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Grindrod Bank Limited

South Africa Bank Analysis **April 2016**

Rating class	Rating scale	Rating	Rating outlook	Review date
Long-term	National	BBB+$_{(ZA)}$	Stable	April 2017
Short-term	National	A2$_{(ZA)}$		
Long-term	International LC	BB	Stable	April 2017

Financial data:

(USDm comparative)

	31/12/14	31/12/15
R/USD (avg.)	10.84	15.21
R/USD (close)	11.60	15.57
Total assets	797.9	721.3
Primary capital	59.4	53.2
Secondary capital	0.8	1.2
Net advances	341.2	300.1
Liquid assets	432.9	400.1
Operating income	27.7	22.7
Profit after tax	9.7	8.0
Market cap. ‡	R8.9bn/USD607.3m	
Market share†	0.2%	

‡ Grindrod Limited Johannesburg Stock Exchange ("JSE") listing (14 April 2016, R/USD 14.62).
† As a percentage of banking sector assets at 31 December 2015 (per BA900s).

Rating history:

Initial/last rating (not applicable)
Long-term: first time/new rating
Short-term: first time/new rating
Rating outlook: first time/new rating

Long-term (International LC): First time/new rating
Rating outlook: first time/new rating

Related methodologies/research:

Global Criteria for Rating Banks and Other Financial Institutions, updated March 2016

South Africa Bank Statistical Bulletin (December 2015)

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Summary rating rationale

- The ratings reflect Grindrod Bank Limited's ("Grindrod Bank" or "the bank") established and streamlined business model (offering niche banking products and services to private, corporate and institutional clients in South Africa), its sound standalone financial profile, and demonstrated financial support from its parent (Grindrod Limited). The bank's risk appropriate capitalisation, conservative risk appetite, sound asset quality, and resilient profitability, mitigate to an extent its structural reliance on confidence-sensitive wholesale funding.
- The bank is a subsidiary (96.6%) of Grindrod Limited ("the group"), an established freight, shipping and financial services group with operations in South Africa, Africa and Asia. The group had a consolidated capital base of R19.1bn and assets of R40.5bn at FYE15.
- Grindrod Limited has supported the bank's R1bn Domestic Medium Term Note ("DMTN") Programme launched in October 2012 and has issued an irrevocable and unconditional guarantee (as primary obligor and not merely as surety) on issued notes, demonstrating strong financial support. At FYE15, issued notes (R160m) under the DMTN Programme contributed 1.4% (FYE14: 5.5%) of the bank's total funding liabilities (including equity). The guarantee permits creditors to press claims against the guarantor in the event of default. Furthermore, implicit linkages with the parent, such as shared corporate identity, common management (ie, board membership) and intercompany loans/deposits (insignificant at 3.4% of total loans and 0.6% of total deposits at FYE15), were also favourably considered.
- The bank's total qualifying/regulatory capital and reserves grew by 21.3% (FYE14: 17.5%) to R847m at FYE15, mainly due to earnings retention (R100m) and growth in preference share capital (R40m). The bank reported a total risk weighted capital adequacy ratio ("CAR") of 13.5% at FYE15 (FYE14: 13.0%). The CAR was well above the statutory minimum of 10.25%, calculated in line with Basel III capital requirements, as currently applicable in South Africa.
- Asset quality remains sound, notwithstanding an increase (25%) in non-performing loans ("NPLs") in F15 (albeit from a very low base), on the back of a challenging economic environment. The gross NPL ratio increased slightly to 2.1% at FYE15 (FYE14: 2.0%), although partly masked by the 18.2% (FYE14: 18.3%) loan growth. The gross NPL ratio compared favourably to the domestic banking industry average of 3.1% at end-2015. Specific provisions covered 11.1% of NPLs at FYE15 (FYE14: 7.5%), pre-collateral. Provisions plus collateral fully cover arrears. The ratio of NPLs net of provisions to the bank's capital amounted to 8.4% at FYE15 (FYE14: 8.7%). Note is taken of South Africa's deteriorating corporate environment, rising interest rate cycle, and subdued global markets, which will continue to negatively affect the bank's asset quality despite its select clientele and highly collateralised loan book.
- Earnings before tax grew by 12.5% to R142.7m in F15 (F14: 13.6%) supported by credit growth and improved net interest margin despite a rise (155%) in loan impairment charges. Overall, the bank's ROaE and ROaA stood at 20.2% (F14: 20.3%) and 1.2% (F14: 1.1%) respectively for F15.
- Although the structural makeup of the group's funding base remains an issue due to the wholesale nature and short maturity structure, direct funding and liquidity risks are partly ameliorated by the high coverage of short dated liabilities by liquid assets at 60.7% as at FYE15 (FYE14: 58%). Furthermore, the bank's loan to deposit ratio remains conservatively low at 46.8% at FYE15 (FYE14: 50.6%).

Factors that could trigger a rating action may include

Positive change: Evidence of healthy and stable financial metrics through the economic cycle, an improved funding structure (term/diversification), and an enhanced market position and support structure, could lead to upward ratings migration.

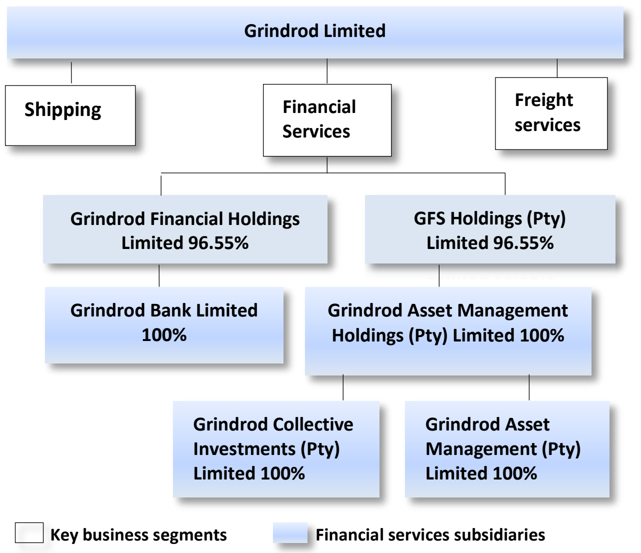
Negative change: A significant deterioration in the bank's profitability, asset quality, and liquidity and capital ratios associated with a highly challenging and volatile operating environment and weak credit administration and/or weakening support factors could see ratings come under pressure.

Organisational profile

Business summary

Grindrod Limited is a South African based company, offering products and services through its subsidiaries, joint ventures and associates in three key business segments ie, freight services, shipping and financial services (encompassing Grindrod Bank and Grindrod Asset Management Holdings (Pty) Limited, although the asset management's contribution is small). Grindrod Limited is listed on the JSE, providing access to the equity market. In 2014, the group successfully raised equity capital of R4bn for planned infrastructure expansion (mainly on African continent) over the next few years.

Figure 1: Group structure

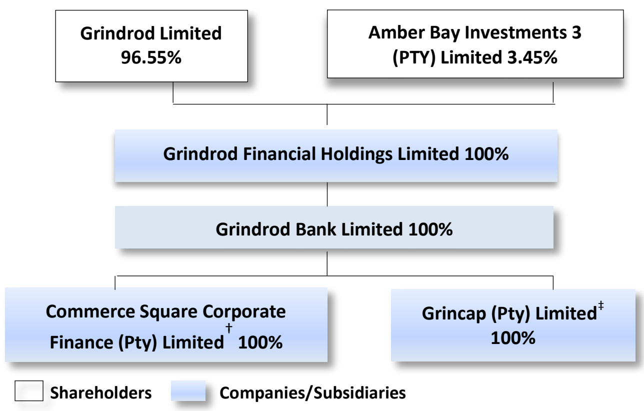


Grindrod Bank's roots can be traced back to 1994 when it was granted a banking licence by the South African Reserve Bank ("SARB"). The bank is headquartered in Durban, South Africa and has offices in Johannesburg, Cape Town and Pretoria. The bank contributed 27.7% of the group's consolidated assets at FYE15 (FYE14: 32.3%).

Ownership structure

The bank's ownership structure (and subsidiaries) is depicted in Figure 2.

Figure 2: Bank ownership structure and subsidiaries



† The company facilitates adhoc corporate finance deals from time to time.

‡ Preference share issuing vehicle. The company raises preference share funding from retail and institutional investors with a view to investing the raised funds in dividend yielding investments.

The bank's subsidiaries contributed 7.7% of the bank's consolidated assets at FYE15. A breakdown of Grindrod Limited's key shareholders at 31 December 2015 is shown in Table 1.

Table 1: Grindrod Limited – Top 10 shareholders	%
Remgro Limited (Remgro)	22.7
Grindrod Investments	9.7
Government Employee Pension Fund	9.5
Newshelf 1279	8.4
Dimensional Fund Advisors	2.4
Old Mutual	2.4
Sanlam	2.2
PSG Konsult	2.1
Vanguard	1.7
Liberty Group	1.4
Other	37.6
Total	**100.0**

Source: Grindrod Bank.

Remgro is a JSE listed investment holding company with diverse interests in food, liquor, home care, banking, healthcare, infrastructure and industrial businesses. Remgro's intrinsic NAV was R146.7bn at 31 December 2015. Furthermore, Remgro held cash amounting to R4.1bn and minimal debt of R3.4bn at 31 December 2015. Remgro operates a decentralised business model with its involvement in subsidiaries/ investments concentrated on the provision of strategic, financial and managerial support.

Group financial profile

Table 2 provides a summary of the group's financial position at FYE15.

Table 2: Summary group financials (Rm)	F14	F15
Revenue	28 760	27 995
Profit attributable to ordinary shareholders	1 001	(1 426)
Total capital	17 490	19 149
Total assets	37 364	40 529

Source: AFS.

Earnings performance in F15 was impacted by the weaker global environment, lower commodity prices, as well as weak domestic growth. Consequently, the R1.4bn loss was mainly as a result of the impairments to the ship carrying values, mineral logistics and rail businesses in F15.

Table 3: Attributable income by division (Rm)	F14	F15
Freight Services	613	(109)
Shipping	224	(1 496)
Financial Services	112	165
Group	52	14
Total	1 001	(1 426)

Source: AFS.

Strategy and operations

Grindrod Bank distinguishes itself as a relationship bank offering a personalised approach to financial services to private, corporate and institutional clients. The bank's main operating business units are shown in Table 4.

Table 4: Key business units	
Business unit	**Products and services**
Corporate lending	Invoice discounting; Corporate lending; Commercial and industrial finance; Property; and Mezzanine property finance.
Retail	Payments systems participation; White label card issuing; and SASSA† /Net1 retail deposit management.
Treasury	Deposit raising; DMTN issuance; and Surplus liquidity management.
Corporate finance	Advisory services; Mergers and acquisitions; Sponsor and designated advisor; and, Capital raising.
Capital markets	EFTs/ETNs management and Preference share fund management.

† Grindrod Bank provides banking services for the South African Social Security Agency (SASSA) grant recipients, paying 20.9m grants to 9.77 million distinct cardholders amounting to R9.5bn per month in close association with Cash Paymaster Services (CPS) who provide the card technology and manage the card programme on behalf of the government of South Africa. Each grant recipient has a Grindrod Bank account which provides full access to traditional banking services such as ATM's, EFTs and POS transactions.

Source: Grindrod Bank.

Governance structure[1]

Corporate governance is guided by the Code and Report on Governance Principles for South Africa (King III), relevant bank statutes and JSE listing requirements.

Grindrod Bank's current directorate comprises two executive and six non-executive (with the majority being independent) directors. A comprehensive board charter is in place to guide the conduct of the board of directors ("board"). The board chairman is also the Chief Executive Officer of Grindrod Limited. Although, the chairman does not fulfil the strict criteria of "independence" as set out in King III, the board is of the view that the board chairman's experience and intimate knowledge of the business and the economy equip him best to lead the board and group. In addition, the duties of the chief executive officer and the non-executive board chairman have been separated (in line with the board charter) so that no single individual (and/or minority group) has unfettered control over any part of the decision making process. The board has sufficient independent non-executive directors to ensure the necessary objectivity essential for its effective functioning. All the subsidiaries and associate boards include representatives from the group board. The bank has also recently appointed two additional members to the bank's board (ie, a representative from Remgro and the Head of Finance), subject to SARB approval.

The bank's board has delegated some of its responsibilities to various board committees, namely: Audit and Compliance; Credit Risk; Directors Affairs; Remuneration; Risk and Capital Management; and, Asset and Liability ("ALCO").

Risk management

The board is responsible for risk management processes and discharges its duties through the Risk Management Framework in place which reviews identified and new/emerging risks, and is supported by continuously updated operational risk registers (which identify the risks impacting each division). The effectiveness of the risk framework is reviewed by an independent internal audit function.

Operating environment

Economic overview

South Africa's 2015 real GDP growth moderated to 1.3% (2014: 1.5%). Continued labour unrest and energy constraints contributed to lower productivity and rising inflationary pressures. The Rand traded weaker against major currencies in 2015, closing at R15.57/USD at end-2015 (end-2014: R11.60/USD), exacerbating inflationary pressures for most of 2015. With its foremost focus on inflation targeting, the SARB raised the repo rate by a cumulative 50bps in 2015, and by 50bps in January 2016 and a further 25bps in March 2016, in response to the 2015 estimated official inflation rate of 4.6% and 2016 forecast rate of 6.8% (exceeding the South African Reserve Bank ("SARB") target range of 3-6%). While lower oil prices offered some respite in 2015, the Rand has remained weak, and was dealt a further blow following a shuffle in the Finance Ministry during December 2015.

Several factors continue to weigh on South Africa's economic growth prospects, including a weak global economic climate, low commodity prices, a rising interest rate cycle, volatile labour relations, a severe drought, low investment and business confidence, and increasing polarisation of socio-political sentiment. The impact of higher indirect taxes, coupled with a weak Rand and other aspects of the relatively austere 2015 and 2016 national budgets are expected to place further downward pressure on disposable incomes. Given the continued economic challenges being faced, the SARB's real GDP growth projections for 2016 have been revised down to 0.9% (from 1.5% in the September Monetary Policy Committee statement). Actual performance in 2015 was an extension of 2014's challenges, in both the corporate and consumer environments. In light of the above, South Africa faces the risk of a sovereign rating downgrade to non-investment grade.

2015 corporate sector performance has amplified concerns regarding the health/prospects of selected sectors. The most pervasive challenges remain the cost/availability of electricity, potential labour force instability, and weak consumer demand (which is impacting pricing even in more buoyant sectors). The services sector posted modest, positive real growth in 2014 and up to December 2015, with the finance sector making the most compelling contribution.

Consumer spending and household income growth slowed in 2015, remaining at historically low levels. Persistent high unemployment levels, lustreless consumer confidence, and modest lending growth support the *status quo*. While debt to disposable income levels (a debt affordability proxy) trended

[1] Given the intricacies associated with good corporate governance, GCR recommends an independent assessment to test compliance.

downward in 2014, they were erratic during 2015, culminating in a downward trend in the last quarter. Growth in households' financial liabilities combined with a slower appreciation in the value of housing stock and equity holdings contributed to a moderation in household net wealth growth in 3Q 2015.

Banking sector overview

Despite the challenging operating environment, characterised by weak global and domestic macroeconomic conditions and more onerous regulatory requirements, the South African banking sector remained resilient, reporting 21.1% growth in profitability for the 12-months to 31 December 2015, attesting to banks' robust risk management structures, diversified revenue streams and established franchises.

South Africa's banking landscape is highly concentrated, with the top four banks commanding 82% of total industry assets at 31 December 2015. Grindrod's asset market share at that date was 0.2%. The top five banks (Barclays, FirstRand, Nedbank, Standard Bank and Investec) are considered to be systemically important, although smaller banks may also have a systemic impact if they are highly exposed to consumers, particularly on the deposit-taking side. The industry comprises 17 registered commercial banks, 15 local branches of foreign banks, 5 mutual/cooperative banks as well as 39 representative offices. After having been placed under curatorship in 2014, the SARB granted approval to African Bank Limited to set up a new bank with its remaining good assets.

A major change for banks as a result of Basel III is the introduction of two minimum standards for liquidity and funding. The Liquidity Coverage Ratio ("LCR"), which became effective on 1 January 2015, is designed to ensure that banks can withstand an acute stress scenario, and requires banks to hold stocks of high quality, liquid assets to cover net outflows over a period of 30 days. Banks are required to maintain an LCR of at least 60% during 2015, increasing by equal annual increments of 10% to reach 100% by 1 January 2019. The Net Stable Funding Ratio ("NSFR"), which comes into effect on 1 January 2018, requires banks to utilise a minimum quantum of stable sources of funding relative to the liquidity profile of assets and off-balance sheet commitments. These regulatory requirements have seen banks accumulate more liquid assets (which typically yield low interest rates) and lengthen the tenor of their funding profiles, which has placed pressure on margins, while liquidity and funding costs have risen. Furthermore, the effect of higher capital requirements being phased in under Basel III has continued to influence regulatory capital levels. The sector's total capital adequacy ratio decreased against the comparable period to 14.1% (2014: 14.8%), but remained well above the minimum regulatory capital level.

Gross loans and advances grew by 11.3% for the 12-months to 31 December 2015, mainly driven by corporate and investment banking demand. The level of impaired advances increased by 7% year-on-year (reversing a four-year downward trend), which points to the economic challenges being faced.

Prospects for domestic banks largely depend on innovation and proactive risk management in order to mitigate the headwinds that are likely to persist in 2016.

Financial Reporting

Grindrod's financial statements are prepared in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa. Deloitte & Touche, the bank's external auditor, issued an unqualified opinion for the F15 financial statements.

Financial profile

Likelihood of support

Although the South African government has demonstrated its position as interventionist, this must be viewed as a systemic protection mechanism only.

Therefore state-sponsored (financial) intervention is considered remote and shareholder support is viewed as the only reasonable alternative. Shareholders have demonstrated support for the bank, underwriting all capital/fund raising initiatives.

Funding composition

A breakdown of the bank's funding profile is shown in Table 5. Operations are predominantly funded by customer deposits, augmented by equity. Capital market funding has also provided an additional source of funding, accounting for 2.3% of total funding at FYE15. Total funding grew by 21.8% to R11.1bn at FYE15, mainly driven by growth in customer deposits.

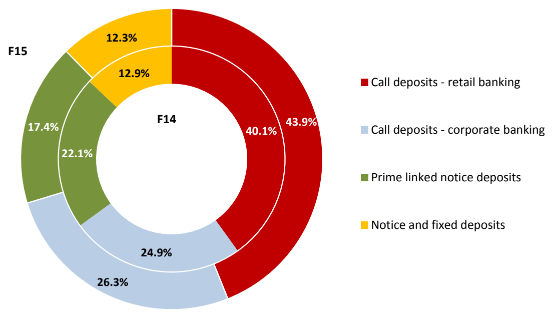
Table 5: Funding profile by source	**F14 Rm**		**F15 Rm**	**%**
Customer deposits	7 823	85.4	9 992	89.7
Call deposits - retail banking	*3 137*	*34.2*	*4 390*	*39.4*
Call deposits - corporate	*1 946*	*21.2*	*2 632*	*23.6*
Prime linked notice deposits	*1 727*	*18.9*	*1 741*	*15.7*
Notice and fixed deposits	*1 013*	*11.1*	*1 229*	*11.0*
Capital/Money market funding	592	6.5	259	2.3
Bond issue†	*500*	*5.5*	*160*	*1.4*
Preference shares	*92*	*1.0*	*99*	*0.9*
Other (accrued interest)	44	0.4	50	0.4
Equity	701	7.7	836	7.6
Total	**9 160**	**100.0**	**11 137**	**100.0**

† JSE listed 3 year bond maturing on 15 October 2018. Interest is payable quarterly and is linked to the three month JIBAR rate plus a spread of 2.20%.

Source: AFS.

The majority of deposits are in the form of call deposits sourced from retail (43.9%) and corporate (26.3%) clients. Prime linked notice deposits and notice and fixed deposits contributed 17.4% and 12.3% of customer deposits at FYE15, respectively. The deposit base is fairly diversified, though the dependence on expensive wholesale funding vis-à-vis cheaper and more stable retail deposits makes the bank vulnerable to changes in investor sentiment.

Figure 3: Customer deposits profile

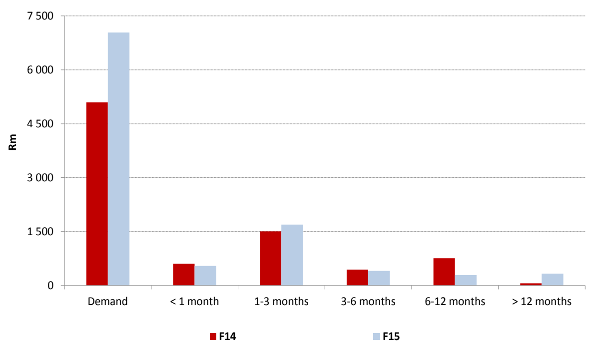


The single largest depositor and top 20 depositors accounted for 1.8% and 14.4% of total deposits at FYE15. Deposits from related parties (the group, bank subsidiaries and directors) constituted a small 0.1% of customer deposits at FYE15 (FYE14: 0.1%).

Bond issue
On 15 October 2012, the bank issued R500m (Tranche 1, Series 1) in senior unsecured floating rate notes ("the notes") under its R1bn DMTN Programme. The JSE-listed 3 year notes matured in October 2015. On 15 October 2015, R160m of the notes were rolled over and with an expiry date of 15 October 2018 (Tranche 1, Series 2). Interest is payable quarterly and is linked to the three month JIBAR rate plus a spread of 2.2% (originally 1.8%). Grindrod Limited (the parent) issued an irrevocable and unconditional guarantee (as primary obligor and not merely as surety) to the noteholders. The guarantee permits creditors to press claims against the guarantor in the event of default. The notes contributed 1.4% of the bank's total funding liabilities (including equity) at FYE15 (FYE14: 5.5%). Management advised that, note issues are also subject to acceptable interest rates and market conditions.

Funding maturity profile
The liability funding pool has a particularly short duration profile, both at origination and remaining contractual maturity. Consequently, the resultant term and cash flow mismatch may leave an operational gap.

Figure 4: Funding maturity profile (excluding equity)



Fixed and notice deposits and debt funding have to some extent helped lengthen the maturity profile. In addition to diversification of funding sources, management plans to reduce structural volatility in the deposit book by extending term and restricting and monitoring large deposits.

Liquidity risk
The bank's asset/liability structure reflects a significant amount of liquidity risk, mainly due to a reliance on short-dated wholesale funding to fund longer dated loans and advances. Near-term liquidity concerns and funding volatility are to some extent also offset by the high cash cover, with the liquid assets (excluding statutory reserves required to be held at SARB) amounting to 60.3% (FYE14: 53.8%) of short-term liability funding (excluding equity) at FYE15. The ratio of net advances/total funding (including borrowings but excluding equity) amounted to 45.4% at FYE15. GCR considers an advances/deposits ratio above 80% to be a pressure point.

Day-to-day funding is actively managed, with cash flow measurement and projections conducted for the next day, week and month, and by ensuring that term deposits are rolled over at maturity. Furthermore, the bank's prudent liquidity risk management policy, limits, processes and oversight through regular reporting and ALCO meetings, mitigate these risks to a significant extent, as do various liquidity buffers maintained. The bank's contingency funding plan and sources, stress triggers and remediation plans were are well-documented ALCO reports.

Market risk
Market risk is largely confined to interest rate risk. The short-dated funding vis-à-vis longer dated assets heighten repricing risk in a rising interest rate environment. To mitigate repricing risk, the majority of lending is on a variable interest rate basis. Furthermore, whenever fixed rate loans are issued, the bank enters into interest rate swap agreements with counterparties in line with internal policy guidelines. Equally, most of the bank's liabilities reprice on demand with prime or jibar thus limiting repricing risk. The interest rate re-pricing gap is reported on and monitored monthly, and discussed in ALCO meetings. The bank does not have a foreign currency license consequently loans and deposits are in local currency.

Capital adequacy
Core (total Tier 1) capital grew by 20.3% to R829m at FYE15 (FYE14: 17.6%). The majority of this growth was achieved through the retention of residual earnings and preference shares issued. Accordingly, total regulatory capital grew by 21.3% at FYE15 (FYE14: 17.5%). Risk weighted assets grew by 16.7% at FYE15 (FYE14: 180%). The regulatory capital adequacy ratios remain well above regulatory minima. Table 6 represents a comparative of the bank's regulatory capital base and its risk adjusted assets.

Table 6: Capitalisation	F14 Rm	F15 Rm	% growth
Common equity tier 1 capital	544	644	18.4
Additional tier 1 capital (Pref. shares)†	145	185	27.6
Total tier 1 capital	**689**	**829**	**20.0**
Tier 2 capital	9	18	100.0
Total regulatory capital	**698**	**847**	**21.3**
Total risk weighted assets ("TRWA")	5 356	6 253	16.7
Key capitalisation ratios (%)			
Common equity tier 1 ratio	10.2	10.3	2.0
Tier 1 ratio (minimum - 7.0%)	12.9	13.3	3.1
Total capital ratio (minimum - 10.25%)	13.0	13.5	3.8

† Non-cumulative, non-redeemable, non-participating, non-convertible no par value preference shares.
Source: AFS.

Operational profile

Asset composition

Total assets grew by 21.3% to R11.bn at FYE15 (FYE14: 0.9% decrease) in line with the growth in funding liabilities. According to BA900 data[2] the YoY banking sector average asset growth was 14.7% over the same period.

Table 7: Asset composition	F14		F15	
	Rm	%	Rm	%
Cash and liquid assets	5 022	54.3	6 229	55.5
Cash and balances with SARB†	*529*	*5.7*	*753*	*6.7*
Interbank placements	*3 451*	*37.3*	*4 365*	*38.9*
Interbank current accounts	*52*	*0.6*	*46*	*0.4*
Money market investments	*467*	*5.0*	*472*	*4.2*
Treasury bills, SARB debentures	*330*	*3.6*	*566*	*5.0*
Marketable/trading securities	*193*	*2.1*	*28*	*0.2*
Loans and advances	3 958	42.8	4 672	41.6
Investment in subsidiaries	<1	<0.1	< 1	<0.1
Other investments (shares)	<1	<0.1	< 1	<0.1
Derivative instruments	-	-	3	< 0.1
Fixed assets	11	0.1	11	0.1
Other assets	265	2.8	314	2.8
Total	**9 256**	**100.0**	**11 231**	**100.0**

† Includes mandatory cash reserve deposits with the central bank not available for the bank's daily operations of R173m (F14: R150m).
Source: AFS.

The bulk of the credit risk exposure emanates from the loan portfolio and interbank placements constituting 41.6% and 38.9% of on-balance sheet assets at FYE15, respectively. Government securities, cash on hand and central bank balances, which are considered risk free, comprised 11.7% (FYE14: 9.3%) of total assets. Government securities are in the form of treasury bills and bonds issued by the SARB. Balances/placements with other banks are with local banks, which have strong credit ratings and are considered low risk. The bank assesses credit and counterparty risk and has set exposure limits for each counterparty.

A small portion of the bank's credit risk exposures were also held off-balance sheet. Contingent liabilities amounted to 1.7% of total on- and off-balance sheet assets at FYE15 (as in the previous year). Irrevocable unutilised facilities formed the bulk (76%) of the off-balance sheet exposure. The majority of financial guarantees relate to property loans which are paid out on transfer. This is in line with the bank's general marketing strategy targeting small to medium sized entities and high net worth individuals. Property is held as collateral for most property guarantees and cash in some instances.

Table 8: Contingencies	F14		F15	
	Rm	%	Rm	%
Financial guarantees	15	9.3	47	23.9
Irrevocable unutilised facilities	146	90.7	150	76.1
Total	**161**	**100.0**	**197**	**100.0**

Source: AFS.

Loan portfolio

Lending is mainly to corporates and close corporations making up 73.5% at FYE15 (FYE14: 75.3%), while loans to households were 2.4% (FYE14: 3.0%) of the book with the balance classified as loans to unincorporated businesses, preference shares and other.

Table 9: Gross loans and advances by counterparty	F14 Rm	%	F15 Rm	%
Companies and close corporations	2 994	75.3	3 456	73.5
Unincorporated businesses and other	288	7.2	228	4.8
Households	119	3.0	111	2.4
Preference shares	537	13.5	870	18.5
Other (interest accrued/ revaluations)	38	1.0	37	0.8
Total	**3 976**	**100.0**	**4 702**	**100.0**
By sector				
Agri, hunting, forestry and fishing	42	1.1	29	0.6
Mining and quarrying	29	0.7	29	0.6
Manufacturing	281	7.1	201	4.3
Construction	-	0.0	40	0.8
Wholesale/retail/hotels/ restaurants	96	2.4	91	1.9
Transport/storage/ communication	157	3.9	167	3.6
Financial intermediation/ insurance	307	7.7	354	7.5
Real estate	1 511	38.0	2 106	44.8
Business services	120	3.0	90	1.9
Community, social& personal services	16	0.4	13	0.3
Private households	99	2.5	101	2.1
Other†	1 318	33.2	1 481	31.4
Total	**3 976**	**100.0**	**4 702**	**100.0**
By geography				
South Africa	3 976	100.0	4 702	100.0
Total	**3 976**	**100.0**	**4 702**	**100.0**

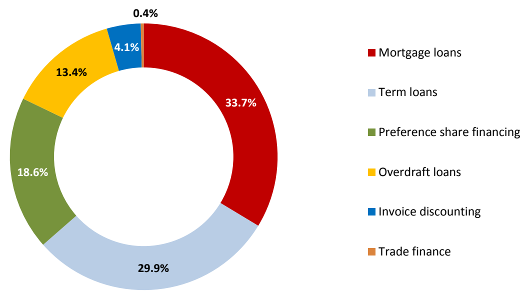
† Loans which do not conclusively fall within the predefined categories.
Source: AFS.

In terms of economic sectors, the bank shows significant concentration to the real estate sector, constituting 44.8% of the loan portfolio at FYE15 (FYE14: 38%). In terms of size, collectively, the bank's 10 and five largest exposures equated to 27.5% (154.7% of capital) and 15.9% (89.5% of capital) of gross loans and advances respectively at FYE14. The single largest exposure accounted for 3.7% of the gross loan book and 20.7% of core capital. Exposures are maintained within the SARB's prudential guidelines, which limits single-counterparty exposures to 25% of qualifying/ regulatory capital and 800% aggregate limit on large exposures (ie, the sum of exposures exceeding 10% of capital) to regulatory capital. Loans to related parties (the group, bank's subsidiaries and directors) amounted to 3.4% of the loan portfolio at FYE15 (FYE14: 1.4%).

Lending is on a secured basis including for term and overdraft facilities. Collateral includes cash, mortgage bonds, cession of leases, shares, discounted invoices, guarantees and suretyships.

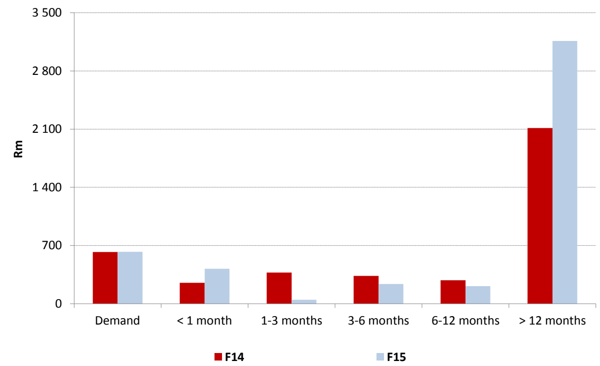
Figure 5: Loan portfolio by product

2 BA900 – Quarterly returns submitted by banks to the SARB's bank supervision department.



The loan portfolio is skewed towards the long-term with 67.2% of the loan portfolio maturing after one year at FYE15 (FYE14: 53.1%).

Figure 6: Contractual loan (gross) maturity profile



Asset quality

Gross NPLs increased by 25.3% to R99m at FYE15 on the back of a challenging economic climate. Nothwithstanding this, gross impaired loans amounted to 2.1% of gross loans at FYE15, a marginal increase from 2.0% at FYE14, although this ratio was partly masked by loan growth.

Table10: Asset quality	F14 Rm	F15 Rm
Gross loans	**3 976**	**4 701**
Performing	**3 897**	**4 603**
Non-performing	**79**	**99**
Special mention	*56*	*81*
Sub-standard	*18*	*12*
Loss	*5*	*6*
Less: Impairment provisions	**(19)**	**(29)**
Specific impairments	*(6)*	*(11)*
Portfolio impairments	*(13)*	*(18)*
Net loans and advances	**3 958**	**4 672**
Fair value of collateral on NPLs	73	88
Net NPLs	73	88
Write-offs	-	-
Key asset quality indicators		
Gross NPL ratio	2.0	2.1
Net NPL ratio	1.5	1.5
Net NPL/Total Capital	<0.1	<0.1
Coverage ratio (provisions)	7.5	11.1
Coverage ratio (including collateral)	100.0	100.0

Source: AFS.

Individually assessed (specific) provisions increased by 83.3%, with coverage increasing to 11.1% at FY15 (FYE14: 7.5%). Specific provisions for loan losses are raised after taking into account expected recoveries on NPLs, which includes the liquidation of collateral or partial loan repayments. However, the bank remains vulnerable to collateral valuation changes, particularly given lacklustre economic growth and the rising interest rate cycle. A breakdown of impaired loans by sector and analysis is shown in Table 11, with arrears mainly emanating from the manufacturing and real estate sectors.

Table 11: Impaired loans and advances by sector	F14 Rm	F14 %	F15 Rm	F15 %
Agri, hunting, forestry & fishing	<1	0.6	1	1.0
Manufacturing	11	13.9	22	22.2
Wholesale/retail/hotels/restaurants	<1	0.6	-	-
Real estate	26	32.9	31	31.3
Community/social/personal services	5	6.3	6	6.1
Private households	2	2.5	<1	<1
Other	35	44.2	39	39.4
Total	**79**	**100.0**	**99**	**100.0**
By age analysis				
Current	-	-	40	40.8
< 3 months overdue	36	45.6	21	21.4
6-12 months overdue	21	26.6	-	-
> 12 months overdue	22	27.8	37	37.8
Total	**79**	**100.0**	**98**	**100.0**

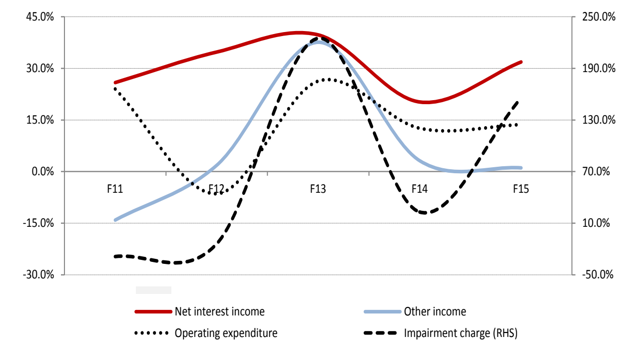
Source: AFS.

Financial performance

A five year financial synopsis is shown at the back of this report, supplemented by the commentary below.

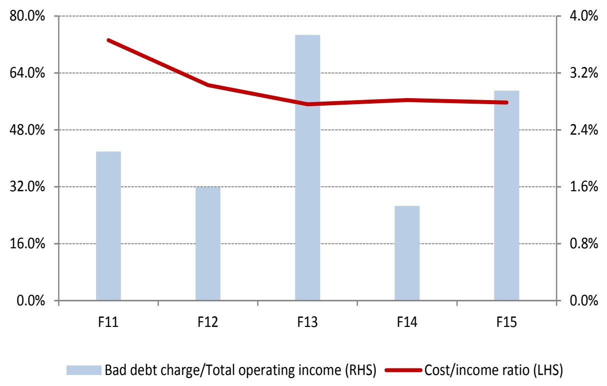
The bank reported a pre-tax profit of R143m for F15, up 12.5% (F14: 13.6%). The high level of pre-impairment operating profit was able to absorb an increase (155%) in credit costs in F15.

Figure 7: Annual change in primary income statement line items



Net interest income grew by 31.9% (F14: 20.2%) supported by loan growth and upward adjustments in prime lending rates in line with the hike in the repo rate during the year. The net interest margin improved to 1.9% in F15 from 1.6% in F14. Meanwhile non-interest income grew by a marginal 1.1% in F15 (F14: 3.1%) and mainly comprised transaction fee and commission income from retail and corporate banking. As in the previous year, non-interest income contributed 48.1% of total operating income. Overall, total operating income grew by 15.0% in F15 (F14: 10.2%).

Figure 8: Operating efficiency



Operating expenses grew by 13.67% in F15 compared to a growth of 12.6% in F14. Staff costs constituted 64.2% of total operating expenses in F15 (F14: 63.4%). The cost ratio improved slightly to 55.7% in F15 from 56.4% in F14. Non-interest income covered operating costs by 86.2% in F15, down from 99.1% in F14. The bank has generated high levels of non-interest income benefiting from the SASSA card holder base and ATM rollout (810 ATMs operated by Net 1). In line with growth in NPLs, loan impairment charges increased to 3.0% (F14: 1.3%) of total operating income in F15. GCR takes note of the uncertainty regarding the renewal of the SASSA agreement expiring in March 2017 and the potential impact on earnings. Under the terms of this agreement with SASSA, the bank benefits both in terms of the free float of the relevant funds, and from fee income derived from distributing the funds.

Future prospects

Grindrod Bank's actual unaudited results for the two months ending 29 February 2016, together with the budget for the same period are shown in Table 12.

The bank recorded a net profit before tax of R34.7m for the period ending 29 February 2016, which was well ahead of budget. Overall earnings growth of 32.5% to R189m is expected for F16.

Table 12: Income statement (Rm)	Budget 2M F16	Actual 2M F16	Variance %
Interest income	98	114	16.5
Interest expense	(68)	(77)	12.6
Net interest income	**30**	**38**	**25.2**
Other income	17	26	59.6
Total operating income	47	64	**37.5**
Bad debt charge	**(<1)**	**(<1)**	**(50.0)**
Operating expenses	(29)	(29)	0.3
Net profit before tax	**17**	**35**	**101.7**

Source: Grindrod Bank.

Looking ahead, earnings performance will be supported by growth in the loan book and fee and commission income. Lending will remain cautious while more focus will be placed on the recovery of NPLs, as well as liquidity and capital preservation.

Grindrod Bank Limited

(South African Rands in Millions except as noted)

Year end: 31 December	2011	2012	2013	2014	2015
Income Statement Analysis					
Interest income	216.5	284.5	386.2	493.0	592.6
Interest expense	(156.4)	(203.5)	(273.1)	(356.9)	(413.2)
Net interest income	**60.1**	**81.0**	**113.1**	**136.0**	**179.4**
Net fee and commission income	107.0	106.2	135.4	151.4	155.5
Trading income	(0.3)	0.3	7.2	(0.2)	0.5
Other income	6.8	9.1	16.5	12.9	9.9
Total operating income	**173.6**	**196.6**	**272.2**	**300.1**	**345.2**
Impairment charge	(3.6)	(3.1)	(10.2)	(4.0)	(10.2)
Amortisation of acquired income streams)	(0.5)	(1.0)	-	-	-
Operating expenditure	(127.2)	(119.0)	(150.3)	(169.2)	(192.3)
Net profit before tax	**42.3**	**73.4**	**111.7**	**126.9**	**142.7**
Tax	(3.4)	(17.3)	(17.8)	(21.9)	(20.8)
Net profit after tax	**38.9**	**56.1**	**93.9**	**105.0**	**121.8**
Balance Sheet Analysis					
Ordinary shareholders' equity and reserves	374.5	406.3	476.8	556.0	650.6
Preference shares	50.0	120.0	120.0	145.0	185.0
Total capital and reserves	**424.5**	**526.3**	**596.8**	**701.0**	**835.6**
Customer deposits	2 930	4 716	8 020	7 822	9 992
Bond issue	-	500	500	500	160
Preference share funding	-	99	79	91	99
Other *(interest accrued)*	32	47	35	44	50
Liability funding	**2 961.2**	**5 361.9**	**8 634.8**	**8 457.3**	**10 300.6**
Payables/Deferred liabilities	71.4	100.7	108.2	97.8	94.61
Other liabilities	**71.4**	**100.7**	**108.2**	**97.8**	**94.6**
Total capital and liabilities	**3 457.1**	**5 988.9**	**9 339.8**	**9 256.2**	**11 230.8**
Cash and balances with the central bank	52.2	402.1	621.3	528.8	753.5
Fixed assets	2.4	2.9	10.7	11.5	11.5
Other assets	175.8	221.7	274.1	265.6	314.0
Non-earnings assets	**230.4**	**626.7**	**906.1**	**805.9**	**1 079.0**
Net loans and advances	2 207.8	2 862.0	3 347.7	3 957.6	4 672.4
Bank placements/short-term loans	828.3	2 189.7	4 557.0	3 969.9	4 882.3
Marketable/Trading securities	190.3	310.3	529.0	522.7	593.6
Other investments (incl. derivative instruments)	0.4	0.2	0.0	0.0	3.4
Total earning assets	**3 226.7**	**5 362.2**	**8 433.7**	**8 450.3**	**10 151.8**
Total assets	**3 457.1**	**5 988.9**	**9 339.8**	**9 256.2**	**11 230.8**
Contingencies	280.5	288.6	219.2	160.9	197.1
Ratio Analysis (%)					
Capitalisation					
Internal capital generation	10.4	13.8	19.7	18.9	18.7
Total capital / Total assets†	12.3	8.8	6.4	7.6	7.4
Liquidity					
Net advances / Customer deposits + other short-term funding	75.4	60.7	41.3	47.1	46.8
Net advances / Total funding (excl. equity portion)	74.6	53.4	38.8	46.8	45.4
Liquid and trading assets / Total assets	29.5	47.0	59.6	52.6	53.9
Liquid and trading assets / Total short-term funding	35.1	59.6	69.0	58.0	60.7
Liquid and trading assets / Total funding (excl. equity portion)	34.4	52.4	64.5	57.6	58.8
Asset quality					
Impaired loans / Gross advances	2.1	2.3	2.4	2.0	2.1
Total loan loss reserves / Gross advances	0.2	0.0	0.1	0.1	0.2
Bad debt charge (income statement) / Gross advances (avg.)	0.2	0.1	0.3	0.1	0.2
Bad debt charge (income statement) / Total operating income	2.1	1.6	3.7	1.3	3.0
Profitability					
Net interest margin	2.2	1.9	1.6	1.6	1.9
Non-interest income / Total operating income	65.4	58.8	58.4	54.7	48.0
Cost ratio	73.3	60.5	55.2	56.4	55.7
Effective tax rate	8.1	23.5	15.9	17.2	14.6
ROaE	10.7	14.4	21.3	20.3	20.2
ROaA	1.3	1.2	1.2	1.1	1.2
Nominal growth indicators					
Total assets	41.7	73.2	56.0	(0.9)	21.3
Net advances	25.2	29.6	17.0	18.2	18.1
Shareholders funds	6.1	8.5	17.4	16.6	17.0
Total capital and reserves	20.3	24.0	13.4	17.5	19.2
Customer deposits	46.0	61.0	70.1	(2.5)	27.7
Total funding (excl. equity portion)	45.9	81.1	61.0	(2.1)	21.8
Net profit after tax	(35.5)	44.3	67.4	11.8	16.0

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S FINANCIAL INSTITUTIONS GLOSSARY

Arrears	An overdue debt, liability or obligation. An account is said to be 'in arrears' if one or more payments have been missed in transactions where regular payments are contractually required.
Asset Quality	Asset quality refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (i.e. being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Bad Debt	A bad debt is an amount owed by a debtor that is unlikely to be paid due, for example, to a company going into liquidation. There are various technical definitions of what constitutes a bad debt, depending on accounting conventions, regulatory treatment and the individual entity's own provisioning and write-off policies.
Balance Sheet	Also known as a Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Basel III	A comprehensive set of reform measures designed to improve the regulation, supervision and risk management within the banking sector. Largely in response to the credit crisis, banks are required to maintain prescribed leverage ratios and meet certain capital requirements.
Bond	A long term debt instrument issued by either: a company, institution or the government to raise funds.
Cap	A provision in a loan agreement that sets a limit on the interest rate which can be charged during the term of the loan.
Capital	The sum of money that is invested to generate proceeds.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent.
Capital Base	The issued capital of a company, plus reserves and retained profits.
Collateral	Asset provided to a creditor as security for a loan.
Contingent Liabilities	Liabilities not recorded in an entity's financial reports, but which might become due.
Corporate Governance	Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Rating Agency	An entity that provides credit rating services.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and/or interest when due.
Creditworthiness	An assessment of a debtor's ability to meet debt obligations.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Downgrade	The assignment of a lower credit rating to a company or sovereign borrower's debt by a credit rating agency. Opposite of upgrade.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Fair Value	The fair value of a security, an asset or a company is the rational view of its worth. It may be different from cost or market value.
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Forecast	A calculation or estimate of future financial events.
Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.
Impairment	Reduction in the value of an asset because the asset is no longer expected to generate the same benefits, as determined by the company through periodic assessments.
Intangible Assets	The non-physical assets of a company such as trademarks, patents, copyright, information systems and goodwill.
Interest Rate Risk	The potential for losses or reduced income arising from adverse movements in interest rates. Interest rate risk in the banking book is the risk that earnings or economic value will decline as a result of changes in interest rates. The sources of interest rate risk in the banking book are repricing/mismatch, basis and yield curve risk.
Interest Rate Swap	An interest rate swap is an agreement in which two parties make interest payments to each other for a set period based upon a notional principal.
Investment Grade	Credit ratings equal to or higher than 'BBB-'.

JIBAR	The Johannesburg Interbank Agreed Rate, or JIBAR, is the annualised interest rate at which banks obtain unsecured loans from each other. It is often used as the basis for pricing floating interest rate instruments, and is the main reference rate used in South Africa.
King III	King Code of Governance Principles and the King Report on Governance (King III) is a corporate governance code determining standards of conduct for public, private and non-profit organisations.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Long term	Not current; ordinarily more than one year.
Market Capitalisation	The total value of a company's shares as quoted on a stock exchange. It is calculated by multiplying the total number of shares in issue by the market price.
Market risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Monetary Policy	Measures taken by the central bank to influence the quantity of money or the rate of interest with a view to achieving stable prices, full employment and economic growth.
Net Interest Margin	Net interest margin is the net interest income divided by average interest earning assets.
Non-Investment Grade	Credit ratings equal to or lower than 'BB+' (double B plus).
Non-Performing Loan	When a borrower is overdue, typically 90+ days in arrears or as defined by the lender, or in the transaction documents.
NPL Ratio	The ratio of non-performing loans and advances to total gross loans and advances, expressed as a percentage.
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Preference Share	Preference or preferred shares entitle a holder to a first claim on any dividend paid by the company before payment is made on ordinary shares. Such dividends are normally linked to an interest rate and not determined by company profits. Preference shares are normally repayable at par value in the event of liquidation. They do not usually carry voting or pre-emptive rights. Preference shares can be redeemable or perpetual.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Outlook	A Rating outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Regulatory Capital	The total of primary, secondary and tertiary capital.
REPO Rate	In South Africa the REPO rate refers to the rate at which the South African Reserve Bank lends money to banking institutions. The money is lent through a repurchase agreement.
Repricing Risk	Repricing/mismatch risk is the timing differences in the maturity (for fixed-rate) and repricing (for floating-rate) of bank assets, liabilities and off-balance-sheet positions.
Risk Management Process	The systematic application of management policies, procedures and practices to the tasks of risk identification, assessment and measurement, response and action, monitoring and review, and risk reporting.
Secured Loan	A loan which is backed by a pledging of real or personal property (collateral) by the borrower to the lender. Unlike unsecured loans, which are backed by a promise by the borrower that he will repay the loan, in case of a secured loan, the lender can initiate legal action against the borrower to reclaim and sell the collateral (pledged property).
Securities	Various instruments used in the capital market to raise funds.
Security	An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default.
Short Term	Current; ordinarily less than one year.
Swap	An exchange of payment streams between two parties for their mutual benefit. Swaps can involve an exchange of debt obligations, interest payments or currencies, with a commitment to re-exchange them at a specified time.
Treasury Bill	Short-term obligation backed by the government that bears no interest and is sold at a discount.
Write-off	The total reduction in the value of an asset.

SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

Grindrod Bank Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have has been disclosed to Grindrod Bank Limited with no contestation of the ratings.

The information received Grindrod Bank Limited and other reliable third parties to accord the credit rating(s) included:

- Audited financial results of the bank at 31 December 2015 (plus four years of comparative numbers);
- Unaudited management accounts of the bank as at 29 February 2016;
- Corporate governance and enterprise risk framework;
- Reserving methodologies and capital management policy;
- Industry comparative data and regulatory framework; and
- A breakdown of facilities available and related counterparties.

The ratings above were solicited by, or on behalf of, Grindrod Bank Limited, and therefore, GCR has been compensated for the provision of the ratings.