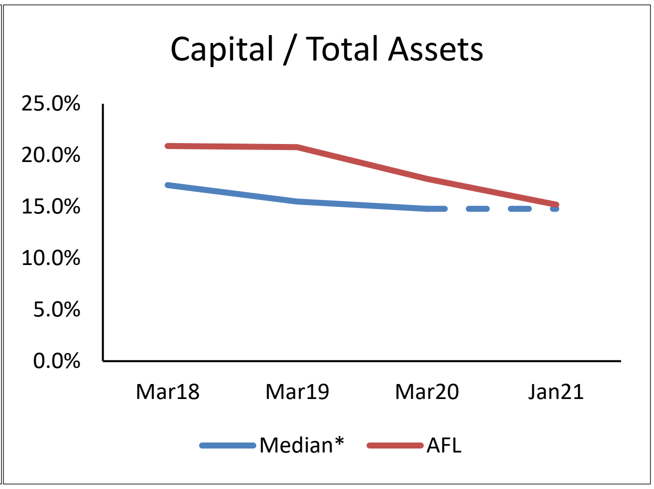
*Median figure for FY20 is based on entities for which financial statements were available at Jan21

The Company's provision for loan impairments has historically represented more than a tenth of its gross loans and ~50.0% of impaired assets over the period reviewed. At Sep20, the Company's total impairment provisions stood at $3.4m (Mar20: $2.7m) comprising primarily provisions made against interest accruals on a single big-ticket underperforming loan, alluded to previously. The provisions also included additional $0.1m towards collective impairment allowance made by the management as part of conservative measures adopted due to the outbreak of COVID-19. Subsequent to 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 at Jan21. In line with its impaired assets, the Company's loan provisions indicator has also consistently lagged industry median over the periods reviewed.

In general, AFL's asset quality metrics are expected to vary to a higher degree than its NBDT peers, reflective of higher credit counterparty/repayment risks that correspond to the high returns on its diversified lending products portfolio.

7.3 Capitalisation



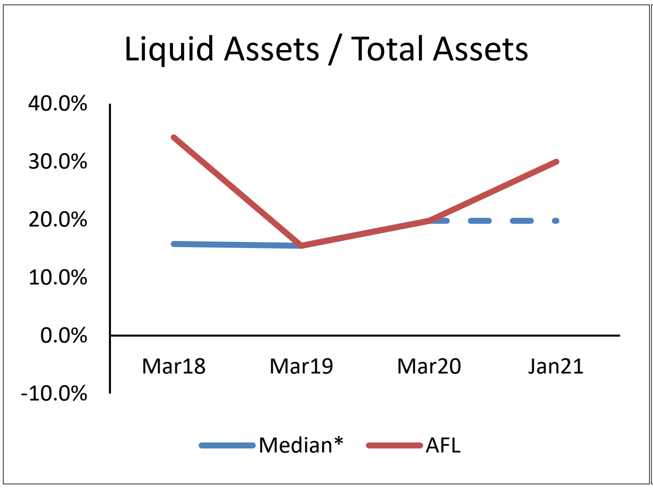


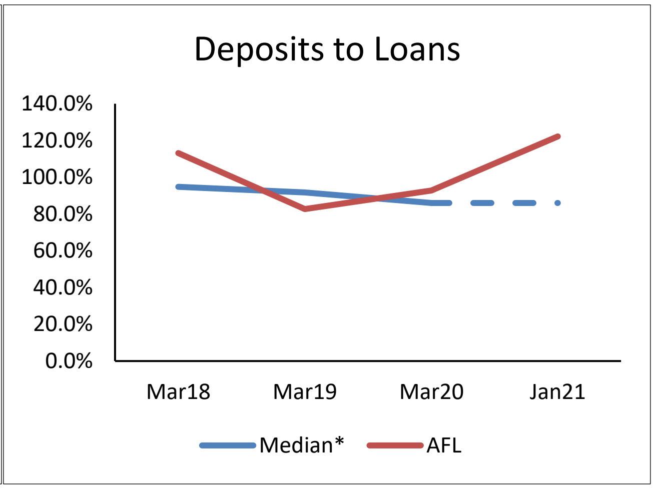
Source: Reported financial statements of Peer Group from FY18 to FY20.

*Median figure for FY20 is based on entities for which financial statements were available at Jan21

The Company's decreasing capital ratio offers limited room for further growth in the loan book, while maintaining some buffer to the capital requirements stipulated by the Debenture Trust Deed and prudential requirements prescribed by RBNZ. Over the periods reviewed the Company's capital ratio has declined to 14.7% (Mar18: 20.1%) at Jan21 which is below the industry median. The reduction in the capital ratio has largely been due to an increase in the Company's loan book to $29.9m at Jan21 from $17.9m at Mar18. The above increase in loan book, pressure on NIMS, asset quality metrics and regular dividend payouts have exerted downward pressure on the Company's capital ratio. Positively, despite the reduction, the capital ratio maintains an adequate 470bps headroom over the minimum requirement of 10.0% stipulated by the Debenture Stock Trust Deed. The Company has some capacity to withstand shocks in the near to medium term, however, its capacity to continually fund growth in the loan book is expected to require a curtailment of dividend payouts and/or capital injection.

7.4 Funding and Liquidity





Source: Reported financial statements of Peer Group from FY18 to FY20.

*Median figure for FY20 is based on entities for which financial statements were available at Jan21

Over the periods reviewed the Company has operated with a sound liquidity position. AFL's liquid assets to total assets ratio has largely remained in-line with (or better than the) industry median. The increase in liquid assets during 10MFY21 was supported by an increase in deposits and conservative lending policies adopted by the Company in response to outbreak of COVID-19. 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 Jan21 (Mar20: $6.6m), representing 30.0% (Mar20: 19.8%) of total assets.

The recent growth in the Company's operations has primarily been funded by consumer term deposits, and there has been no corresponding material increase in its capital. As such, the Company's liquidity profile and capacity to fund operations through raising additional deposits is considered satisfactory, however, it is expected to require a corresponding increase in capital to meet regulatory requirements going forward.

8 Financial Benchmarks

Description	Percentile	CUA	CUB	FCU	FPCU	GBFL	MCFL	SSCUI	WBS	LFT	CSL	NZPFCU	GFL	AFL
Financial Year		2020	2020	2020	2020	2020	2020	2020	2020	2020	2020	2020	2020	2020
Scale:														
Operating income ($ 000s)	79%	2,706	30,881	20,752	382	2,221	2,255	1,433	4,493	2,340	3,903	5,014	1,924	6,559
Total Assets ($ 000s)	43%	22,107	518,775	403,878	4,785	30,691	32,829	31,115	168,405	61,564	221,631	144,441	47,787	34,183
Gross loans ($ 000s)	29%	15,548	349,447	226,184	2,854	27,257	29,281	11,210	127,164	53,386	164,616	42,517	34,965	25,867
Profitability:														
Net Interest Margin (%)	93%	6.6%	7.9%	5.7%	6.9%	6.1%	5.9%	3.9%	2.3%	3.8%	1.8%	4.0%	4.2%	15.1%
Non Interest Income to total operating income (%)	86%	48.6%	-1.5%	37.0%	17.9%	21.7%	17.5%	18.6%	22.3%	0.0%	9.8%	3.1%	27.1%	38.0%
ROE (%)	86%	-5.9%	-0.7%	1.3%	-11.1%	3.2%	9.4%	-0.3%	9.7%	13.1%	5.6%	3.1%	9.2%	10.6%
Return on assets (%)	93%	-0.9%	-0.1%	0.2%	-2.9%	0.8%	1.7%	0.0%	1.2%	1.6%	0.7%	0.6%	1.5%	2.0%
Cost to Income (%)	36%	100.7%	86.8%	85.8%	134.2%	44.0%	52.5%	99.3%	79.4%	31.7%	59.3%	84.7%	71.0%	66.3%
Capitalisation:														
Leverage (Gross loans to Equity) (x)	57%	4.8	6.1	3.7	2.5	3.6	4.8	3.2	5.8	6.7	5.8	1.6	6.0	4.3
Capital ratio - risk adjusted (%)	21%	15.7%	10.4%	15.7%	23.7%	22.0%	13.0%	16.7%	14.3%	20.2%	14.3%	23.3%	19.6%	14.3%
Capital to total assets ratio (%)	64%	14.8%	11.1%	14.9%	23.9%	24.8%	18.6%	11.4%	13.0%	13.0%	12.7%	18.3%	12.2%	17.7%
Funding and Liquidity:														
Gross loans as a % of total assets (%)	71%	70.3%	67.4%	56.0%	59.7%	88.8%	89.2%	36.0%	75.5%	86.7%	74.3%	29.4%	73.2%	75.7%
Deposits to gross loans (%)	21%	114.4%	127.5%	149.2%	120.7%	80.3%	88.9%	242.4%	113.1%	98.7%	116.3%	276.6%	118.6%	93.8%
Liquid assets to total assets (%)	36%	26.2%	28.4%	37.8%	39.0%	9.8%	8.8%	62.9%	17.6%	12.2%	24.0%	67.9%	26.1%	19.8%
Asset Quality:														
Write-offs to gross loans (%)	7%	0.8%	2.5%	0.9%	0.2%	2.1%	1.0%	0.0%	0.2%	0.0%	0.0%	0.0%	0.0%	5.2%
Impaired loans to gross loans (%)	7%	2.9%	2.3%	4.0%	0.9%	0.0%	0.7%	2.5%	2.1%	4.2%	0.0%	0.3%	2.6%	23.4%
Impairment provision to gross loans (%)	7%	2.0%	1.4%	1.3%	0.3%	3.2%	0.4%	1.2%	0.5%	0.8%	0.1%	0.3%	0.3%	12.0%

9 Summary Financial Data

Asset Finance Ltd						
$'000s	Trend	FY17	FY18	FY19	FY20	10MFY21
Income Statement						
Net Interest Income		4,697	4,740	4,655	5,411	4,121
Non Interest Income		3,191	3,340	3,409	4,066	2,730
Operating Income		6,635	6,361	6,073	6,559	4,968
Operating Expense		3,753	3,883	3,619	4,346	3,489
Pre Provision Operating Profit		2,878	2,477	2,466	2,203	1,462
Credit Impairment Charge / (Reversal)		1,498	689	1,720	1,301	935
Operating Profit Before Tax		1,380	1,788	746	902	527
Other non Operating Income / (Expense)		-	-	-	-	-
Net Profit		994	1,287	537	640	377
Financial Position						
Total Assets		29,270	28,828	29,068	34,183	44,744
Customer Deposits		20,647	20,284	19,085	24,272	36,561
Loans		23,213	17,925	23,065	25,867	29,930
Liquid Assets		4,781	9,869	4,492	6,754	13,426
Ratios						
Profit Before Tax to Operating Income Margin (%)		21%	28%	12%	14%	11%
Net Interest Margin (%)*		12%	13%	13%	15%	9%
Cost to Income (%)		57%	61%	60%	66%	70%
Return on Asset (%)*		3%	4%	2%	2%	1%
Return on Equity (%)*		18%	23%	9%	11%	7%
Capital Ratio (%)		14%	20%	16%	14%	15%
Capital to Total Asset Ratio (%)		18%	21%	21%	18%	15%
Leverage Ratio - (Total Loans / Equity) (x)		4.3	3.0	3.8	4.3	4.4
Charges-offs / Total Loans (%)		2%	7%	2%	5%	11%
Neither Impaired or Past Due to Gross Loans (%)		54%	46%	53%	57%	88%
Non - Performing Loans to Gross Loans (%)		19%	30%	29%	26%	5%
Loan Loss Provision / Loans (%)		11%	11%	14%	12%	2%
Deposits to Loans (%)		89%	113%	83%	94%	122%
Liquid Assets to Total Assets (%)		16%	34%	15%	20%	30%

*Annualised

**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 Equivalents (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		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		High
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

http://corporatescorecard.com.au/services_credit_ratings.php

https://www.corporatescorecard.com.au/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, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without Equifax's prior written consent.

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of Equifax Australasia Credit Ratings Pty Ltd [AFSL #341391]. This document is intended to be provided only to 'wholesale clients' within the meaning provided by the Corporations Act 2001. By continuing to access this document from within Australia, you represent to Equifax that you are, or are accessing the document as a representative of, a 'wholesale client' and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to 'retail clients' within the meaning of the Corporations Act 2001. Equifax's credit rating is an opinion as to the creditworthiness of an issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be inappropriate for 'retail clients' to make any investment decision based on Equifax's credit rating, and Equifax recommends you consult with your financial or other professional adviser.

Please refer to http://corporatescorecard.com.au/services_credit_ratings.php for further information and additional regulatory disclosures, including our code of conduct, published ratings, criteria and methodologies.