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Digesting the ABIL impact

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ABIL's (African Bank Investment Limited) shock SENS announcement on the morning of 6 August 2014 threw the South African financial industry into unknown territory. As the bank's share price began its sharp decline, the financial community debated the impact that its failure would have on the country's much admired financial system.

The SARB (South African Reserve Bank) reacted immediately, working over the weekend to establish an R17bn bailout plan, aided by a consortium comprising the five largest banks and the PIC (the largest investment fund in South Africa). The bailout mapped out steps to establish and recapitalise a "New Bank", which would house the better performing loans. The senior unsecured debt holders would however, suffer a 10% haircut. The speed at which the bailout was announced, as well as the level of commitment by the industry's largest players, indicated that ABIL was viewed as capable of creating a crisis of confidence in the banking sector.

With the benefit of two months hindsight, it is now possible to start forming an opinion as to the ramifications that ABIL has had on South Africa's financial landscape. The reaction has been largely mixed, with some industry players bouncing back whilst others have felt a material negative impact.

Initially all eyes turned to Capitec with concerns over similar asset quality issues emerging in their book and a possible run on the bank by retail depositors. The bank has indicated that subsequent to ABIL and the much criticised credit rating downgrade by Moody's, they did experience difficulties in attracting fixed term funding. However, the release of their interim results which showed continued earnings growth and a largely stable loan book, reinforced Management's belief that they are significantly different to ABIL. A more conservative provisioning policy and a burgeoning retail transaction business have largely shielded the bank from the ructions witnessed in the unsecured lending space.

One positive of course, is that their major competitor has largely exited the market (for the meantime at least), and management indicated that they are starting to see more customers coming into their branches.

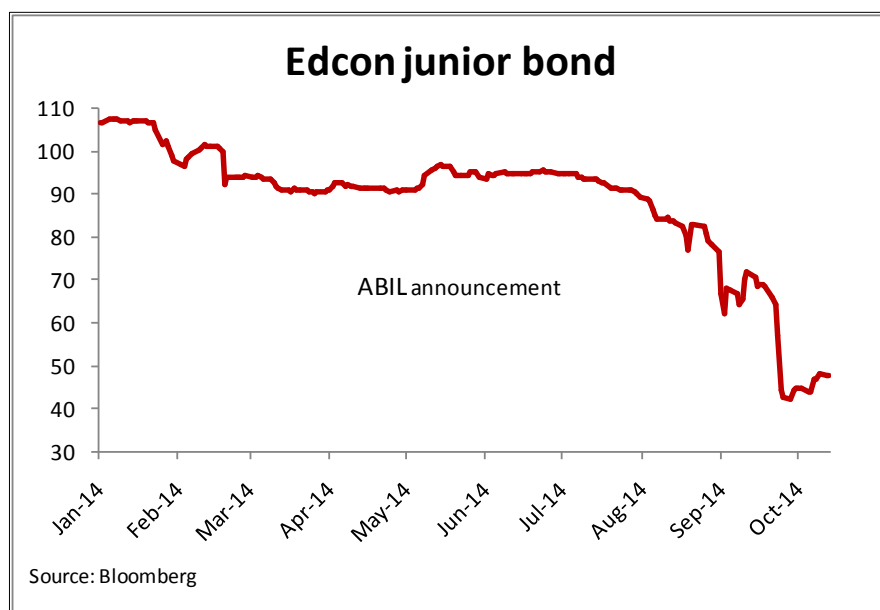
Other micro providers were not as lucky. Another prominent unsecured player, Bridge Corporate has applied for business rescue after experiencing a dramatic turn in investor sentiment, which resulted in two major anticipated funders pulling out, leaving the business short of capital.

Money market and fixed income players were also negatively impacted. At the time of being placed under curatorship, ABIL had just under R40bn in domestic money market and corporate bond debt. In the days following ABIL's announcement, over R10bn flowed out of money market funds as investors attempted to avoid exposure to the imposed haircut. Over 50 investment funds applied to the FSB (Financial Services Board) for approval to side pocket their ABIL exposures.

Although the FSB subsequently announced that the total exposure of money market funds to ABIL only amounted to 1.3% of total assets, the event is a black mark against the industry. In order to protect South African retirement savings from another "ABIL", there are calls from certain corners of the industry to impose similar capital requirements on money market funds as there are on banks.

Whether or not the fixed income industry will provide funding to the "New Bank" once it re-lists is debatable. Capitec has yet to return to the wholesale debt market, mainly as a result of still being able to attract retail deposits, but management has indicated that they will be returning to this market next year – this will be an interesting data point as it will indicate whether the money market and fixed income industry still has appetite for unsecured lenders.

The ABIL fallout placed corporate debt levels under the spotlight. The debt burdened retailer, Edcon, has seen the price of its euro junior bond decline by 45% since the announcement – see graph below.

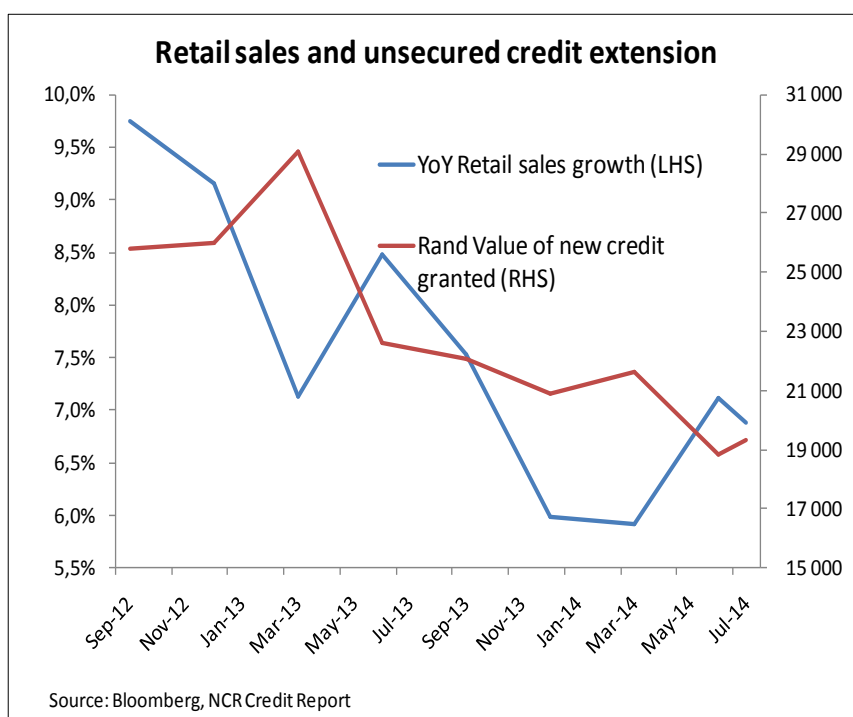


The retailer was the subject of a leveraged private equity buyout in 2007 and is now battling to carry its financial burden. With debt levels at 7.6x that of EBITDA, Edcon's woes were further compounded by the fall of ABIL as the bank had been lined up as the retailer's second choice credit provider.

The first choice credit provider, Barclays Africa, has previously cut back its appetite for Edcon credit, limiting the ability of Edcon to grow its top line and thus service its interest bill (estimated at around R2.9bn). Barclays' actions are however understandable. In the interim period to June, the Edcon book incurred R700m in credit losses (15% of the total gross book value) and is the bank's worst performing division.

The Edcon example clearly indicates the impact that the credit slowdown has on retailers. Truworths (a local fashion chain) has also slowed its credit sales, with the result that like-for-like store sales growth increased by only 1% in its financial year to June 2014 vs the 9% growth achieved in 2011, when the credit granting cycle was in full swing.

Data released by the National Credit Regulator (NCR) shows that the quarterly rand value of new unsecured credit extension has slowed from R29bn at its peak in the fourth quarter of 2012, to R19bn in the second quarter of 2014. Although difficult to determine, the data compiled below clearly demonstrates the correlation between retail sales growth and the level of unsecured credit extension – see graph below. This data is up to June 2014 and thus is yet to fully reflect subsequent events.



However, a slowdown in unsecured lending has its obvious advantages such as allowing the necessary deleveraging of the SA consumer. Data presented by Capitec in their recent interim results presentation, pointed to an improvement in this regard. It cited that the percentage of loan clients with greater than 40% of their cash available post debt servicing, has increased from 74% in August 2013 to 79% to August 2014.

Only time will tell what the full impact of ABIL will be. The unsecured industry, as we know it today, is in itself relatively new, barely seven years old (since the introduction of the National Credit Act in 2007) and thus we have limited knowledge on the full impact it has on the SA economy and its long-term cyclical behaviour.

Glacier Research would like to thank Matthew Pouncett for his contribution to this week's Funds on Friday.

Qualifications:

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Matthew served articles at Deloitte's Johannesburg office in their financial institutions team servicing banking, insurance and private equity clients. After completing articles was seconded to Deloitte's San Francisco's office and qualified as a Chartered Accountant at the beginning of 2013. Prior to joining Laurium, worked for Deloitte Corporate Finance's Transaction Services team performing buy side due diligence reviews.

