

### Research Update:

## PGG Wrightson Finance Ltd. Assigned 'BB/B' Ratings, Stable Outlook

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## Research Update:

# PGG Wrightson Finance Ltd. Assigned 'BB/B' Ratings, Stable Outlook

## Overview

- We assigned our 'BB' long-term and 'B' short-term counterparty credit ratings to PGG Wrightson Finance.
- We assigned a stable rating outlook to PGG Wrightson Finance.

## Rating Action

On Feb.17, 2010, Standard & Poor's Ratings Services assigned its 'BB' long-term and 'B' short-term counterparty credit ratings to PGG Wrightson Finance Ltd. (PWF), a New Zealand-based finance company wholly owned by PGG Wrightson Ltd. At the same time, we assigned a stable rating outlook to PWF.

## Rationale

The ratings on PWF reflect our opinion of the company's concentrated exposure to the agriculture sector, which is riskier than some other sectors. Also underpinning the ratings is PWF's high, albeit reducing, counterparty concentration risk. These weaknesses are offset by the company's good brand and national footprint in the New Zealand rural finance services market, and PWF's access to its parent's broad distribution platform and large rural client base. PWF's reasonably diversified funding sources also support the 'BB' rating. We consider PWF to be a core business within the PGG Wrightson group. This was evidenced by PGG Wrightson's recent capital injection of about NZ\$33.8 million to PWF via preference shares to improve PWF's capital position.

With a less-diverse business profile than its peers, PWF has a concentrated exposure to the agribusiness sector, which we believe is inherently riskier than some other sectors in the New Zealand financial services industry, such as residential mortgages. Nonetheless, we note that PWF's operations and loan portfolio are geographically diversified across New Zealand.

PWF's asset quality, in our opinion, is sound, reflecting the company's good level of security over loans, good loan-to-value ratios, satisfactory credit policy, adequate provisioning, and geographically diverse loan book. Nonetheless, asset quality is tempered by high counterparty concentration risk, with PWF's top 10 loans representing almost 100% of equity in January 2010. Standard & Poor's expects this ratio to improve further during 2010 because of planned asset sales. PWF is planning to sell its large exposure to banks, and is targeting NZ\$84 million in proceeds from the divestment of large assets in the medium term.

Underpinning PWF's credit quality is the company's reasonably diversified funding sources and good financial flexibility, which we consider are better than most of its peers in the non-bank financial institution sector. The company's funding sources comprise retail funding and wholesale funding. At Oct. 31, 2009, the company's NZ\$498 million funding comprised secured bonds, secured deposits, unsecured rural saver accounts, unsecured current accounts, wholesale borrowings, and banker risk-sharing agreements. PWF had a NZ\$113 million undrawn bank facility at Feb. 17, 2010.

Factoring in the benefits from the recent capital raising, Standard & Poor's considers that PWF has adequate capital relative to its risk profile and growth needs. The company's adjusted total equity-to-adjusted assets ratio averaged about 10.6 % for the past three years, and we expect this ratio to improve in the near term. While capital has improved following the preference shares issue, Standard & Poor's notes that preference shares are lower quality capital than common equity. Nonetheless, the preference shares are short-dated and mandatory convertible preference shares.

### **Short-term credit factors**

The short-term rating on PWF is 'B'. In our view, PWF's liquidity position is adequate, benefiting from access to a sizable banking facility. An undrawn commitment of NZ\$113 million (at Feb. 17, 2010), together with on-balance-sheet cash and liquid assets of NZ\$7.8 million, support PWF's adequate liquidity position. However, in our opinion, PWF's on-balance-sheet liquidity is lower than many of its peers; the company's strategy is to fund short-term or unexpected liquidity requirements from its banking facilities rather than by maintaining high levels of cash or securities. In this context, retention of banker confidence in PWF is likely to be a critical rating factor at the current rating level. Any decrease in banker confidence that is unanticipated is likely to result in negative rating momentum.

PWF has a NZ\$100 million retail bond with an initial maturity of 2010 but an option to extend for a further 12 months. The company intends to increase the size of its wholesale bank facilities to refinance the bond. Alternatively, extension of current issuance of the retail bond could be achievable given PWF's brand strength and relationship with retail investors, many of whom are customers of PGG Wrightson. A key rating factor will be how PWF manages refinancing requirements over the short-to-medium term.

## **Outlook**

The stable outlook reflects PWF's reasonably diversified funding sources, our expectation that the company's improving capital position should give PWF some headroom to weather further industry challenges, and PWF's strategic importance to PGG Wrightson. In addition, we believe that PGG Wrightson's recent recapitalization and refocused strategy should enhance its capability to support PWF if needed.

Downward rating movement could be precipitated by:

- Evidence of lesser support by PGG Wrightson to PWF, or if PWF were no longer a core or wholly owned subsidiary of PGG Wrightson;
- Deterioration of PGG Wrightson's credit standing, given PWF's reliance on its parent's brand strength, depending on the circumstance that causes the weakening credit profile of its parent;
- A weakening of PWF's standalone financial strength, stemming from funding or liquidity stresses because of lack of banker confidence, debenture refinancing problems, or other factors; or
- Significant deterioration in PWF's asset quality.

Upward rating movement in the near term is unlikely, although such a scenario may be considered in the medium-to-long term if the credit profile of PWF's parent improves, combined with no diminution of PWF's own credit profile or its core role within the group. If PWF's standalone credit quality improves significantly and PGG Wrightson's credit profile is not diminished, an upgrade might be considered; however, this is by no means certain, with any rating upgrade likely limited to one notch.

## Related Research

This article is based in part on the following criteria article: Rating Finance Companies, published on March 18, 2004.

## Ratings List

New Rating; CreditWatch/Outlook Action

PGG Wrightson Finance Ltd.

Counterparty credit rating      BB/Stable/B

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