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Nedbank's R3.7bn exposure to Resilient

By Rob Rose

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It's an old cliché that if you owe a bank R1m, you're in trouble; but if you owe plenty of billions and your weakness spells trouble for the entire property sector, it's the banks who are in trouble.

By this logic, there must be some very nervous bankers in town, considering that the Resilient Property Group, whose share prices have nearly halved in the past eight weeks, owes SA's banks more than R20bn.

It's been a grim few weeks for Des de Beer who founded the company in 2002. Resilient owns many second-tier shopping centres such as the Jabulani Mall in Soweto, properties in far-flung places like Romania as well as a healthy chunk of SA's industrial real estate.

This year, however, Resilient's stock has plunged 59%. In addition, that of Fortress "B" has fallen 61%, Nepi Rockcastle's has shed 45% and Greenbay's is down 50%. The sharp sell-off is due partly to concerns over a labyrinthine cross-shareholding structure that critics say has masked the true values of the companies: Resilient owns 16% of Fortress and 17% of Greenbay, while Fortress holds 6% of Resilient, 24% of Nepi Rockcastle and 25% of Greenbay.

The concern, as Sanlam's Glacier put it crisply last month, is that the group "[continually] raises equity capital and [the companies] subscribe to each other's shares, which means too much value stems from financial engineering instead of the underlying bricks-and-mortar assets".

Investment company 36One goes further, saying the "premium valuation of the [Resilient] companies did not arise from normal market activities, but from deliberate and frequently concealed actions by some of the influential owners". Those are pretty serious allegations - serious enough to have caused the JSE to launch its own investigation into the share trading in the companies.

Last week, two exhaustive research reports were released that reveal that the bank with the most to worry about is Nedbank, which had lent R3.7bn to Resilient and Fortress by June last year.

Though Nedbank is owed less than Standard Bank (R8.1bn) and Rand Merchant Bank (R6.3bn), it is worrying that its loans are backed mostly by shares, which have taken a hammering in recent weeks.

In one of the reports, Avior Capital Markets says it is concerned that "82% of Nedbank's collateral relates to investment securities - we assume Fortress and Resilient's stock was used".

Another analyst points out that if Nedbank were to try to sell those shares, this "would likely cause a material fall in the share prices".

But Mike Brown, the veteran CEO of Nedbank, told the *Financial Mail* he's not worried in the slightest.

"The amount we lent to Resilient and Fortress is backed by full recourse to their balance sheets and, in addition, they also pledged shares to us. Only if those companies defaulted would we have to rely on those shares and other security pledged to us," he says.

Brown says Resilient's market value is R26bn and its net asset value in December was R42.8bn.

"Even if you ascribe zero value to its shares in Fortress, Greenbay and Nepi as well as its BEE loans, it would still have a net asset value of above R10bn thanks to the equity in its properties and consolidated loan-to-value covenants - even after repaying all its debt," he says.

Of course, Brown isn't saying what extra steps Nedbank has taken to cover its exposure to the Resilient group in recent weeks, since the share rout began.

"We can't disclose details of our lending to individual clients or changes in the make-up of our security," he says.

However, Resilient's most recent annual report, for the year to June 2017, shows it had a number of covenants in place that would have been triggered when the share prices began falling. This suggests the banks had been renegotiating their facilities.

At that stage, Nedbank was owed R1.58bn by Resilient, of which only R866m was backed by physical property, while the bank had collateral of R1.7bn in shares. If those shares were worth zero, Nedbank's loan-to-value ratio would spike to 183%. (It may, of course, have been given extra collateral since.)

Equally, Nedbank's R2.15bn loan to Fortress was backed by R624m in physical property and R4.8bn in shares. If those shares fell to zero, the loan-to-value ratio would be 346%.

All the other banks have physical property as collateral for their debt, except for Sanlam, which has lent R500m to Fortress with only R1.1bn in shares as collateral.

But Avior says: "We are less concerned about Standard Bank, FirstRand and Barclays Africa's exposure to physical property as collateral, in a positive SA environment. Nedbank's collateral is probably exposed to the share prices of

Resilient and Fortress."

When contacted, De Beer would say only that he had "no concern about the banks".

De Beer, who qualified as a lawyer, has strong links to Nedbank. After an early stint at Barclays, he worked as the head of property finance at the bank before founding the property group in 2002.

A profile of De Beer in *Real Estate Investor* magazine says he "first began investing in his own properties in the 1990s, after obtaining consent from the bank to avoid conflicts of interest". When he quit to start Resilient in 2002, the bank chose to be his partner.

Today, Brown says, Nedbank has only a client relationship with De Beer: "I've met Des only about six or seven times. We don't have any special relationship with him."

While some analysts have said Nedbank may have to set aside R450m as extra provision for bad debts on its Resilient exposure, Brown is adamant that there's no need.

"We disagree. That would assume our recourse to the balance sheet of Resilient is worth zero and that we're overly reliant on the shares without having taken any additional security since June 2017, which is not the case," he says.

Brown reiterates that Resilient had a net asset value (NAV) of R42.8bn at December - which suggests there's no reason for the banks to worry.

That calculation, of course, goes to the heart of the issues around Resilient. Its critics argue that NAV is inflated because a large part of it relates to its holding in other group companies, which are similarly inflated.

In a research report last month, Dubai-based Arqaam Capital said: "We estimate that the true net asset values of Resilient and Fortress are 32% and 21% below their [disclosed] net asset values."

(Nedbank would presumably argue that even if you discounted Resilient's NAV by 32%, that would still put its value at around R29bn.)

But there are other problems: last year, part of the revenue of Resilient and Fortress came from loans being repaid by their own empowerment shareholder, the Siyakha Education Trust, at prime plus 2%.

Last year, Resilient was paid R317m in "interest" by the Siyakha trust, while Fortress was paid R269m. This cash was then used to make up part of the dividend paid to investors.

Arqaam warned that this revenue is "likely not sustainable", raising questions over whether its distributions to investors might fall. Distributions are a key attraction for real estate investment trusts like Resilient. At the moment, Resilient and Fortress own 49% of Siyakha, but they may have to consolidate it into the company's accounts.

But Resilient finance director Nick Hanekom told the *Financial Mail* a few weeks ago that consolidating it "wouldn't even matter . our dividend won't change".

That remains to be seen, however.

Two weeks ago, Resilient said that it had "commenced negotiations" with the trust, to renegotiate the loans. "The outcome of the negotiations may [affect] the distributable earnings of Resilient," it warned.

Though Brown may be confident of its partnership with De Beer's group, other lenders seem less so.

Investec Bank, for example, is now skittish about taking shares in the Resilient group companies as collateral for its loans.

Ursula Nobrega, speaking for the bank, says: "[To] some of our wealth and investment clients, who wanted to borrow money and put up shares as collateral, [we said we would not] be taking shares in the Resilient companies to cover these loans."

For investors, it's been a roller-coaster ride, with the stock soaring one day then plummeting the next. The cloud over the group will probably continue to hover until the results of an internal probe as well as those of the JSE investigation are released.

For some investment funds that have taken big bets on De Beer, such as Absa's Property Equity Fund and Stanlib, it's been a bruising start to the year.

Source: Financial Mail