

**Land Bank New Year's Eve results release - plus an update on the capital repayment****Author: Olga Constantatos, Head: Credit****Updated: 18 January 2021 (First published on 13 January 2021)**

There has been a flurry of new information on Land Bank since our last update on 26 November 2020: 1) the publication of abridged and interim results on New Year's Eve, and 2) the release of two SENS notices on 11 January 2021.

We provide brief highlights of this new information, together with our views and some questions on which we require clarity.

**1. New Year's Eve results – nothing to celebrate**

While most of us were likely enjoying our New Year's Eve (appropriately socially distanced and within the curfew and other regulations of course!), Land Bank's abridged audited results for the financial year ended 31 March 2020 and the unaudited interims for the six months ended 30 September 2020 were released. (See here for the announcement.)

The fact that the results released are "abridged" is problematic. It means that we do not have a full picture of the financial position, profitability or cashflows of the Land Bank for FYE2020. This is exacerbated by the announcement that the full set of audited Annual Financial Statements (AFS) for the year ended on 31 March 2020 will be released in Q1 2021. Even with the additional dispensation given by the JSE for COVID-related delays, this is very delayed – and is even more critical in the context of the most recent audit opinion.

*Disclaimed audit opinion*

Land Bank has been one of the few SOEs that historically has had successive years of unqualified audit opinions. So it came as a surprise that the FYE2020 results have a disclaimed audit opinion from the Auditor-General ("AG"). A disclaimed opinion is one where the auditor is unable to give an opinion due to "insufficient evidence in the form of documentation on which to base an audit opinion".

In reviewing the AG's accompanying report, the reasons for the disclaimed opinion – and our comments - are as follows:

- 1. Lack of certainty around Land Bank's ability to continue as a going concern.** This was to be expected, as the debt restructure and implementation of the liability solution (following the event of default in April 2020) had not yet been finalised at the date of the AG's report. We highlighted the ongoing delays in executing the liability solution and expressed our concerns around this in a note published on 26 November 2020.
- 2. An inability by the AG to obtain sufficient audit evidence that expected credit losses have been adequately accounted for.** This is of deep concern. By its very nature, the Land Bank is a lending institution. Its key asset is its lending book and consequently, if the AG cannot express an opinion on this due to a lack of information and "inadequate financial controls", then creditors to the Land Bank are in the dark as to the validity and valuation of the book.
- 3. Uncertainty regarding the collateral held by Land Bank (as security for advances made to farmers).** Specifically mentioned in the report is an amount of R7.1 billion included in the collateral register which Land Bank is not entitled to claim in the event of default by the farmer(s) who owe Land Bank money. Again, this points to a worrying lack of information, records and internal controls around the lending book. In many instances these loans will have been secured over assets (land, moveable property, stock etc) and in the event of default, the recovery of amounts owed to the Land Bank may be substantially less than anticipated.
- 4. An inability to express an opinion as to whether the credit risk disclosure note in the AFS (which is not included in the abridged results that were made available) is properly**

**accounted for.** The AG points to a lack of “reliable ... data” and an inability to confirm the disclosure note by alternative means. As the note is not disclosed in the information released on 31/12/2020, we are unable to ascertain the impact of this.

In addition to the disclaimed opinion, the AG required a restatement of prior year figures (for FYE ended 31 March 2019), and this “resulted in the entity’s reported profit for the prior year being restated to a loss”. The AG’s report mentions note 49 in reference to this comment, but as the full set of AFS has not been released, we are unable to ascertain the impact of this. What is clear from a review of the original 2019 AFS, is that an impairment charge of R324 million in the original AFS has been restated to R1 188 million in the prior year – a 267% increase from the original charge.

### *Abridged audited AFS for the FYE 31 March 2020*

Page 9 of the abridged results for FYE20 highlights:

- A significant drop in net interest income (R646 million in FY20 compared to R1 097 million in FY19);
- An increase by 52% in impairment charges to R1 807 million from the restated FY19 numbers (the increase is 457% from the original FY19 impairment charge of R324 million);
- A loss for the year of over R1.7 billion; and
- A spike in the bank’s cost-to-income ratio to 111% (PY restated 70.8%, PY original 57%).

A number of financial covenants are in breach as a result of the above points, adding to the existing ongoing events of default that are related to non-payment of matured instruments and the existing cross default.

Some additional detail is given on the worsening book and the increased impairments charge on page 12 of the presentation. This paints a worrying picture of a decline in the performing book – these are loans that are up-to-date with their instalments - from 82% in the prior year to 72% as at 31 March 2020 and a doubling of the non-performing book from R4 billion in FY19 (restated) to over R8.1 billion in FY20. And because of the disclaimed opinion (specifically around credit information), these numbers could be worse - or better... we just don’t know.

### *Interim financial results for the six months ended 30 September 2020*

These were also released on New Year’s Eve – and continue the theme presented in the abridged results for FYE20. NPL<sup>1</sup>s remain at just over R8 billion, and the performing book drops to 66.3%, mainly as a result of repayments made by clients of the Land Bank. It has long been a concern of ours that the liquidity crunch experienced by Land Bank following the ongoing existing default will result in Land Bank’s inability to continue to advance funds to its clients - and that quality clients will consequently repay Land Bank and move their business to another funding institution. From the drop in performing loans, it appears as if this is already happening, and points to an overall worsening of the quality of the lending book over time as those farmers without funding alternatives (usually the riskier clients) will be the ones to remain with the Land Bank and will form an increasing proportion of the lending book. This is a grave worry for us as lenders: as part of the liability solution, we are being asked to term out our exposures and thus be potentially exposed to an increasingly worse performing book.

### *Inaction has consequences too*

Statements made in the documentation released on 31 December indicate a “loss of corporate memory which resulted from resignations of key employees”. We agree with this assertion and would add that this was likely compounded by the delays in appointing permanent replacements and the shuffling of executives in acting positions over the past two years. It is worth repeating what we wrote in our note to clients on 23 April 2020, shortly after the initial SENS reporting the event of default:

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<sup>1</sup> Non-performing loans

*"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."*

While all decisions have consequences, not making a decision has consequences too. The consequence of being slow to appoint permanent replacements is evident in the disclaimed audit opinion and the deteriorating financial performance of the Land Bank.

#### *Liability solution update*

Similar to inaction on staff appointments, the lack of significant progress on the execution of the liability solution continues to be of grave concern. We were previously promised a reviewed set of documents (specifically the DMTN<sup>2</sup> and the guarantee) in early December; however, these were not sent to noteholders before the Christmas break.

Despite a request for a revised date for the receipt of the updated documents - and clarity on the very detailed and specific requirements from noteholders which were first communicated to Land Bank, its shareholder and advisors as early as June 2020 - Land Bank, National Treasury and their advisors have not committed to a date by which they will respond. We believe significant risk remains to the proposed liability solution execution deadline of 31 March 2021.

## **2. The SENS notices of 11 January 2021 raise concerns**

The two SENS notices issued on Monday 11 January 2021 provide some further detail on the proposed capital repayment first outlined in the SENS of [22 September 2020](#).

The SENS notices deal respectively with matured (and unpaid) and non-matured listed instruments, but the general theme is consistent across both notices. The notices state that the capital reduction to noteholders will be increased to 10% of outstanding nominal (from the 5% in the SENS of 22 September 2020). The increased capital repayment arises out of the Land Bank's upcoming amortising payments due to certain international DFIs – and that to "uphold the INSOL principles and align the South African lenders", Land Bank is increasing the capital repayment that will happen before 28 February 2021 from 5% to 10% of outstanding nominal.

The notices outline that outstanding and accrued interest (from the date of the last interest payment to the settlement date) due on the capital reduction will also be repaid at the same time as the capital repayment in February 2021. The capital repayment will be done as a Buy-Back Offer, and there is a

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<sup>2</sup> Domestic Medium Term Note Programme – the document that governs the lending relationship between bondholders and the issuer, Land Bank.

specific process for asset managers to follow in order to get the 10% repayment on behalf of our respective clients.

Land Bank has stated its continuing commitment to upholding INSOL principles by making a further payment to other lenders as well as the DFIs whose amounts will fall due in February and March 2021; however, the quantum that the DFIs will be repaid is in excess of the 10% that is being offered to Noteholders (it ranges between 11-14% of their outstanding nominal). Our question is whether INSOL is in fact being upheld when the capital redemption is not applied equally across all lenders. The fact that some lenders are getting more of their capital back (relative to other lenders) is not, in effect, treating all creditors fairly. We will be posing this question to Land Bank management and their advisors in the coming days. (\*\*Refer to the brief update below for events subsequent to this note first being published.)

Further, the SENS notices contain some alarming provisions surrounding the Buy Back Offer, most notably provisions that the Offer may be rejected by Land Bank if it has not acknowledged receipt of the documentation sent by Noteholders or for "any other reason". We believe that this places an unacceptable risk on Noteholders. It means that, despite completing all the documentation properly and following the appropriate process, Land Bank may decide to not accept the offer from some or all Noteholders. As with the above question on INSOL, we are awaiting clarity on these provisions from Land Bank and its advisors. (\*\*Refer to the brief update below for events subsequent to this note first being published.)

#### *Looming deadline*

We reiterate our urgent call for Land Bank, its shareholder and its advisors to substantively progress this matter and make the crucial decisions that have long been needed to implement the liability solution - on terms that are appropriate for a defaulted and distressed entity borrowing money from pension fund clients.

On 11 December 2020, as part of the Standard Chartered litigation, the court imposed certain conditions which Land Bank needs to meet by 31 March 2021 in order to delay the repayment of the amounts it owes to Standard Chartered. These conditions are not detailed in the SENS of 11 December 2020. The court order is a matter of public record and it includes the requirement that there is agreement by all financial creditors to implement the liability solution (which is required to cure the ongoing event of default) by 31 March 2021. The consequence of this is that the execution of the liability solution has a hard (and looming) deadline of 31 March 2021.

Continued inaction and delays will have dire consequences for Land Bank's future financial and operational sustainability and its ongoing ability to fund in the capital markets. This will likely negatively impact the ability of other SOEs to obtain funding from pension fund clients in the capital markets.

The clock is ticking ...

#### **\*\*A SENS was issued on 15 January 2021 providing an update on the partial capital redemption:**

Land Bank sent an updated SENS on 15 January 2021, in which they increased the amount of the partial capital buy-back offer from 10% of the outstanding nominal to 12%. We understand that this was done to ensure that parity remained between all lenders due to the DFI payments and hence ensures that INSOL principles remain intact. The SENS also removes some of the conditionality that was present in the previous buy-back offer process.

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