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Credit Ratings & Research

Credit Rating Synopsis
Xceda Finance Limited

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Credit Rating Synopsis

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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

Corporate Scorecard
From Equifax

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1 Credit Rating Synopsis

Xceda Finance Limited ('Xceda' 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 offer loans to public. Xceda offers term deposit accounts and lending products including personal, business and property loans.

Equifax Credit Ratings Australasia Pty Ltd ('Equifax') has affirmed XFL's credit rating of 'B' at Mar23, which is a sub-prime classification with a moderate level of risk. No outlook is assigned as the rating is currently on a 'Credit Watch – Evolving' classification on account of anticipated resolution of a historical loan account in the near-term.

XFL's credit rating is supported by its incumbent market position in the New Zealand NBDT industry, positive overhaul of business and operating strategies including steps towards expansion of product offerings, sound liquidity profile commensurate with its size, healthy capital adequacy levels and improving asset quality metrics and potential benefits to its ability to attract deposits by the new Deposit Takers Act. The risks to the XFL's credit rating arise from the current macroeconomic environment, relatively small scale when compared to the overall banking sector, a high proportion of non-amortizing loans and limited product offerings.

Strengths

- The Company has a healthy and improving incumbent market position in the niche secured consumer and commercial lending segments underserved by traditional banks. This is evident from the recent growth in the deposits and loan book underpinned by a relatively sticky borrower and depositor base supported by a credit positive overhaul of its business and underwriting strategies detailed below.

- The Company's overhauled business and operating strategies augur well for its credit profile on forward looking basis. Various management initiatives such as tightened underwriting standards, increased proportion of first mortgages in the asset mix, rebranding, skilled managerial recruitments from the banking industry and plans to offer housing mortgages and savings accounts in the near term favourably position the Company to grow and sustain its improving asset quality metrics amidst macro-economic headwinds detailed below. The Company's cost to income ratio continues to decline, evidencing the benefits of investments made in staff, systems and processes in the previous financial year.

- XFL's liquidity position is deemed sound, supported by healthy retail deposit reinvestment rates, liquid assets to total liabilities ratio of 13.0% at Aug23, 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 (98.0% of the loan book at Aug23).

- The Company continues to maintain sound capital adequacy levels, with a capital ratio of 15.17% at Aug23 (Mar23: 15.4%) which is above the minimum Trust Deed requirement of 10.0% and adequately supports the expected growth in the loan book in the near-term.

- The newly enacted Deposit Takers Act ('DTA'), which received Royal Assent on 6 July 2023, aims to place all deposit takers under one prudential framework and introduce a depositor compensation scheme. The proposed changes under DTA, though evolving and to be progressively introduced until 2028 with industry consultation, 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 likely to face the impact of inflation pressures, which remain elevated due to the evolving geo-political landscape and high energy costs. Higher interest rates weighing on debt servicing levels and property prices are also likely to impact the industry participants with coincidence of higher NPLs and reduction in collateral coverage.

- High proportion of non-amortising loans remain a source of risk. Notwithstanding the Company's improving asset quality metrics, the loan book remains relatively small when compared to the overall banking sector and hence underperformance of one or more loan accounts, similar to a single loan representing 4.3% of loan book at Aug23 that recently turned non-performing, may disproportionately impact the Company's profitability, liquidity and/or capital metrics. Positively, we note that the aforementioned loan remains well-collateralised, and the Company is actively pursuing various strategies to address issues/risks identified in addition to diversifying its loan book.

- 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 to support near term growth.

- 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 non-bank lenders represents an ongoing risk, in our view.

Risk Rating

B

Credit Watch - Evolving

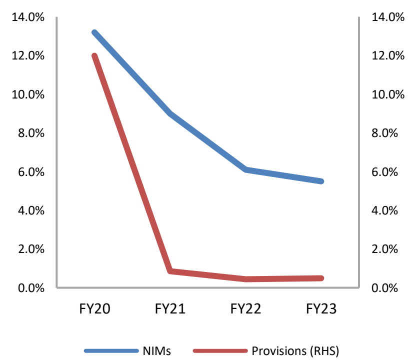
Public, Under ongoing monitoring

Industry Percentiles

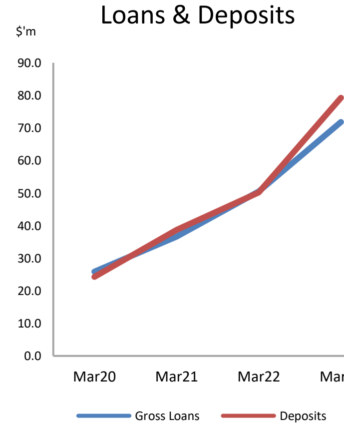
Scale:	
Total Assets	47%
Gross loans	53%
Profitability:	
NIM	60%
ROE	67%
ROA	73%
Efficiency Ratio	53%
Capitalisation:	
Leverage (Gross Loans to Equity)	13%
Capital Ratio	53%
Capital to Total Assets	13%
Funding and Liquidity:	
Deposits to Loan Ratio	47%
Liquid Assets to Total Assets	40%
Asset Quality:	
Net Charge-offs	13%
Impaired Loans	7%
Provision for Loan Losses	60%

Key Trends

Net Interest Margins (NIMs) and Provisions(RHS)



Loans & Deposits



2 Scope of Report

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

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

Report Details	
Date of Report	**15 November 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**

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	**Audited Financial Statements for the years ended 31 March 2023, 2022, and 2021. Management Accounts for the five-month interim period to Aug23.**
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 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

https://www.corporatescorecard.co.nz/services_credit_ratings.php

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

Additional indicators used are computed as follows:

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

2. Regulatory Disclosures and Disclaimer

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

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

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

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

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