

Fund Rating Announcement

GCR affirms Sanlam Alternative Income Fund's national scale fund rating of AA-(ZA)(f); Outlook Stable

Rating action

Johannesburg, 4 November 2021 – GCR Ratings ("GCR") has affirmed the national scale fund rating* of AA-(ZA)(f) on Sanlam Alternative Income Fund, with the outlook accorded as Stable.

| Rated Entity | Rating class | Rating scale | Rating* | Outlook / Watch |
|--------------------------------|--------------|--------------|------------|-----------------|
| Sanlam Alternative Income Fund | Fund rating | National | AA-(ZA)(f) | Stable |

* Fund ratings provide an opinion regarding the fund's ability to preserve principal value under varying market conditions, with reference to the relevant asset management environment (refer to published rating scales and definitions).

Fund data/summary

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| Fund inception date | 25 May 2007 |
| Fund currency | South African Rand |
| Assets under management ('AUM') | R6.6bn |
| Fund benchmark | Average after tax yield on Money Market Funds |
| Net asset value ('NAV') | Targeted constant price of R1.00 |
| Association for Savings and Investment | South Africa – Multi Asset – Income |

Rating rationale

Fund profile: Sanlam Alternative Income Fund ('SAIF', 'the fund') has a mandate to invest primarily in dividend yielding instruments and attracts corporate/institutional investors with a short to medium term investment horizon. The fund aims to outperform traditional money market fund returns after tax, while prioritising capital preservation and high liquidity.

Weighted Average Credit Quality ('WACQ'): The weighted average credit quality of 15.50 balances the counterparty risk with the structural subordination of some of the portfolio instruments and asset concentrations in line with the market. Whilst the counterparties are similar to other rated funds, the fund has c.34% invested in subordinated preference shares with no liquidity or default put options that gives senior unsecured rights. Asset concentrations, on the other hand, is a common feature in most South African cash strategy funds as mandates typically limit the investment universe to top tier banks and government backed instruments, and the structure of South Africa's banking sector is oligopolistic. In addition, the market has fewer dividend yielding asset classes (mostly preference shares) in the fixed income space, with banks being the regular issuers.

Maturity & Duration: The weighted average maturity ('WAM') is above that mandated for money market funds but in line with most income funds, averaging 385 days over the last 12 months, while the weighted average duration ('WAD') remained low and stable at 15 days given portfolio assets are repriced to prime frequently. Duration is therefore managed firmly lower at levels supportive of the rating and we provide 0.25 risk score uplift for limited interest rate risk.

Management & Governance: Management assessment is neutral to the rating. Nonetheless, a strong manager track record is viewed positively. We view the fund to be managed within a strong control environment, leveraging on the systems and capabilities of the Sanlam Group. Returns continue to exceed benchmark, while AUM growth is muted due to limited dividend yielding assets in the market.

Liquidity: Liquidity is rating neutral, balancing moderately high investor concentrations and adequate liquidity supported by credit protection tools. Investor concentrations are somewhat high but compare adequately to rated peers, with top 10 investors contributing c.47% of total portfolio investments as at 31 August 2021. Liquidity, on the other hand, benefits from liquidity put options on instruments that are senior ranking obligations of high credit quality issuers. Top tier banks account for c.65% of portfolio assets, with 53% having liquidity and/or default put options. Furthermore, 14% of portfolio is in overnight assets placed with rated money market funds. Redemption risk is also managed by close contact with the investors and strong understanding of the seasonality and behaviour of cash flows.

Outlook statement

The Stable outlook reflects our expectations for a stable WACQ dominated by the top tier banks and moderate exposure to corporates. We expect AUM growth to remain muted, while performance and liquidity are managed adequately.

Rating triggers

If the WACQ increases to higher levels and the mandate demonstrates more conservatism, we could raise the ratings. Conversely, a significant increase in subordinated assets, increase in maturity/duration and/ or reduction in the liquidity without a simultaneous reduction in concentrations could bring down the ratings, however this is unexpected over the ratings horizon.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
GCR Rating Scales, Symbols & Definitions, May 2019
Criteria for Fund Ratings, July 2020

Ratings history

| Rated Entity | Review | Rating class | Rating scale | Rating | Outlook/Watch | Date |
|--------------------------------|---------|--------------|--------------|------------|----------------|---------------|
| Sanlam Alternative Income Fund | Initial | Fund rating | National | AA-(ZA)(f) | Stable Outlook | October 2016 |
| | Last | Fund rating | National | AA-(ZA)(f) | Stable Outlook | November 2020 |

Risk score summary

| Fund Rating Factors | Risk Scores |
|---|-----------------------|
| Credit Quality | 15.50 |
| Weighted Average Credit Quality (WACQ) | 15.50 |
| Adjustments | 0.00 |
| Maturity and Interest Rate Risk | 0.25 (average) |
| Weighted Average Maturity (WAM) Assessment | (0.50) |
| Weighted Average Duration (WAD) Assessment | 1.00 |
| Management Assessment | 0.00 |
| Franchise Strength and Manager Track Record | 0.00 |
| Performance | 0.00 |
| Liquidity | 0.00 |
| Liquidity Assessment | 0.00 |
| Adjustments | 0.00 |
| Total Score | 15.75 |

Glossary

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| Cash | Funds that can be readily spent or used to meet current obligations. |
| Credit Risk | The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and/or interest when due. |
| Diversification | Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in. |
| Downgrade | The assignment of a lower credit rating to a company or sovereign borrower's debt by a credit rating agency. Opposite of upgrade. |
| Exposure | Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. |
| Fixed Deposit | Where funds are deposited in a savings account for a pre-determined period of time. |
| Interest Rate Risk | Interest rate risk in the banking book is the risk that earnings or economic value will decline as a result of changes in interest rates. The sources of interest rate risk in the banking book are repricing/mismatch, basis and yield curve risk. |
| Liquid Assets | Assets, generally of a short term, that can be converted into cash. |
| Liquidity | The speed at which assets can be converted to cash. The ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting market price. |
| Liquidity Risk | The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market. |
| Long-Term | Not current; ordinarily more than one year. |
| Maturity | The length of time between the issue of a bond or other security and the date on which it becomes payable in full. |
| National Scale Rating | Provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, a 'AAA' long term national scale rating will typically be assigned to the lowest relative risk within that country, which in most cases will be the sovereign state. |
| Net Asset Value | The value of an entity's assets less its liabilities. It is a reflection of the company's underlying value and is usually quoted on a per share basis. |
| Portfolio | A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value. |
| Risk | The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives. |
| Risk Management | Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy. |
| Security | An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default. |
| Short-Term | Current; ordinarily less than one year. |
| Tenor | The time from the value date until the expiry date of a financial instrument. |

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable fund rating document.

The fund rating has been disclosed to SAIF. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating.

SAIF participated in the rating process via virtual management meetings and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from SAIF and other reliable third parties to accord the fund rating included:

- A breakdown of the fund investment portfolio, including information on the instruments, their terms, conditions and credit quality;
- A breakdown of the fund investor portfolio;
- Details regarding the fund management, investment management and administration activities of the fund; and
- Industry comparative data and regulatory framework.

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