MOODY'S INVESTORS SERVICE

CREDIT OPINION
27 March 2019

Update

Rate this Research

Nedbank Limited

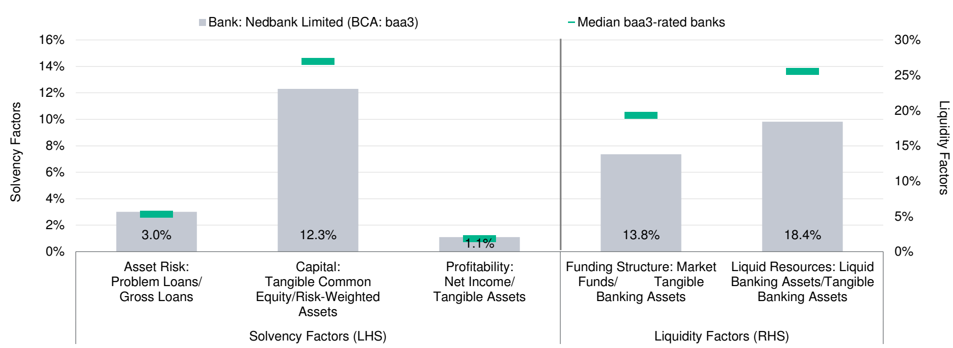
Update to credit analysis

Summary

Nedbank Limited's Baa3 (stable) deposit and senior debt ratings are in line with its baa3 Baseline Credit Assessment (BCA). The bank's ratings are at the same level as South Africa's Baa3 government ratings, reflecting the interlinkage between Nedbank's creditworthiness and that of the government. As of December 2017, the bank's direct and indirect government exposure was equivalent to about 170% of its capital. The majority of this exposure is on account of statutory liquidity requirements.

Nedbank's ratings reflect our expectation that (1) the bank's profitability will remain robust, supported by its solid local franchise (Nedbank is one of South Africa's four-largest banks with an 19% share of system deposits as of December 2018); (2) asset risks will continue to be relatively low despite rising credit losses; and (3) capitalisation will be resilient (reported Common Equity Tier 1 capital ratio of 11.6% as of December 2018). These strengths are moderated by the bank's high proportion of confidence-sensitive wholesale deposit funding and credit concentrations — structural issues faced by all major South African banks. Also, we expect the slow economic growth in South Africa to continue to exert negative pressure on the bank's financial performance.

Exhibit 1
Rating Scorecard - Key financial ratios



These represent our Banks rating methodology scorecard ratios, whereby asset risk and profitability reflect the weaker of either the three-year average and the latest annual figure. Capital is the latest reported figure, but includes our adjustments. Funding structure and liquid resources ratios reflect the latest fiscal year-end figures.
Source: Moody's Financial Metrics

THIS REPORT WAS REPUBLISHED ON 28 MAR 2019 TO CORRECT THE NAME OF A STAKEHOLDER IN NEDBANK GROUP IN THE AFFILIATE SUPPORT SECTION.

RATINGS

Nedbank Limited

Domicile	Johannesburg, South Africa
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	(P)Baa3
Type	Senior Unsecured MTN - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	Baa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Credit strengths

» Robust profitability, supported by a solid local franchise.

» The bank's loss-absorption capacity is supported by resilient capital metrics.

Credit challenges

» A challenging operating environment, which is characterized by low economic growth, will strain the bank's asset quality.

» A high reliance on confidence-sensitive wholesale deposit funding, which is a structural feature of the South African banks, is partially moderated by liquidity improvements.

Outlook

Nedbank's long-term senior unsecured and deposit ratings have a stable outlook, partly reflecting South Africa's stable outlook. The stable outlook also reflects our expectations that the credit metrics of the bank will remain within the thresholds assumed by the bank's ratings over the next 12 to 18 months despite the risks posed by the still weak macroeconomic environment in South Africa.

Factors that could lead to an upgrade

In view of the sovereign rating constraint at Baa3, there is limited upward rating momentum for Nedbank's ratings over the near term. Any upgrade of the bank's ratings needs to be preceded by a sovereign rating upgrade, combined with an improvement of the bank's credit risk profile.

Factors that could lead to a downgrade

Nedbank's deposit ratings could be downgraded if (1) the South African sovereign rating is downgraded, and (2) the bank's credit profile weakens substantially from the levels assumed by its current ratings.

Key indicators

Exhibit 2

Nedbank Limited (Consolidated Financials) [1]

	6-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (ZAR million)	942,595	903,961	900,061	860,733	753,444	6.6[4]
Total Assets (USD million)	68,771	73,018	65,818	55,547	65,128	1.6[4]
Tangible Common Equity (ZAR million)	58,050	58,351	54,288	49,560	46,040	6.8[4]
Tangible Common Equity (USD million)	4,235	4,713	3,970	3,198	3,980	1.8[4]
Problem Loans / Gross Loans (%)	-	3.0	2.8	2.5	2.6	2.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	-	12.3	11.7	11.0	11.5	11.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	-	29.0	28.9	27.2	27.6	28.2[5]
Net Interest Margin (%)	2.8	2.9	2.8	2.8	3.0	2.9[5]
PPI / Average RWA (%)	-	3.8	3.8	3.6	4.0	3.8[6]
Net Income / Tangible Assets (%)	1.1	1.3	1.0	0.9	1.1	1.1[5]
Cost / Income Ratio (%)	58.9	60.3	60.2	61.2	60.1	60.1[5]
Market Funds / Tangible Banking Assets (%)	8.3	13.8	12.1	15.9	13.4	12.7[5]
Liquid Banking Assets / Tangible Banking Assets (%)	18.5	18.4	20.9	19.3	17.4	18.9[5]

Gross Loans / Due to Customers (%)	-	102.7	98.1	101.9	103.7	101.6[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully-loaded or transitional phase-in; IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented.
Source: Moody's Financial Metrics

Profile

Nedbank Limited (Nedbank) is a South African bank which, along with its subsidiaries, provides a range of banking and financial services. As of December 2018, the bank held a market share of 17% in South Africa in terms of total assets. As of December 2018, the bank reported a total consolidated asset base of ZAR972 billion (about $68 billion). The bank operates primarily in South Africa, which accounted for 96% of its loans and advances as of year-end 2017.

Nedbank was established in 1888 as Nederlandsche Bank en Credietvereeniging voor ZuidAfrika, but was renamed Nedbank Limited in 1971. The bank is a wholly owned subsidiary of Nedbank Group Limited (Nedbank Group), a South Africa-based company listed on the Johannesburg Stock Exchange (ticker: NED).

For further information on the bank's profile, see Nedbank Limited: Key Facts and Statistics - H1 June 2017, October 2017.

Detailed credit considerations

Challenging operating conditions will exert asset-quality pressure, and credit losses will likely rise

Nedbank's asset-quality ratios deteriorated in 2018. South Africa's challenging operating conditions characterized by low economic growth will likely pose continued challenges to all South African banks' asset quality. We expect real GDP growth of 1.3% in 2019 and 1.5% in 2020, from 0.8% in 2018, levels still below the government's targeted growth levels.

Nedbank's reported nonperforming loans (NPLs) at the group level stood at 3.4% of gross loans as of December 2018, increasing from 2.7% in December 2017. The 28.9% increase in NPLs reflects both the transition to IFRS 9 from IAS 39 on 1 January 2018, and the challenging operating environment in South Africa which exerts negative pressure in borrowers' repayment capacity, particularly for indebted households and smaller businesses whose balance sheet and cash flow strength tend to be modest. Based on South African Reserve Bank's (SARB) BA900 returns, Nedbank's unsecured household loans and credit cards accounted for 5% of total loans and residential mortgages accounted for an additional 20%, as of December 2018. However, the bank's exposure is lower than the banking system average where unsecured household loans and credit cards account for 8% and residential mortgages 25% of the banking system's total loans. This relatively limited exposure to households has supported Nedbank's asset quality because South African corporates tend to perform better than households as they have more resilient cash flow and lower debt levels, though we note that corporate performance varies across sectors. Despite the increase, the NPL ratio remains within the group target of less than 3.5% (through the cycle).

Reported loan-loss provisions-to-average gross loans ratio increased marginally to 0.53% as of December 2018 from 0.49% as of December 2017. Given the pressures highlighted above, we expect some upward pressure on the bank's cost of risk over the next 12 to 18 months, however, we expect this pressure to be manageable.

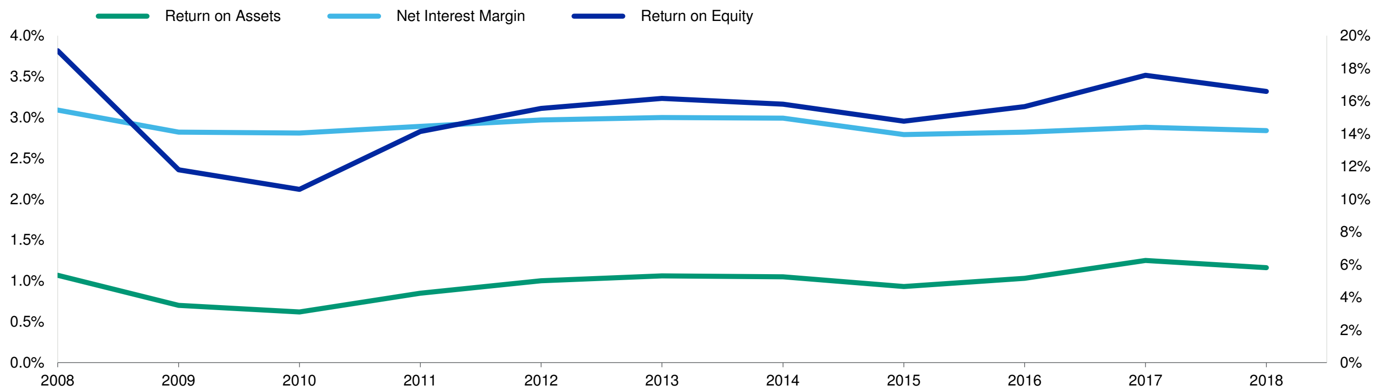
Nedbank's specific coverage of NPLs (Stage 3) at the group level was 36.8% in December 2018, with total provisioning coverage amounting to 61%. The bank's low specific provisions are mainly a reflection of its high collateral-based lending, such as commercial mortgages and household installment lending. Commercial property and home loans contributed to 42% of the bank's total advances as of December 2018, and their credit losses have been lower than the average credit losses for the bank as a whole.

We expect profitability to remain resilient, despite pressure on revenue

In 2019, we expect Nedbank to continue to face slow business and earnings growth and a pickup in loan-loss provisions, on the back of subdued economic growth and weakness in certain corporate sectors and the consumer credit market. However, we expect profitability to remain resilient, supported by the bank's strong earnings quality. The bank's pre-provision income historically displays a low volatility (standard deviation of less than 25%).

Nedbank's profitability metrics have remained resilient despite slow economic growth (see Exhibit 3) and an uptick in portfolio impairments on account of IFRS 9. The bank's reported return on assets and return on equity slightly decreased to 1.2% and 16.6% respectively as of December 2018 from 1.3% and 17.8% respectively the prior year. The bank's profitability is supported by a solid net interest margin, which was 2.8% in 2018. The bank's cost-to-income ratio deteriorated marginally to 58.9% as of December 2018 from 58.2%, as of December 2017.

Exhibit 3
Nedbank's profitability has remained broadly resilient, despite the deterioration in the operating environment
Profitability metrics



Source: Nedbank Limited

Loss-absorption capacity is supported by resilient capital metrics

The bank's reported Common Equity Tier 1 capital ratio stood at 11.6% as of December 2018, down from 12.6% in December 2017, but within management's target range of 10.5% - 12.5% and well above the regulatory minimum requirement. The decrease in the bank's capitalisation ratios reflects the growth in risk-weighted assets during the period and the full impact of IFRS 9 implementation. The bank's Tier 1 ratio stood at 12.7%, as of December 2018, and is comparable to similarly rated global peers. Nedbank's reported total capital adequacy ratio (including unappropriated profits) stood at 15.7%, as of December 2018.

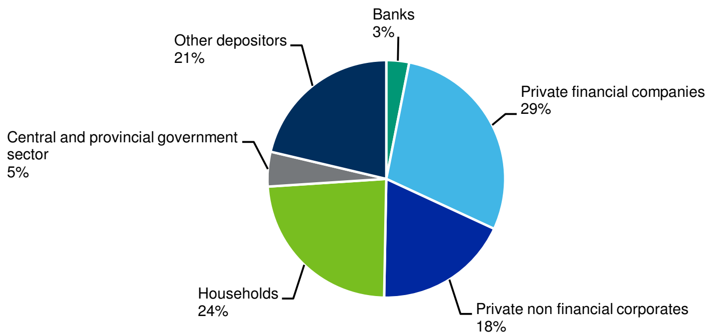
We expect Nedbank's capital metrics to remain resilient over the next 12 to 18 months as the bank should generate enough pre-provision income to cover its cost of risk.

High reliance on confidence-sensitive wholesale funding is partially moderated by gradual liquidity improvements

South African banks, including Nedbank, heavily depend on wholesale deposits, primarily sourced from South African corporates and financial institutions, including asset managers, insurance and pension companies, and money-market funds. Financial institutions, corporates and local banks contributed about 50% of Nedbank's rand-denominated deposits, as of December 2018, while household deposits contributed just 24% (see Exhibit 4). This wholesale funding (from financial institutions, local banks and corporates) is generally more expensive and confidence-sensitive than retail deposits.

We negatively adjust South Africa's Macro Profile for this systemic issue, and as a result, we do not make any further adjustment to Nedbank's scorecard. We also note that the closed rand system, whereby all rand transactions (physical and derivatives) have to be cleared and settled in South Africa through a registered bank and clearing institution domiciled in South Africa, mitigates the risks to some extent and makes the institutional funding base fairly stable. Additionally, South African banks, including Nedbank, have low reliance on foreign-currency funding.

Exhibit 4
Nedbank relies heavily on wholesale funding, which is a structural feature for South African banks
Local-currency deposit structure (December 2018)



Source: SARB BA900

Notwithstanding the funding risks we highlighted above, Nedbank's funding profile has improved in the recent years, supported by management's efforts to lengthen the bank's long-term funding ratio, as well as diversify its funding base. The bank has lengthened its funding ratio by issuing senior unsecured bonds and Basel III-compliant subordinated debt, while retail and savings products have attracted household depositors. The bank's net loans-to-deposits ratio decreased to 90%, as of December 2018, from 94%, as the end of December 2017.

Nedbank's liquidity buffers have also improved, with the quarterly daily average liquidity coverage ratio (LCR) improving to 109% as of December 2018, which is above the 90% minimum for 2018[1].

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank-specific figures originate from banks' reports and Moody's Banking Financial Metrics. In some instances where data for Nedbank was unavailable, Nedbank Group's numbers were used because they provide a good proxy to Nedbank. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

Support and structural considerations

Affiliate support

We do not incorporate affiliate support uplift in Nedbank's ratings. In March 2016, Nedbank's strategic partner, Old Mutual Plc, announced a new strategy (which was completed in 2018) to separate its four key underlying businesses, including Nedbank Group (the holding company of Nedbank). As of year-end 2018, Old Mutual Ltd's stake in Nedbank Group was 19.9%. We believe that the impact of this separation on Nedbank will be largely neutral in view of the bank's relative independence and direct access to capital markets.

Government support

We assign a global local-currency deposit rating of Baa3, stable to Nedbank, in line with its baa3 BCA. We do not incorporate any government support rating uplift on Nedbank's ratings given that the BCA is already at the sovereign issuer level of Baa3, stable. Additionally, following the events relating to African Bank Limited, we believe that the inclusion of a bail-in of senior unsecured bondholders and wholesale depositors by the SARB indicates the regulator's willingness to impose losses on creditors of troubled banks.

Counterparty Risk Ratings

Moody's Counterparty Risk Ratings (CRRs) are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. We believe that CRR liabilities have a lower probability of default than the bank's deposit and senior unsecured debt as they will more likely be preserved in order to minimise banking system contagion, minimise losses and avoid disruption of critical functions. For this reason, we assign CRR, prior to government support, one notch above the adjusted BCA.

Nedbank's CRRs are positioned at Baa2/Prime-2

We consider South Africa a jurisdiction with a non-operational resolution (non-ORR) regime. For non-ORR countries, the starting point for the CRR is one notch above the bank's Adjusted BCA (of baa3). No government support uplift is incorporated in the ratings as the government's capacity to provide support is constrained at its Baa3 rating. Nedbank's Counterparty Risk (CR) Assessment is also positioned at Baa2(cr)/P-2(cr), as the approach to reaching this assessment is identical to that for the CRR.

National scale ratings (NSRs)

Nedbank's national scale long-term deposit rating is Aa1.za, indicating that the bank is one of the strongest credits within South Africa. NSRs are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks, and they are not comparable with our globally applicable ratings.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 5

Nedbank Limited

Macro Factors		
Weighted Macro Profile	**Moderate**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	3.0%	baa2	←→	baa2	Quality of assets	
Capital						
TCE / RWA	12.3%	baa3	←→	baa3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.1%	baa3	←→	baa3	Earnings quality	Expected trend
Combined Solvency Score		baa3		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	13.8%	baa2	←→	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.4%	ba2	←→	ba2	Access to committed facilities	
Combined Liquidity Score		baa3		baa3		
Financial Profile				baa3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Baa3		
Scorecard Calculated BCA range				baa2-ba1		
Assigned BCA				baa3		
Affiliate Support notching				0		
Adjusted BCA				baa3		

Instrument class	**Loss Given Failure notching**	**Additional Notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	baa2	0	Baa2	Baa2
Counterparty Risk Assessment	1	0	baa2 (cr)	0	Baa2 (cr)	--
Deposits	0	0	baa3	0	Baa3	Baa3
Senior unsecured bank debt	0	0	baa3	0	(P)Baa3	(P)Baa3
Dated subordinated bank debt	-1	0	ba1	0	(P)Ba1	Ba1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
NEDBANK LIMITED	
Outlook	Stable
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa3/P-3
NSR Bank Deposits	Aa1.za/P-1.za
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Senior Unsecured MTN	(P)Baa3
NSR Senior Unsecured MTN	Aa1.za
Subordinate	Ba1
NSR Subordinate MTN	Aa3.za

Source: Moody's Investors Service

Endnotes

1 The LCR minimum increased to 80% on 1 January 2017 and incrementally increased to 100% by 1 January 2019.

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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