EQUIFAX

Credit Ratings & Research

Credit Rating Review

Mutual Credit Finance Limited

NZBN: 9429031969055

Credit Rating Synopsis

Date: 13 December 2024

Prepared for: Mutual Credit Finance Limited

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

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Currency used in this report: This report is presented in New Zealand Dollars unless otherwise noted

Corporate Scorecard

From Equifax

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1. Executive Summary

Mutual Credit Finance Limited ("MCF" or "the Company")

MCF is a Non-Bank Deposit Taking (NBDT) organisation licensed and regulated by the Reserve Bank of New Zealand (RBNZ) and primarily caters to customers relatively underserved by traditional banks.

Equifax Credit Ratings Australasia Pty Ltd ('Equifax') has assigned MCF a credit rating of 'B+' at Sep24, which is a sub-prime classification with a moderate level of risk. The rating has been upgraded to 'B+' at Sep24 from 'B' at Mar24, supported by continued increase in net operating income (on an annualised basis), sustained healthy net interest margins amidst the pressures on cost of deposits, and substantial growth of the loan book backed by demonstrated ability to raise deposits in the interim period (follows a slowdown in loan book/deposit base growth in FY24). Equifax has a 'Stable' outlook for the rating over the next 12 months as MCF seeks to adopt a judicious approach to further lending while it navigates the downward cycle in interest rates and to absorb any potential adverse impact of the implementation of the Depositor Compensation Scheme in FY25.

MCF's credit rating reflects its long operating history, improving scale and profitability, consistently healthy net interest margins, adequate liquidity position and potential net positive impacts of the proposed regulatory reforms. The risks to the rating arise from the lingering macro-economic risks, competitive pressures for deposits, increasing exposure to the property sector, a high proportion of non-amortising loans and second mortgages in the asset mix, and geographical concentration risks.

Strengths

- MCF's competitive position is supported by its long operating history since 1956, and the profile of its management team. Most Directors and Executive management (CEO and Finance Manager) are chartered accountants and have extensive industry experience in leadership roles. Further, the Company's loan book has grown by 132% since Mar20 as MCF has been able to capitalise on the market's increasing appetite for its offerings. This growth has been supported by a corresponding 119% growth in deposits while maintaining healthy net interest margins, reflecting a successful operating strategy, in our view.

- MCF's healthy earnings underpin its improving Return on Equity (6MFY25: 27.1%, FY24: 20.5%, FY23: 18.7%, FY22: 16.8%, FY21: 13.8%) and together with adequate retention of profits (36.6% of dividend payout ratio over the review period), in line with the Company's dividend policy, have helped the Company consistently maintain adequate capital ratios (Sep24: 12.6%, Mar24: 12.2%, Mar23: 13.1%, Mar22: 14.5%, Mar21: 12.8%). A resumption of growth in the loan book, after a slowdown in FY24 (growth of 2.2%) is likely reflective of the opportunities available for short-term lending particularly to residential property mortgage/developments potentially due to relatively better economic conditions in the Canterbury region vis-à-vis rest of New Zealand. This combined with sustained healthy net interest margins of >5.0%, healthy lending activity driven non-interest income and a reduction in Cost-to-income ratio (6MFY25: 37.3%, FY24: 41.4%, FY23: 45.3%) have underpinned the above-mentioned improvement in earnings.

- MCF's liquidity is considered adequate despite the decline in cash reserves to $0.9m at Sep24 (Mar24: $3.7m). Management advised that this is due to the timing of loan and deposit payments/repayments and that cash reserves have improved substantially at Nov24. Further, the Company has a finance facility with ASB of $4.5m which gets included in the calculation for the liquidity ratio resulting in a ratio of 9.1% at Sep24 (8.75% stipulated in the Trust Deed if the Capital Ratio is between 11.0%-13.0%). The Company's liquidity position is also supported by its favourable asset-liability maturity profile with loans worth $65.0m due within one year compared to $39.0m for maturity of deposits for the same period.

- MCF has maintained its exposure to the gaming sector to $5.9m at Sep24 (Mar24: $5.7m; May23: $0.8m), representing 7.4% of the loan book (Mar24: 8.2%; May23: 1.3%), helping the Company to diversify both in terms of sector and type of loans (amortising loans).

- RBNZ is in the process of aligning the regulation of all deposit takers under one framework (The Depositors Takers Act is expected to be fully in force by 2028) and introducing a depositor compensation scheme. More stringent regulatory oversight of NBDTs will promote public confidence in the sector, and in turn, enhance MCF's capacity to obtain funding from depositors in the long-term, in our view.

Constraints

- The NBDT sector players including MCF face significant macroeconomic headwinds in the short-term, despite the recent cuts in interest rates, due to the lagged effect on the economy and therefore pressures on asset quality will persist, in our view. In our view, MCF's asset quality may come under pressure with double impact of adverse property price movements eroding collateral coverage and a deterioration in borrowers' repayment capacity in tough economic conditions. However, we note that current performance of the loan book is considered satisfactory, evidenced by low NPLs and credit loss ratio.

- The Company remains exposed to a high proportion of non-amortising loans (91.8% of the loan-book at Sep24) despite exposure to the gaming sector as noted above. Further, the loan book growth is being driven by property related loans which accounted for 85.9% of the loan book at Sep24 and therefore the lack of diversification makes the Company vulnerable to sector-specific downturns. Moreover, presence of loans secured by second mortgages (7.9% of the loan book) in the overall asset mix also weighs on risk adjusted capital requirements. Positively, majority of MCF's loans have less than one year maturity and the average Loan to Value of the loan book is 69.6% at Sep24, thereby partially mitigating some of these risks.

- Notwithstanding the recent growth in the deposit base, competitive pressures remain and therefore attaining further growth in the deposit base whilst managing the cost of deposits is a key challenge in the next 12 months, for sustaining healthy net interest margins and achieving near-term growth objectives. Further, the immediate impact of the Depositors Compensation Scheme, which is scheduled to get implemented in 2H25, remains uncertain. We note an increasing trend in cost of deposits (6MFY25: 7.2%, FY24: 6.1%, FY23: 5.3%, FY22: 4.9%) potentially reflecting industry-wide competition for deposits amongst other factors. Positively, the cost of deposits appears to have peaked as banks and NBDTs align their deposit rates with the substantial cuts in the interest rates by RBNZ (three cuts in four months). We note that MCF has not offered any increase in rates on 12-month term deposits since May23 and may seek to reduce its interest on deposits in-line with the sector which may alleviate pressure on its net interest margin.

- MCF's operations are exposed to a high level of geographic concentration risks as most of its business is generated in the Canterbury region of New Zealand. In our view, this makes MCF's business and earnings highly susceptible to region-specific shocks. However, we acknowledge that operating in a specific region may allow the Company to better serve its customers' specific financial needs while maintaining close ties to its local community.

- MCF's limited offerings and relatively small operating scale also constrain its overall business and competitive profile. MCF, similar to majority of other NDBT organisations, does not provide full suite of banking services thereby limiting its ability to compete with larger peers and traditional banks to retain and grow its depositor base. Furthermore, increased competition from innovative new financial products and FinTech's may impact the Company's ability to generate healthy returns on its loan assets.

The outlook for MCF's credit rating is 'Stable' at Sep24. A rating upgrade would require a sustainable improvement in scale and diversification of operations, while maintaining profitability and asset quality. There may be downward pressure on the rating if the Company's asset quality, capital ratio or liquidity positions materially deteriorate, on an individual or a collective basis.

Risk Rating

B+

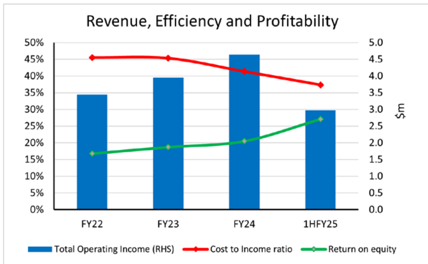
Outlook: Stable

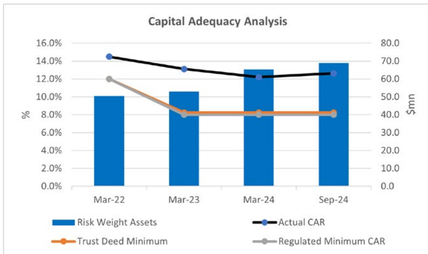
Type: Public, Monitored

Industry Percentiles

Scale:	
Total Assets	25%
Gross loans	33%
Profitability:	
NIM	75%
ROE	100%
ROA	100%
Efficiency Ratio	83%
Capitalisation:	
Leverage (Gross Loans to Equity)	42%
Capital Ratio	8%
Capital to Total Assets	67%
Funding and Liquidity:	
Deposits to Loan Ratio	92%
Liquid Assets to Total Assets	0%
Asset Quality:	
Net Charge-offs	42%
Impaired Loans	50%
Provision for Loan Losses	33%

Key Trends





2. Scope of Report

The purpose of this report is to provide a Credit Rating Synopsis on Mutual Credit Finance Limited.

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

Report Details	
Date of Report	**13 December 2024**
Request Type	**Issuer (Self-assessment)**
Assessment Type	**Under ongoing monitoring**
Rating Initiation	**Issuer based (solicited)**
Rating Distribution	**Public**
Report Distribution	**Unrestricted**
Purchased by	**Mutual Credit Finance Limited**
Report Fee	**Fixed Price**
Ancillary fees	**Nil**
Issuer Name	**Mutual Credit Finance Limited**
Issuer First Time Rated	**No**
Issue Name	**Not Applicable**
Issue First Time Rated	**Not Applicable**
Financial Scope	**Standalone Entity**
Entity Structure	**Limited Company**
Issuer Industry	**Financial Services**
Issuer Sector	**Non-Bank Deposit Takers**

This Report should be taken as a whole and cannot be abridged or excerpted for any reason.

We have conducted this assessment on the basis of the information provided to us by Mutual Credit Finance Limited, publicly available information and from our own enquiries. We have derived a credit rating on the Company based on the understanding that Mutual Credit Finance Limited has no contingent liabilities, cross guarantees or other liabilities to any other entity other than as disclosed to us or as detailed in the financial statements. Our duty does not include auditing the financial statements.

Information Sources	
Financial Statements	**- Statutory Financial Statements of Mutual Credit Finance Limited for the six-month interim period ended 30 September 2024.** **- Audited Financial Statements of Mutual Credit Finance Limited for the years ended 31 March 2024, 2023, and 2022.**
Name of Auditor	**PricewaterhouseCoopers (PwC)**
Other Information Sources	**The Company's response to our Request for Information, the Company website, industry and regulatory websites, management interviews, media articles, adverse searches, and internet searches.**
Issuer Participation	**Full**
Material Financial Adjustments	**None**
Limitations of Assessment	**None noted**
Outsourced Assessment Activities	**No**
Confidentiality Agreement	**No**
Material Client	**No**
Rating Amended Post Issuer Disclosure	**No**
Potential Conflict of Interest	**None noted**
Rating Methodology	**Financial Institution Rating Criteria**

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

APPENDICES

1. Explanation of the Equifax's credit rating

1.1 What is a rating?

Credit ratings provide an Agency's opinion as to the capacity, viability and willingness of an entity, issuer, or counterparty to meet their respective financial commitments. As such, Equifax assigns ratings based on the credit worthiness of an entity, commitment, or product, and provides probabilistic assessments of default over the short, medium, and long-term.

Credit ratings are a critical measure used extensively in commercial, financial, and capital markets to support key business decisions. Equifax's credit ratings are used to support debt and bonding decisions, loan origination and recovery, insurance and warranty, funds management, portfolio management, tendering and procurement, counterparty risk assessments and other commercial contracts.

Equifax provides credit ratings on government and commercial agencies, international conglomerates, infrastructure consortia, financial institutions, publicly listed entities, private corporations, and small-to-medium sized enterprises across a range of industry sectors both domestically and internationally. As such, Equifax is also able to provide detailed industry intelligence, benchmarking reports, and analysis across a wide range of sectors.

1.2 Equifax's credit rating

Equifax and other credit rating agencies all attempt to measure the probability of an entity being able to honour its financial commitments as and when they fall due. The most recognised credit rating is that based on Bond Rating Equivalents (BRE) used over the past eighty years to determine the proximity of an entity's securities to default (non-payment of interest or principal). The accuracy of this method has been extensively tested and is accepted worldwide.

The Equifax's database contains more than 100,000 financial years of information spanning more than twenty-five years. As such Equifax is in a unique position, having developed a large and empirical data source on entities across various industry sectors with long data histories covering a range of economic conditions and one or more complete business cycles. Equifax has therefore been able to use a variety of quantitative validation tools and comparisons using this information to adequately verify the stability, accuracy, and consistency of its rating models.

Equifax's rating models have been designed to assess the proximity of an entity to defaulting on its financial commitments and obligations. Proprietary risk analytics are used to evaluate the multivariate interrelationship of key risk indicators using scientifically based and empirically derived risk metrics. These models evaluate the financial performance, position, and profile of an entity in the context of its industry, size, and structure. They have been validated on Australian and international data with the assistance of Professor Edward Altman, an internationally recognised leader in the field of credit risk analysis and bankruptcy prediction.

Equifax uses its comprehensive benchmarking database to evaluate the financial position, performance and credit quality of an agency, institution, corporation, or entity relative to an industry and its peers. This enables the identification of key sensitivities, trends, cautionary alerts, and exception reports based on identified anomalies and/or outliers across key credit indicators of a select benchmarking group.

While there is no single method to discriminate unambiguously between firms that will default and those that will not, Equifax can make probabilistic assessments of default. This requires a large database of actual defaults to enable an assessment of default probabilities and actual default rates from empirical evidence. The Australasian market has a comparatively small number of corporate bond issues and a relatively benign credit climate over recent decades, and as such empirical data on Australian default rates is limited. Therefore, Equifax considers it is more appropriate to apply default probabilities using empirical data from international markets over several economic cycles.

Equifax's default statistics have been derived from nearly twenty years' experience analysing mainly US non-financial, non-utility corporate bond issuers. The analysis covered a relatively large number of companies (approximately 1,000 rated each year) and follows the well-established static pool approach used by Credit Rating Agencies to report their default experience. Static pools were created for bond issuers each year by both notch and grade, and the history of these bond issuers was then analysed over the period. The pools were then combined so that long-term average default experience by duration could be calculated, and both annual and cumulative default experience was calculated from the pools.

Equifax's risk analytics enable analysts to evaluate the most critical and sensitive financial and risk items through the Risk Assessment Platform by analysing key indicators to derive a definitive credit risk score and Bond Rating Equivalent (BRE), providing Probabilities of Default (PoD) over the short-, medium- and long-term horizon.

1.3 Rating Definitions

Credit ratings provide an Agency's opinion as to the capacity, viability, and willingness of an entity to meet their respective financial and contractual commitments. As such credit ratings are assigned in accordance with the entity, commitment, or product's proximity to default. Equifax adheres to internationally recognised grades and are similar to other agency classifications, providing ratings across twenty-two credit notches from 'D' (in default) to 'AAA' (extremely strong).

Moody's	Fitch	S&P	Rating	Default rates (5 years)	Classification	Risk Level
Aaa	AAA	AAA	AAA	0.17	High Grade	Negligible
Aa1	AA+	AA+	AA+	0.31		
Aa2	AA	AA	AA	0.44		
Aa3	AA-	AA-	AA-	0.55		
A1	A+	A+	A+	0.76	Investment Grade	Very Low
A2	A	A	A	0.81		
A3	A-	A-	A-	1.47		
Baa1	BBB+	BBB+	BBB+	2.08		Low
Baa2	BBB	BBB	BBB	3.19		
Baa3	BBB-	BBB-	BBB-	4.37		
Ba1	BB+	BB+	BB+	7.13	Near Prime	Low to Moderate
Ba2	BB	BB	BB	7.49		
Ba3	BB-	BB-	BB-	10.52		
B1	B+	B+	B+	16.34	Sub Prime	Moderate
B2	B	B	B	22.21		
B3	B-	B-	B-	24.16		High
Caa1	CCC	CCC+	CCC+	28.16	Credit Watch	Very High
Caa2		CCC	CCC	29.90		
Caa3		CCC-	CCC-	39.16		
Ca		CC	CC	52.87	Distressed	Extremely High
		C	C	55.00		
C	D	D	D	100.00		

Equifax assigns ratings based on the credit worthiness of an entity or a specific financial commitment, and provides probabilistic assessments of default over the short, medium, and long-term. Every entity or commitment has some probability of default over a period of time, even those assigned with the strongest of ratings. An Investment Grade classification is attributed to credits that exhibit a lower probability of default, while a Sub-Prime classification has a greater expectancy of default.

An Equifax's credit rating may also be assigned additional clarification markers (symbols) to qualify the credit risk assessment. These may include:

Conditional Rating (#)

A Conditional Rating is used where Equifax has rated an entity on the basis of significant risk factors and/or report qualifications, with recommendations providing one or more conditions precedent and/or mitigation action(s) to reduce identified uncertainty and risk.

Provisional Rating (*)

A Provisional Rating is used when the most recent financial figures are based on draft management accounts or are deemed out-of-date. Entities with a provisional rating should be re-evaluated as soon as finalised financial statements become available.

Indicative Rating (^)

An Indicative Rating is used where Equifax is engaged to conduct preliminary analysis only, and as such an official rating assignment would require a more detailed and comprehensive investigation and due diligence assessment prior to the provision of our professional opinion.

1.4 Rating Outlooks

Equifax's forward estimates help ascertain the trajectory of ratings as well as the risks to ratings. Ratings with a positive trajectory are assigned 'Positive Outlooks'. Ratings with a negative trajectory are assigned 'Negative Outlooks'. Where Ratings are expected to remain unchanged, a 'Stable Outlook' assigned.

Rating trajectories are closely related to the outlook for the corporate's earnings. Earnings growth that is within sustainable growth parameters together with an attenuation of earnings volatility provide upward rating pressure and so may warrant the assignment of a Positive Outlook.

Credit Concepts measured

The main credit concepts measured against Australian and New Zealand Standard Industry Classifications (ANZSIC) and specific Peer Groups based on entity size are available in Corporate Scorecard's Rating methodology, which can be found at the below-mentioned links

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

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

2. Regulatory Disclosures and Disclaimer

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

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

The credit rating issued by Equifax Credit Ratings reflects our current opinion of the relative credit risk of the institution. This opinion has been formed in accordance with Equifax's published credit ratings methodology - financial institution rating criteria (Issue 8, November 2021).

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

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