STANDARD & POOR'S

CREDIT RESEARCH REPORT

New Zealand Nonbank Finance Company Avanti Finance Ltd. Rated 'BB-/B'; Outlook Negative

Counterparty credit rating

BB-/Negative/B

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Publication Date
Sept. 24, 2009

Overview

- Avanti Finance Ltd. is a New Zealand nonbank financing company being rated by Standard & Poor's for the first time.
- We are assigning a corporate credit rating of 'BB-/B' to Avanti Finance Ltd.
- The outlook on the ratings is negative.

Rating Action

On Sept. 25, 2009, Standard & Poor's Ratings Services assigned a 'BB-/B' corporate credit ratings to Avanti Finance Ltd. The outlook is negative.

Rationale

The counterparty credit ratings on Avanti Finance Ltd. (Avanti) reflect the company's moderate liquidity and susceptibility to funding pressures, stemming from a concentrated funding base that is heavily reliant on ongoing debenture investor support and access to bank funding from sister company Galatos Finance Ltd. (Galatos).

This said, Avanti has enjoyed good support from its debenture investor base, on the back of a long-standing relationship with many investors and its good operating performance, and the company has reasonable capacity to manage its liquidity position in the short term if its debenture-reinvestment experience were to materially deteriorate.

Although Avanti's credit-loss experience has been well managed to date, the company's credit profile is moderated by the high-risk profile of its loan-receivables portfolio, which exhibits a high level of loan arrears. Favourable features of Avanti's credit profile include its strong capital-adequacy ratio and interest margins, which provide good capacity for the company to absorb materially higher credit losses. Additionally, Avanti's management team and risk-management framework are considered sound and positive credit factors, although the company does have a high reliance on its two key shareholders.

Avanti is a moderate-size New Zealand-based finance company whose lending activities include personal lending, motor vehicle dealer loans, and short-term bridging loans. Finance provided is in the form of principal and interest loans and are typically for small amounts and limited to a short term. Avanti has also expanded to the provision of short-term interest-only or interest-capitalising bridging loans secured by way of residential property. Avanti operates in a higher-risk segment of the New Zealand financing sector and relies on generation of higher interest margins, maintenance of a good loan security, and a proactive approach to managing loan arrears to limit its credit losses and maintain its profitability, which has remained good to date despite the current difficult operating environment. This said, Avanti's management and operational systems and framework are assessed as being strong relative to other, similar, finance companies in New Zealand.

Avanti is a wholly owned subsidiary of G&S Investments Ltd. (G&S), a private company owned and controlled by trusts associated with its two founders, Stephen Eltringham and Glenn Hawkins. Although structured as two separate subsidiary companies, Avanti and Galatos are managed as a single company, with Galatos set up with through bank funding to support group-lending activities that Avanti can access via a contractual option that entitles Avanti to call upon Galatos to purchase loans.

Avanti has a very concentrated funding base, with one of its two principal funding sources from the issue of secured debenture stock via a trust deed to about 50 professional debenture stock investors. Avanti's funding and liquidity also are heavily reliant on its ability to sell loans to Galatos, which is itself 100% owned by G&S and funded by a NZ$30 million bank facility from ANZ National Bank Ltd.

Avanti's capital relative to its risk profile is, nonetheless, considered strong at the current rating level, particularly when considering total group capital resources that includes capital in Galatos. Nevertheless, the absolute size of Avanti's capital base is moderate by domestic and international standards, with shareholder equity totalling NZ$11.6 million at March 31, 2009, affording only moderate protection against a major negative operational risk event.

Short-term credit factors

The short-term rating on Avanti is 'B'. Avanti's balance-sheet liquidity is modest, with liquid assets comprised of cash, which stood at NZ$328,000 at March 31, 2009. Avanti has recently implemented a new liquidity policy to maintain a minimum NZ$500,000 in cash on its balance sheet. The company does not have any direct bank facilities itself, with liquidity heavily reliant on cash earnings from operations, the company achieving a high reinvestment rate on its maturing debenture stock, and on Avanti maintaining an ability to sell loan receivables to Galatos. Additionally, Avanti's liquidity position has been moderated by a progressive limit reduction of the Galatos bank facility with ANZ National Bank Ltd. to NZ$30 million from NZ$40 million. Headroom under the facility was NZ$5.1 million at Sept. 1, 2009, and Galatos targets maintaining at least NZ$3.0 million in headroom on an ongoing basis. A recent restructuring of the facility from being an on-demand one to a 12-month term facility that now requires 12 months' notice from the bank for its withdrawal, and an amendment giving Avanti a contractual entitlement to call upon Galatos to purchase NZ$1.0 million of loans from Avanti each month subject to there being available headroom in the facility, is supportive of Avanti's management of its liquidity position. Additionally, Avanti's liquidity position is supported by its ability to actively manage its new lending level, with cash earnings providing adequate cover against scheduled debenture maturities through the next year. Avanti's long-standing and close relationship with key debenture investors has also enabled it to roll about 71% of its debenture maturities past the scheduled expiry date of the government guarantee in October 2010.

Outlook

The negative rating outlook recognises Standard & Poor's current negative bias on the New Zealand finance-company sector, uncertainty around Avanti's ability to manage its liquidity position through 2010 (stemming from changes to the New Zealand government's deposit-guarantee scheme and the imposition of other regulatory requirements on New Zealand nonbank deposit-taking companies), and an expectation that profitability may come under pressure from some further contraction in interest margins and potentially higher credit costs. Although the company's strong interest margins and capital-adequacy ratio exhibit good capacity to absorb an even material rise in credit costs, a material deterioration in asset quality resulting in higher credit losses and a weakening in profitability could undermine funding support from debenture investors and the bank financier of the Galatos bank facility. The rating could also be lowered should there be a change in the commitment from key shareholders that resulted in a weakening of Avanti's credit profile.

A revision of the rating outlook to stable would require a track record of evidence that Avanti was successful in managing its liquidity and funding risks through 2010 and an abatement of concerns around any potential material weakening in operating performance. Upward rating prospects are not anticipated in the short-to-medium term, and would require a step-change improvement in funding diversity and further improvement in the company's liquidity position.

Ratings List

New rating; CreditWatch/outlook action

Avanti Finance Ltd.

Counterparty credit rating BB-/Negative/B

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's

Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation area, select Find a Rating, then Credit Ratings Search.