FUTUREGROWTH
/ ASSET MANAGEMENT

Land Bank: A vital role-player in South Africa

The crisis is evolving, but resolution is slow

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We believe that Land Bank is a vital and necessary role player in South Africa's agricultural sector and that the government, likewise, considers it a strategic contributor to agricultural development.

At the onset of the Land Bank crisis, roughly 27% of agricultural debt in South Africa was supported by Land Bank making them a significant role-player in our agricultural sector. The risks of Land Bank not functioning effectively are dire and include a possible increase in food inflation, as the country becomes increasingly reliant on imported foods. In the current COVID-19 crisis and with global supply chains being disrupted, supply side risks are real. In the absence of adequate funding from the Land Bank and certainty about the timely resolution of the current situation, emerging farmers don't have access to the capital needed to transition into established commercial farmers. The Land Bank therefore plays a critical role in growing and broadening the South African commercial farming base and therefore securing the current and long-term food security of the country.

Land Bank has a long history of operations and, post its restructure in 2006 to 2007, has shown itself to be largely self-sustaining, profitable, and with a suitable credit focus.

Latest events and views

As at the date of writing this update, we have seen some encouraging progress in resuming interest payments to funders as well as recent executive appointments. However, there seems to be some rethinking of the future role of the Land Bank in SA's agri sector – most likely that it becomes a smaller, more developmentally focused business.

The SENS issued on 25 August 2020 notified the market that *"on 18 August 2020, Standard Chartered Bank served an application out of court on the Land Bank to recover certain debt from the Land Bank ...."* and that *"Land Bank is working with its advisers and will be opposing the application."* We have been advised that the court process for this matter has a number of deadlines which need to be met. One of these deadlines was for answering and responding affidavits to be filed which, we are advised, has been met. The next deadline is for "heads of argument" to be filed by 23 October. Land Bank's legal advisors are of the view that the date for this matter to be heard is dependent on a court date being available before the December court recess. If the matter is not heard in early December, it will be heard in early 2021. We continue to monitor the situation and will advise as and when circumstances change.

Land Bank communicated in mid-September that there is no longer a need for the Emergency Liquidity Facility, as detailed in the SENS dated 15 September 2020. Land Bank has subsequently confirmed that the full R3bn equity injection, which was appropriated as part of the June Emergency Budget tabled by the Minister of Finance, has been received. The payment of this R3bn was made in two equal traches, the final payment of which was received on 30 September 2020.

The implementation of the liability solution (which includes restructuring the existing debt) is also delayed, with the new implementation date, as indicated in a SENS dated 22 September 2020, of late November 2020.

Importantly, the most recent SENS provides for a 5% capital reduction for all funders at the time of the implementation of the liability solution. If the liability solution is not implemented by 30 November 2020, the SENS details that this payment will be made by no later than 28 February 2021. This was a key provision that noteholders agreed with Land Bank in response to their stated intention communicated to noteholders in August 2020, to repay certain DFI[1]s in September. This 5% repayment to funders protects the principle of treating all creditors equally which Land Bank had undertaken to do, publically (via SENS) and in private communications with noteholders. One of the Noteholder conditions in agreeing to the DFI payment in August, was that the funds to be used for the 5% liability reduction had to be set aside. As at 30 September 2020, Land Bank confirmed that this was the case in a letter from the CEO to the Noteholder Committee.

Futuregrowth remains an active participant in the Noteholder Committee (together with c.9 other institutional asset managers who hold Land Bank debt) – having been engaged since April 2020 with the Land Bank and its advisors on the restructure of Land Bank following its notice of Event of Default. As part of this restructure, and due to the lack of collective action and debt standstill provisions that arise from Land Bank's unique legal status, holders of Land Bank debt have been in a "de facto" debt standstill. Noteholders continue to rely on the Land Bank's undertakings to treat all creditors fairly.

There is regular dialogue between noteholders and the Land Bank and its advisors, and with National Treasury. We understand that this matter continues to receive urgent attention by management, National Treasury and lenders to restore the Land Bank to sustainability. Progress since the first SENS notifying the market of this default on 20 April 2020 has been slow. Current indications are that Land Bank will continue to uphold the principles of fair treatment for all creditors during the restructure process and that the implementation of the liability restructure is delayed beyond the timelines originally outlined in the 17 June 2020 SENS.

We continue to assess all new information as it is made available.

What is needed?
The current liquidity shortfall experienced by Land Bank, coupled with the fact that a significant portion of its debt is funded with a maturity of less than 12 months (approximately 41% at March 2020), necessitates a coordinated, speedy and constructive engagement amongst all stakeholders - most notably by the government as the shareholder (and represented by the Minister of Finance) - in order to address the liquidity crisis that caused the Event of Default and to move forward with a plan to restore Land Bank's position to that of a sustainable enterprise that serves developmental and economic needs. As a key partner in developmental finance in South Africa for over 20 years, and as a significant funder, historically of Land Bank, Futuregrowth continues to work with Land Bank and other key stakeholders to support them through this challenging period, insofar as this can be done whilst honouring our fiduciary duty to our clients.

From the funders' side there were broadly two groups: The Noteholders Committee (i.e. those holding Land Bank listed and unlisted debt instruments), which continues to work on the implementation of the liability solution and a smaller group of potential Emergency Liquidity Providers, which has, as of mid-September 2020, fallen away. The Noteholders Committee is seeking to protect their investors, gather information, ensure the debts (capital and interest) are serviced, and where possible repaid, and that any resultant liability solution is sustainable, appropriate and results in a better outcome for existing noteholders than the current position. The Emergency Liquidity Providers group, which included commercial bank lenders, as well as a few institutional investors, was in negotiations with the Land Bank, National Treasury and their advisors about the provision of an emergency liquidity facility that would have allowed Land Bank to remain operational during this period but that was subsequently deemed unnecessary due to the earlier-than-expected injection of the R3bn equity from the shareholder (government).

[1] Development Finance Institution

Futuregrowth continues to be an active participant in the Noteholder Committee with the goal to achieve a sustainable solution for our clients and the Land Bank. The key focus of the Noteholder Committee at this stage is to negotiate appropriate terms and conditions for the liability solution, including the DMTN and the proposed partial guarantee. We believe a key determinant of the likely success of the proposed liability solution is investors being suitably comfortable that the terms and conditions of the DMTN and the proposed guarantee are appropriate and mitigate the risks of continuing to lend our clients' money to a distressed entity.

Latest financial information
Land Bank released financial performance figures mid-September to lenders, indicating that they remain solvent and adequately capitalised, with a Capital Adequacy Ratio of 11.7% as at June 2020. This ratio would have been 17.6%, including the R3bn equity injection by National Treasury, of which R1.5bn was received on 11 September 2020 with the remainder expected at the end of September 2020.

The period ended 30 June 2020 saw Land Bank's loan book negatively impacted by restricted disbursements due to liquidity challenges of the Bank. The non-performing loans increased to 14.9% (31 March: 11.4%), with management indicating that the NPL ratio will increase even further as the loan book reduces over time.

Cash on hand at the end of June improved to R1.9bn (31 March 2019: R723m), as a result of restrictions imposed on disbursements. Net loans and advances declined to R40.8bn at 30 June 2020 (March 2020: R42.6bn; March 2019: R44.17bn) due to increased credit provisioning at 31 March 2020 and a reduction in disbursements.

The restrictions imposed on distributions have resulted in declines in net interest income by c. 40%. For the financial year ended 31 March 2020, credit impairments increased to R1.8bn due to additional provisioning required post a review of the loan book and IFRS9 adjustments. This has pushed Land Bank to an operating loss of R1.95bn at 31 March 2020 (31 March 2019: operating profit of R46m). For the period up until 30 June 2020, impairments were stable at R45m.

Impact on credit view

We expected that IFRS9 and additional provisioning would severely affect the income statement of Land Bank, however, we are comfortable that there are still sufficient levels of capital at Land Bank, with the loan book adequately provided for. A better performing agricultural sector, supported by recent good rains, should assist the Land Bank's farmers and in turn result in better debt collections from farmers. We are concerned that Land Bank's stated intention to "right-size" their balance sheet may mean that the higher-quality borrowers may move away from the Land Bank, and that existing borrowers may be constrained by Land Bank's active decision to advance only a portion (50%) of facilities, with implications for the quality of the loan book over time.

This note is based on information we have at the time of writing, and we will endeavour to update it as and when circumstances change.

Questions and answers:

1. What happened at Land Bank?

- **20 April 2020:** SENS notifying market of Event of Default
- **23 April 2020:** SENS retracting earlier default, yet confirming default likely later
- **24 April 2020:** Letter sent from CEO to ASISA requesting Noteholder Committee be formed
- **24 April 2020:** SENS confirmed Event of Default
- **28 April 2020:** SENS announcing appointment of financial adviser, requesting deferral from funders
- **19 & 20 May 2020:** SENS update on the liquidity and debt restructuring process, Land Bank confirms "no creditor worse off" principles
- **20 May 2020:** Land Bank presents to Parliament: Standing Committee on Appropriations
- **20 May 2020:** First noteholder committee meeting held, includes appointment of Weber Wentzel to act for noteholders (paid for by Land Bank)
- **1 June 2020:** SENS announcing upcoming interest payments due between 1-9 June will not be met
- **9 June 2020:** Noteholder committee meets with National Treasury
- **17 June 2020:** Noteholder call with Land Bank, RMB – proposed liability solution introduced by RMB. SENS update on liquidity and debt restructure process
- **26 June 2020:** Noteholder Committee sends list of DMTN terms to Land Bank and its advisors
- **26 June 2020:** Meeting between Futuregrowth and RMB on proposed liability solution
- **9 July 2020:** Meeting between Noteholder Committee, National Treasury, RMB and Land Bank
- **17 July 2020:** Noteholder Committee letter to National Treasury raising concerns
- **30 July 2020:** Noteholder Committee letter to National Treasury again, following no response to 17 July letter
- **5 August 2020:** Noteholder Committee meeting with RMB, National Treasury and Land Bank
- **7 August 2020:** SENS notifying recommencement of interest and general update
- **20 August 2020:** SENS confirming executive and senior management appointments
- **25 August 2020**: SENS confirming commencement of legal proceedings by Standard Chartered Bank
- **25 August 2020:** Letter of intent sent to Noteholder Committee, in which Land Bank indicates it intends repaying certain DFIs
- **26 August 2020:** Noteholder Committee meeting to discuss recent SENS and the letter of intent
- **31 August 2020:** Further Noteholder Committee meeting, meeting with broader noteholder group, letter of demand sent to Land Bank, National Treasury and RMB
- **4 September 2020:** Letter from ENS responding to noteholder demands
- **4 September 2020:** SENS update on the LBK22 bond, interest and principal payment

7 September 2020: N/H Committee meeting to discuss next steps

15 September 2020: SENS update on the liquidity facility, the provision of financial information and a board update

16 September 2020: Letter from Land Bank to noteholders confirming agreement with the list of demands (including the 5% capital reduction) sent in the noteholders letter dated 31 August 2020

22 September 2020: SENS update on the equity injection, the part capital repayment and the provision of financial information

30 September 2020: Land Bank confirms to the Noteholder Committee that the R3bn equity, appropriated in the June Budget, from government has been fully received

30 September 2020: Land Bank confirms to the Noteholder Committee that the R1.8bn to be used for the 5% liability reduction has been set aside as required by Noteholders

In April 2020, it appears that a substantial funder of Land Bank – an international provider of a revolving credit facility – withdrew that line of credit and demanded repayment of its capital. Land Bank apparently engaged with the funder, to no avail.

On 24 April 2020, Land Bank issued a SENS notifying the market that they defaulted on certain of their loan obligations, which fell due on 24 April. The default on these loan obligations caused a corresponding event of default on Land Bank listed bonds.

Land Bank confirmed this Event of Default in a SENS dated 28 April 2020. This SENS provided formal notice to noteholders of the Event of Default, and provided some information about the remedial action the Land Bank intended. This remedial action included the appointment of a financial adviser to *"assist and advise the Land Bank (i) in developing a business plan (on the back of the repurposing plan which is at an advanced stage) and (ii) in negotiating with its funders … regarding the potential restructuring of its financial indebtedness."*

The SENS included some additional requests to funders - including a deferral of upcoming interest and capital, and a request for an "interim deferral/standstill" to give the Land Bank time to address this crisis - and indicated that the Land Bank will be assessing whether it needs to raise some bridging finance as a short-term solution to the current liquidity crisis. The SENS concluded with the statement, that *"the management team of Land Bank remains committed to a transparent process and undertakes to work with Land Bank's funders to mitigate risks identified."*

These two SENS notices follow from two previous SENS notices issued on 20 and 23 April respectively, which warned noteholders about the impending default on a revolving credit facility and the impact that this would have on the Land Bank's listed notes.

On 17 June 2020, Land Bank issued a SENS updating the market on the liquidity and debt restructuring process. The SENS indicated that there are three steps to the restructuring process, viz:

- raising a R3 billion emergency liquidity facility from key funders;
- implementing a liability solution to "*restructure funding obligations … that better matches its lending book whilst not unduly impacting the financial outcomes for funders and … (which) will result in the restructuring of maturities of funding obligations*"; and
- implementing an equity solution to ensure "*adequate equity support … and to allow the Land Bank to fulfill its legally mandated functions on a sustainable basis*".

In addition to the above, the SENS provided an indicative timetable for the liability solution process and outlined some key principles that will be followed, including an expectation that there will be no loss of capital or accrued interest, and that existing funders will participate in a voluntary "*tender and exchange process*" to replace existing instruments with new instruments issued under a new DMTN Programme[2]. The SENS dated 22 September 2020 provides a further update on the proposed liability solution and affirms the initial expectations that the current defaults and cross defaults on funding instruments will be cured if there is a very high (close to 100%) take-up of the liability solution by existing funders, and that it will provide existing funders with a credit-enhanced position and repricing once implemented.

There is still much detail that we need before we assess our position as regards to this latest SENS (of 22 September 2020) and any decision(s) that may be required. The outstanding information includes but is not limited to:

- the quantum, timing and any conditionality of the proposed "equity solution" that is needed to ensure the appropriate levels of equity support from the shareholder, as represented by National Treasury. This would be in addition to the R3bn already committed and received;
- the release of the report from the independent provisioning review of Land Bank's book which has been performed to confirm Land Bank's solvency and ensure its ongoing sustainability;
- the terms and conditions of the new instruments issued under the "new DMTN";
- the nature, extent, timing and any conditionality attached to the proposed credit enhancement (specifically the partial government guarantee) of the new DMTN;
- the proposed maturities of the new instruments; and
- the revised pricing of the new Land Bank instruments.

On 7 August 2020, Land Bank issued a SENS confirming the recommencement of interest payments as from 11 August 2020, noting that:

- *"interest payments that have already contractually fallen due will be paid together with any accrued interest due in respect of such unpaid interest in accordance with the terms of each relevant underlying agreement.*
- *Where no contractual rate was specified, interest on missed interest has accrued at the statutory mora rate.*
- *Interest that has not yet become contractually due and payable on unpaid capital will continue to accrue in accordance with the terms of each relevant underlying contract and will be settled when the liability solution is implemented towards the end of October 2020."*

Also, on 20 August 2020 Land Bank issued a SENS confirming the appointment of a permanent Chief Risk Officer and Head of Treasury.

On 25 August 2020, Land Bank issued a SENS notifying the market that Standard Chartered Bank had commenced legal proceedings to recover certain debt from the Land Bank. The SENS indicates that Land Bank will be opposing this action. Land Bank's legal advisors have subsequently advised that this matter is ongoing and likely to only be heard towards the end of 2020 or January 2021, depending on available court dates.

On 4 September 2020 Land Bank issued a SENS detailing how the maturity of the LBK22 would be treated – the LBK matured on 4 September 2020 and so is currently in default for non-payment of capital.

On 15 September 2020 and 22 September 2020, Land Bank provided the market with updated financial information, an update on the liability solution and confirmed the repayment of 5% of capital of funders.

[2] Domestic Medium Term Note Programme – this is the legal document under which an issuer issues publically listed bonds on the JSE

Land Bank holds approval to issue up to R5.7 billion of government guaranteed debt, of which R4.3 billion currently remains unutilised. Land Bank falls under the purview of the Ministry of Finance (National Treasury) who, according to news reports on Monday 20 April 2020, indicated that "*assistance in the form of recapitalisation and further guarantees is under consideration and would have to be accompanied by balance sheet optimisation of the Land Bank to correct the structural liquidity risk embedded in the balance sheet*." Further, on the afternoon of 24 April 2020, Finance Minister Tito Mboweni was quoted as saying that *"we will do whatever we can to support the Land Bank"*. We await further clarity in this regard, although we do highlight that the SENS of 17 June 2020 states that an "*appropriate level of additional equity required to recapitalize the Land Bank*" is part of the proposed equity solution that reinforces the previous statements. The receipt of the R3bn equity injection by 30 September 2020 provides further evidence of shareholder support for Land Bank. We are of the view that additional equity is likely needed as part of the longer-term sustainable solution for Land Bank and clarity on the form, timing and quantum of this remains an outstanding point.

For completeness, summaries of the 20 April 2020, 23 April 2020 and 24 April 2020 SENS notices are provided below, noting however, that the SENS on 28 April 2020 supersedes these notices:

> 20 April 2020:
> Land Bank issued a SENS announcement on the evening of 20 April 2020 informing the market of a Potential Event of Default under its listed bond programme. The statement noted that Land Bank had failed to make payment to a lender on a revolving credit facility (RCF), which could constitute an Event of Default under that facility, and could also constitute a Potential Event of Default under the JSE listed bond programme. While Land Bank is currently in discussions with the RCF funder to waive the Event of Default, it noted that it is "*currently experiencing a liquidity shortfall and [is] accordingly engaging with various stakeholders with a view to addressing this challenge especially in regard to financial obligations falling due which may need to be deferred*".
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> 23 April 2020:
> The SENS released, in the morning of 23 April, was seemingly contradictory, in that the "Land Bank's external legal counsel had reconsidered … and concluded that the amount payable … did not trigger a cross default under the notes …" But then, the SENS further stated that "notwithstanding the above, the Land Bank anticipates further defaults to occur under debts which fall due today which will result in the threshold for a cross default being breached." They noted that they are "still in ongoing engagements with the relevant lenders regarding the waiver of the Event of Default … and the deferment of the repayment of the debts which falls due today and as soon as these discussions conclude the Land Bank will announce the outcome of such discussions."
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> The SENS mentioned again the liquidity shortfall experienced by the Land Bank and that they were "engaging with various stakeholders with a view to addressing this challenge especially in regard to financial obligations falling due which may need to be deferred."
>
> The SENS concluded by stating that "pending the raising of further funding and the restructuring of its financial indebtedness, the Land Bank will be engaging the noteholders and other funders to agree to a deferral of the payment of interest and capital repayments for a period to be agreed with the noteholders and funders."
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> 24 April 2020:
> The SENS released on 24 April confirmed that an event of default, as described in the earlier SENS notices, had occurred.

2. Briefly define the Futuregrowth original investment thesis and process for including Land Bank in client funds?

Land Bank is a strategically important Development Finance Institution in South Africa that plays a pivotal role in advancing agriculture and rural development in the country. Our investment thesis has been supported by our recognition of the important work that Land Bank does in leveraging private sector investment into the agricultural sector, and in developing partnerships with intermediaries for on-lending into agricultural value chains across the country.

Our credit process on Land Bank (and all our counterparties) incorporates a top-down and a bottom-up approach.

- Our top-down credit process includes consideration of macro-economic factors, agricultural factors (including crop plantings and rainfall trends) and environment-related factors and the impact these are likely to have on Land Bank's loan book. In addition, we consider the strategic importance of Land Bank, the willingness and ability of government to provide extraordinary support if required, Land Bank's enabling legislation, its relationship with its shareholder ministry and its performance against targets as set out in the shareholder compact.

- Our bottom-up credit process includes consideration of a variety of financial and non-financial metrics, a range of forward-looking factors and scenarios, as well as engagements with management and other relevant parties. We consider Environmental, Social and Governance (ESG) factors as part of the assessment of non-financial factors. We note that we have previously downgraded Land Bank on concerns of weakening governance and executive management flux.

The outcome of the top-down and bottom-up process is that we assign an internal Futuregrowth rating to the borrower, which is amended as and when our assessment of new information requires it. *Our most recent formal review was in March 2020, with an update to our Credit Committee on progress with the restructuring at the appropriate times. We internally rerated Land Bank five times over the past 15 months*. We continue to monitor the events at Land Bank on an ongoing basis.

3. Has the Futuregrowth view of the corporate governance at Land Bank (relative to other State-Owned Enterprises (SOEs and SOCs)) changed?

Certain events during the 18 months prior to the Event of Default (including the continued departure of key executives, and the board and shareholder's failure to adequately address this by timeously appointing suitable replacements in a permanent capacity) caused us to reassess Land Bank's risk profile. We noted that management flux and the resultant appointment of acting executive management (as opposed to permanent appointments) is a common theme for many of South Africa's SOEs.

In Land Bank's case, we performed our initial governance review in 2016 and subsequently did a follow-up governance review in 2019. In the most recent review, we reiterated our previously identified concerns around executive management changes. These raised the risk of loss of institutional memory, and did result in sub-optimal leadership and decision making at a time when Land Bank is already under strain.

We believe that the turnover of executives in the 18 months since December 2018 played a direct role in the recent actual event of default on the RCF and the event of default on their listed debt instruments.

However, based on our initial 2016 governance review and a further follow up governance review concluded in December 2019, we have neither seen nor heard any information, which leads us to believe that underlying corruption or malfeasance has precipitated this liquidity crisis. Obviously, that view can only be based on anecdotal or second hand information, but we are affirmed in our view that no such information has yet emerged. Thus, while we have our concerns about the abilities of the management team and the Board, we are not unduly concerned about the ethical base of the organisation at this time.

We believe that an important factor in ensuring ongoing investor confidence in SOE debt is the timeliness and extent of support provided by the shareholder. If shareholder support for Land Bank is perceived to be inadequate in amount and extent, or if it is delayed, there is a very real risk of investors becoming reluctant to fund other SOEs which will likely have an impact on their ability to i) raise funding and ii) increase the cost of any such funding raised.

We believe that SOE contagion risk is continuing given the delays to the timetable in the SENS of 17 June, the revised timing indicated in the SENS of 22 September 2020 which carries significant execution risk and hence likely slippage of indicated dates, the robust negotiation needed on the terms of the proposed liability solution, specifically the DMTN terms and conditions, the guarantee terms and conditions and the quantum, form and timing of the longer-term equity solution, as well as the recent events around the proposed repayments to certain DFIs which, while resolved for now, served to raise anxiety about Land Bank's commitment to treat creditors fairly in this process.

4. During the course of the six months prior to the event of default, what interactions did the Futuregrowth team have with Land Bank?

Futuregrowth has had regular contact with Land Bank management over this time, including:

- A lender call in October 2019;
- Detailed governance questionnaire circulated in November/December 2019;
- Lender engagement in February 2020, following Moody's downgrade;
- Ongoing engagement on agricultural risks and outlook during the course of February/March 2020 and following the release of the interim results around 28 January 2020;
- Detailed engagement with the Land Bank management team on 21 April 2020, following the release of the SENS to discuss the publically available information detailing the potential Event of Default under its listed note programme; and
- We briefly participated in a broader investor call hosted by Land Bank management on 21 April 2020 to discuss the SENS.

As part of our role on the Noteholder Committee we are in ongoing contact with Land Bank management and their advisors, as well as with National Treasury.

5. In those interactions, were there any indicators of an impending default?

As at the financial reporting period for the half year ending September 2019, released via SENS around 28 January 2020, Land Bank was meeting its disclosed covenant levels with satisfactory headroom on all but the non-performing loan ("NPL") covenant, and management confirmed that they were not forecasting any covenant breaches for the foreseeable future.

Our ongoing analysis revealed early indicators of liquidity strain emerging in February 2020, which coincides with the Bank's peak disbursement period. At that time, we took comfort from the extraordinary support provided by National Treasury in providing Land Bank with the ability to raise debt of up to R5.7 billion with a government guarantee. Our (reasonable) assumption at that time was that this government guarantee would be used to address short-term liquidity shortfalls and could potentially have averted the liquidity crisis that caused the Events of Default of April 2020. The fact that the guarantee was not used remains inexplicable to us.

6. How has Futuregrowth's investment thesis and exposure to Land Bank evolved in the 18 months prior to the default?

During the 2019 calendar year we deemed Land Bank's credit profile to have materially deteriorated. We downgraded our internal credit rating of Land Bank by multiple notches in the past 18 months since December 2018, with a measured approach being adopted in response to deteriorating credit metrics and governance concerns, as they arose.

A summary of the key factors that informed our assessment over this period included:

1. **Declining profitability and the deterioration of Land Bank's loan book**, largely due to adverse environmental factors including the drought in many parts of the country;

2. **Increased risks to the Bank's liquidity position**, particularly in light of recent weakened investor sentiment (with counterparty and sovereign downgrades);
3. **A narrowing of headroom to financial covenants** with the Bank's bilateral funders;
4. **The resignation of a number of key executives** over a period of more than a year, with replacement appointments either not being timeously made, or replacements being appointed in an acting capacity - which we believe has resulted in a loss of institutional memory, and which we are concerned may result in sub-optimal leadership and decision making at a time that Land Bank was already under strain and needed an experienced management team;
5. A lack of clarity around the **support that Land Bank will be able to access from National Treasury**; and
6. Information from management, which indicated a likely **breach to the cost to income ratio over the three-year forecast period**, as well as anticipated deterioration in the capital adequacy ratio and non-performing loan NPL ratio.

When the FY2019 results were released in late 2019, they reflected a steeper deterioration in the financial metrics than we had anticipated (particularly to impairments and NPLs, largely due to environmental risks playing out). In January 2020, we took further negative internal rating action due to concerns around Land Bank's ability to access funding during their peak disbursement period, particularly given negative investor sentiment following the Moody's downgrade and the further departure of key executives.

Notwithstanding the increase in credit risk, we were cognisant that a certain amount of seasonality and environmental risks are a natural part of Land Bank's business model and should be viewed in that context. We further considered Land Bank's long track record and its historic resilience in the face of strained macroeconomic conditions, sector specific challenges and severe environmental risks due to persistent drought conditions. We also noted that Land Bank's reporting line (in effect its shareholder) is to the Ministry of Finance (since 2006) that had, in prior years, led Land Bank to have sound financial management and governance.

In early 2020, we noted an incremental improvement in Land Bank's credit profile, given:
- The appointment of suitable individuals in two of the key executive management roles (CEO and CFO);
- An improved outlook for the 2020 maize harvest (due to improved weather conditions, resulting in an increased planting area) which we expect to directly improve Land Bank's financial performance; and
- National Treasury's approval of a new R5.7 billion government guarantee for Land Bank.

As at the financial reporting period for the half year ending September 2019, released via SENS announcement around 28 January 2020, Land Bank was meeting its disclosed covenant levels with satisfactory headroom, and management confirmed that they were not forecasting any covenant breaches for the foreseeable future.

Land Bank released financial performance for the year to 31 March 2020 and the period to 30 June 2020 in mid-September 2020 to lenders, indicating that they remain solvent and adequately capitalised, with a Capital Adequacy Ratio of 11.7% as at June 2020. This ratio would have been 17.6%, including the R3bn equity injection by National Treasury, of which R1.5bn was received on 11 September 2020 with the remainder received on 30 September 2020.

The period ended 30 June 2020 saw Land Bank's loan book negatively impacted by restricted disbursements due to liquidity challenges of the Bank. The non-performing loans increased to 14.9%

(31 March: 11.4%), with management indicating that the NPL ratio will increase even further as the loan book reduces over time.

Cash on hand at the end of June improved to R1.9bn (31 March 2019: R723m), as a result of restrictions imposed on disbursements. Net loans and advances declined to R40.8bn at 30 June 2020 (March 2020: R42.6bn; March 2019: R44.17bn) due to increased credit provisioning at 31 March 2020 and a reduction in disbursements.

The restrictions imposed on distributions have resulted in declines in net interest income by c. 40%. For the financial year ended 31 March 2020, credit impairments increased to R1.8bn due to additional provisioning required post a review of the loan book and IFRS9 adjustments. This has pushed Land Bank to an operating loss of R1.95bn at 31 March 2020 (31 March 2019: operating profit of R46m). For the period up until 30 June 2020, impairments were stable at R45m.

Impact on credit view
We expected that IFRS9 and additional provisioning would severely affect the income statement of Land Bank, however, we are currently comfortable that there are still sufficient levels of capital at Land Bank, with the loan book adequately provided for. A better performing agricultural sector, supported by recent good rains, should assist the Land Bank's farmers and in turn result in better debt collections from farmers. We are concerned that Land Bank's stated intention to "right-size" their balance sheet may mean that the higher-quality borrowers may move away from the Land Bank, and that existing borrowers may be constrained by Land Bank's active decision to advance only a portion (50%) of facilities, with implications for the quality of the loan book over time.

7. What is the seniority of Land Bank exposures, and are any of the exposures government guaranteed?

None of our client exposures to Land Bank are government guaranteed. All of our clients' exposure is senior unsecured debt.

8. What action has Futuregrowth taken following the SENS notification of the actual event of Default on the listed notes?

Following the release of the SENS on 20 April 2020, Futuregrowth continues to have productive and detailed engagements with the Land Bank management team to discuss publically available information on the matter of the Event of Default under the JSE listed bond programme, the proposed liability solution, as well as, other matters relating to its liquidity position, its financial performance and profitability outlook, and the credit quality of its underlying loan book. We also continue to engage Land Bank on governance matters, particularly in light of the significant turnover of Land Bank's staff and directors in the past 18 months since December 2018.

Futuregrowth is participating, together with c.9 other institutional asset managers in the Noteholder Committee that has been established at the request of Land Bank. The purpose of the Committee is to consider the proposals from Land Bank on this issue and to work, together with the rest of the noteholders and holders of shorter-dated unlisted instruments, to resolve this situation in the best interests of our clients and the Land Bank.

As part of the Noteholder Committee, we are assessing our position, the legal steps that follow on the occurrence of an Event of Default and our assessment of the Land Bank's liquidity, solvency and other metrics. We are also involved in assessing the likelihood of success of the proposed liability solution as it directly impacts our existing exposures. This assessment will also include ensuring that the new DMTN (as envisaged in the 17 June 2020 SENS) contains appropriate lending terms and includes all the necessary investor protections that have historically been absent from DMTNs, which are traditionally used to raise debt in the debt capital markets and that are absent in Land Bank's current DMTN. We are leaning on the work done by the ASISA[3] FISC[4] (where Futuregrowth is an active member) over a number of years on this subject and on which we have previously communicated to our clients. Since the receipt of the first draft of the DMTN on 23 September we have been engaged, together with the Noteholder Committee and our legal advisors, in reviewing and marking up these DMTN terms and conditions. In the coming weeks, the negotiation of an appropriate DMTN and ensuring the proposed liability solution is sustainable, will be the focus of our attention and we expect a robust negotiation on this matter. We believe a key determinant of the likely success of the proposed liability solution is investors being suitably comfortable that the terms and conditions of the DMTN and the proposed guarantee are appropriate and mitigate the risks of continuing to lend our clients' money to a distressed entity.

As a key partner in developmental finance in South Africa for over 20 years, and as a significant funder, historically, of Land Bank, we will endeavour to work with Land Bank, and all other key stakeholders, to support them through this challenging period, insofar as this can be done whilst honouring our fiduciary duty to our clients.

9. What is your approach to your fixed interest investments in the current environment?

The current environment is very challenging for all companies, for the country and for the local and global economy.

We continue to assess all our counterparties in a consistent, evidenced-based way, following our standard process. We have implemented heightened monitoring and more regular check-ins with management teams across the counterparty universe. We are also using the movement in certain market data points to guide our thinking on appropriate risk-adjusted pricing and the investment thesis for each counterparty. We remain focused on appropriately managing the risks, as well as the opportunities, that may eventuate from the current crisis.

10. Please comment on incumbent management and any proposed changes as part of the extension of the liquidity facility and/or note holder term-out.

The new CFO and CEO were appointed in February 2020 and March 2020 respectively, filling – in a permanent capacity – roles that had been vacant or filled with "acting" appointments since the resignation of the former CEO Mr TP Nchocho in December 2018. Since their appointment, they have been seized with dealing with the liquidity crisis and the resultant defaults. There are a number of appointments, which still need to be filled.

Following the appointment of a permanent Chief Risk Officer and a Head of Treasury, our understanding is that the only remaining senior role to be filled is that of General Manager: Finance.

We are not aware of any other changes to the management team.

11. What keeps you awake and is the worst case scenario? What are the potential losses for debt holders in this scenario?

Thus far, our prevailing view has been that the shareholder will provide the appropriate level of support, that the Land Bank's liability profile will likely be appropriately and sustainably restructured and that the Land Bank will, once the defaults are remedied, continue with its business of providing funding to the agriculture sector. The SENS of 17 June 2020 seemed to affirm this view – it contemplated an equity restructuring in addition to the proposed liability solution and communicated that no loss of capital or interest on existing instruments is anticipated. The tabling of a R3 billion appropriation for Land Bank as part of the Supplementary Budget Review presented to Parliament on 24 June 2020 provides evidence of the shareholder's (National Treasury) willingness and ability to continue to support the Land Bank.

[3] The Association for Savings and Investment South Africa
[4] Fixed Income Standing Committee

That this R3bn appropriation was fully received by Land Bank by end-September 2020 provides further evidence of National Treasury's commitment as Land Bank's shareholder.

We highlight that there continues to be significant execution risk to the successful completion of this restructuring, the delayed timetable provides us evidence of this and we believe there is risk of further slippage of the most recent dates. We believe the success of the planned restructuring will largely depend on the final outcome on these points:

- continued adherence by the Land Bank of their public undertaking to treat all creditors fairly during this restructure process and not to advantage one set of creditors over another;
- the quantum, timing and any conditionality of the proposed "equity solution" (over and above the R3bn already committed) that is needed to ensure the appropriate levels of equity support from the shareholder, as represented by National Treasury;
- our review of the report following the independent review of the Land Bank's book which is needed to confirm Land Bank's solvency and ensure its ongoing sustainability;
- the terms and conditions of the new instruments issued under the "new DMTN";
- the nature, extent, timing and any conditionality attached to the proposed credit enhancement (specifically the partial government guarantee) of the new DMTN;
- the proposed maturities of the new instruments;
- the revised pricing of the new Land Bank instruments; and
- certainty that the required very high percentage (close to 100%) of existing funders will agree to the terms of the proposed liability solution.

We highlight that many of the points above have been raised by noteholders with the Land Bank and its advisors for some months now and, while there has only recently been some progress on some of these points, overall progress remains slow and we are concerned about further slippage in the timely execution of these key outcomes.

12. It would seem that for an ordinary portfolio investor, there is no real upside in remaining invested in Land Bank bonds (other than possibly avoiding realising a capital loss), but the real prospect of a long process to resolve the liquidity problem with no interest payments in the near future (2020?) and little to no apparent upside for the investor?

As a bond investor, our primary role is to protect against downside risk, with the only upside we have being the servicing of interest and the repayment of capital. To this extent, the information we have at hand is that there is likely to be no loss of capital or interest on the existing instruments. The SENS (of 17 June 2020) affirms this quite clearly. The SENS of 7 August 2020 has confirmed the resumption of interest payments and we are advised that it is expected that by 6 October 2020, Land Bank will have fully caught up on all outstanding interest.

There is likely to continue to be some volatility in the listed bonds as the situation evolves and as the various investors in the market evaluate their respective positions.

13. What is next for Land Bank?

We reiterate that there continues to be an urgent need for all parties, including Land Bank management, National Treasury (as represented by the Minister of Finance), funders and others, to rapidly execute on the Land Bank's longer-term capital, funding and structural challenges. These challenges have all been exacerbated by the continuing Events of Default on the listed notes.

The SENS issued by Land Bank on 17 June 2020 as well as the SENS notices dated 15 and 22 September 2020, provides some clarity on the proposed resolution of these challenges. We note that more detail is needed to properly assess this proposal and that the successful outcome of this proposal rests on noteholders' satisfaction with:

- the proposed equity solution, including the quantum and timing of the recapitalisation;
- Land Bank's current and future solvency position and the quality of its book; and
- the proposed new instruments' terms and conditions, including the pricing levels, credit enhancement (specifically the partial government guarantee) and proposed maturities.

The SENS issued by Land Bank on 7 August 2020 regarding the resumption of interest suggests that short-term cash flow strain appears to be abating and the information received most recently, seems to indicate that the receipt of the R3bn equity from National Treasury has alleviated the cashflow strain somewhat.

As mentioned elsewhere in this note, despite public statements that Land Bank commits to ensuring that all creditors will be treated equally, the previous request from Land Bank to allow capital repayments to certain DFIs before the implementation of the final liability solution re-emerged in late August and has been adequately resolved with the agreement that Land Bank will repay all funders 5% of their capital at the earlier of the implementation of the liability solution or 28 February 2021. We believe that ongoing adherence to the undertaking by Land Bank to treat all creditors fairly as well as a liability solution that is sustainably structured and contains suitable terms, conditions, reporting and pricing enhances the likelihood of a successful debt restructure.

The key milestones we are currently monitoring include:

1. The outcome of the legal action undertaken by Standard Chartered Bank.
2. The proposed restructuring of Land Bank's business to reduce the size of their operations and to focus more specifically on developmental farming, which has obvious implications for the quality of the underlying loan book, Land Bank's historic business model and funders' assessment of the risk profile of the entity.
3. The timely receipt of the proposed terms of the liability solution that are needed to assess the investment case of the proposed liability solution.
4. The execution of a DMTN that appropriately addresses the requirements sent by noteholders to Land Bank in late June 2020.
5. The successful implementation of the proposed Liability Solution within the revised indicated timeframes.
6. The receipt of the 5% capital repayment that Land Bank has undertaken to make to funders in their SENS of 22 September 2020.

As at the date of this update (6 October 2020), we note that all of the above remains outstanding.

We continue to actively participate in the broader industry and stakeholder discussions, and as part of the Noteholder Committee mentioned above, to ensure the best outcome for our clients.

Conclusion

We are conscious that almost six months have elapsed since the date of the first SENS notifying the market of Land Bank's Event of default – while there has been some limited progress, the timelines and deadlines indicated by Land Bank in their SENS of 17 June 2020 have largely been missed.

In addition, despite public statements that Land Bank commits to ensuring that all creditors will be treated equally, the previous request from Land Bank to allow capital repayments to certain DFIs before the implementation of the final liability solution re-emerged in late August and has been adequately resolved with the agreement that Land Bank will repay all funders 5% of their capital at the earlier of the implementation of the liability solution or 28 February 2021. One of the Noteholder conditions in agreeing to the DFI payment in August, was that the funds to be used for the 5% liability reduction had to be set aside. As at 30 September 2020, Land Bank confirmed that this was the case in a letter from the CEO to the Noteholder Committee.

We believe that ongoing adherence to the undertaking by Land Bank to treat all creditors fairly, as well as a liability solution that is sustainably structured and contains suitable terms, conditions, reporting and pricing, enhances the likelihood of a successful debt restructure. In the coming weeks, the negotiation of an appropriate DMTN and ensuring the proposed liability solution is sustainable, will be the focus of our attention and we expect a robust negotiation on this matter. We believe a key determinant of the likely success of the proposed liability solution is investors being suitably comfortable that the terms and conditions of the DMTN and the proposed guarantee are appropriate and mitigate the risks of continuing to lend our clients' money to a distressed entity.

We continue to assess evolving information and the status of our client exposures to determine the necessary next steps, including assessing our legal remedies, to ensure the best possible outcome for our client funds.

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