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Research Update:

Ratings On GFNZ Group And Quest Insurance Raised To 'B-' On New Funding; Outlooks Positive

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Overview

- The rating upgrades reflect New Zealand finance company GFNZ Group Ltd.'s (GFNZ) improved funding profile after securing a new funding arrangement and exiting a debt moratorium.
- The new funding arrangement, which includes a NZ$30 million Westpac New Zealand Ltd. warehouse trust facility, is expected to improve interest margins and long-term business stability.
- The long-term issuer credit rating on GFNZ has been raised to 'B-' from 'CCC' and removed from CreditWatch. The short-term issuer credit rating on GFNZ has been affirmed at 'C'.
- The outlooks on the ratings are positive.

Rating Action

On Oct. 11, 2013, Standard & Poor's Rating Services raised its long-term issuer credit ratings on New Zealand finance company GFNZ Group Ltd. (GFNZ) and GFNZ's wholly owned insurance subsidiary, Quest Insurance Group Ltd. (Quest) to 'B-' from 'CCC', and removed the ratings from CreditWatch with positive implications, where they were placed on July 17, 2013. The short-term issuer credit rating on GFNZ has been affirmed at 'C'. The outlooks on the ratings are positive.

Rationale

The rating uplifts reflect a holistic refreshing of GFNZ's funding structure, which has enabled the finance company to pay back Bank of Scotland and debenture holders ahead of schedule, exiting its debt moratorium. As a result, our view of GFNZ's funding and liquidity under the new funding arrangements has substantially improved, as the company now is supported by more manageable cash outflows over the short-to-medium term, and minimum expiry notice periods built into key facilities. This improved funding position represents a key milestone for GFNZ, giving it the potential to broaden its prospects for more meaningful lending growth, as funding restrictions that previously existed are now effectively lifted.

GFNZ is a south Auckland-based finance company that commenced in 2002, providing second-tier retail consumer finance services. Key product offerings are car loans and personal loans, which are originated via three channels: dealers, brokers, and directly.

In August 2013 GFNZ repaid all of its creditors using funds secured from new

funding arrangements that include a key NZ$30 million Westpac New Zealand Ltd. warehouse trust facility that drew NZ$17 million at inception. This facility has a rolling two-year maturity with a minimum expiry notice of six months; it provides flexibility for GFNZ to sell eligible receivables into a trust for which Westpac effectively provides close to 80% of the funding. The balance is funded by subordinated loans supplied by GFNZ as a form of credit enhancement. Most new loans are immediately eligible for sale into this trust, except for higher loan-to-value car loans that require three months of seasoning before they become eligible. In our view, this facility frees up GFNZ's cash flows, allowing receivables to grow at more meaningful levels. As the cash advance of new loans to customers precedes cash inflows from any sale into the Westpac facility net of credit enhancements, we do not expect new lending growth to initially surge at substantial levels; however, a staggered increase is more likely as excess reserves accumulate in the warehouse trust that would be available for new lending.

The new funding arrangement also includes a NZ$5 million loan from Fedpac and a NZ$5 million loan from professional investors, which effectively funds the operations of Stellar Collections, a wholly owned subsidiary responsible for the collection of old ledger receivables. At Aug. 31, 2013, 43% of old ledger receivables have made a payment within the past month and any additional cash required to meet interest and operating expenses are met by inter-group loans and transactions. While these loans have a relatively long tenure of three years and are reasonably likely to be rolled if needed (because some of the investors are also shareholders/directors of the company), it is important to note that should the likelihood of default worsen for these classes of investors, the rating will be negatively implicated regardless of the performance of the Westpac facility.

From an earnings perspective, the average cost of funding is lower, and this is driven by the effective rate charged on the Westpac facility. In our view, this is supportive of better profitability that can be achieved over the medium-to-long term by prudent growth in receivables to overturn its cost-to-income ratio, which exceeded 100% over the past few years. While better than budget, year-to-date net profit is at a loss at the end of August 2013. We believe there is scope to revise the rating upward should GFNZ demonstrate meaningful receivable growth, sustainable profitability, and some improvement in the capital position.

Around 85% of the new ledger has made full, up-to-date payments in August 2013, and around 90% has been making a payment in full or partial over August 2013. The overall nonperforming asset ratio is much higher than peers', but offset by a larger reserve ratio. This is driven by the old ledger receivables written under a legacy-underwriting policy. While provision coverage on the 90-days past-due old-ledger receivables is 74%, and provision coverage on old ledger receivables without any payment over 90 days is 137%, the net book value of these receivables is still material, and any additional provisions can significantly impact profitability. Notwithstanding this risk, new impairment expenses have been relatively stable over the past two years, in support of some stability in credit quality.

Outlook

The positive outlooks reflect our expectation that business stability is likely to improve, with lower funding costs and increased ability to meaningfully grow its receivables, which in our view is important for the company's ability to turn around its relatively high cost-to-income ratio and long-term earning prospects. We expect the growth to be staggered rather than spiked, and achieved while maintaining current underwriting standards.

A rating uplift from the current level would require demonstrated receivable growth, sustainable profitability, and some improvement in the capital position. We could remove the rating from positive outlook if receivable growth outpaces profit generation, weakening GFNZ's capital base. Notwithstanding the current positive outlook, we may lower the rating if credit quality significantly worsens from the current level or any other factor that results in a loss of confidence from its key funding provider, Westpac. We could also lower the rating if the likelihood of default worsens for other creditors, notwithstanding the performance of the Westpac facility.

Related Criteria And Research

- Rating Finance Companies, March 18, 2004
- Group Rating Methodology, May 7, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-' And 'CC' Ratings, Oct. 1, 2012

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
GFNZ Group Ltd.		
Counterparty Credit Rating	B-/Positive/C	CCC/Watch Pos/C
Quest Insurance Group Ltd.		
Counterparty Credit Rating		
Local Currency	B-/Positive/--	CCC/Watch Pos/--
Financial Strength Rating		
Local Currency	B-/Positive/--	CCC/Watch Pos/--

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