

Bank Credit Rating from Fitch Ratings of BBB-, Stable

5 November 2013

Heartland New Zealand Limited (NZX: HNZ) advises that Fitch Ratings (**Fitch Australia Pty Ltd**) has assigned a Long-Term credit rating to HNZ subsidiary Heartland Bank Limited (**Heartland Bank**) of BBB-, Outlook Stable, (F3 Short-Term). Fitch Ratings' full report is attached.

The Fitch Rating of BBB-, Outlook Stable complements the existing Heartland Bank credit rating from Standard & Poor's of BBB-, Outlook Developing.

- Ends -

For further information please contact:

Jeff Greenslade
Chief Executive Officer
Heartland New Zealand Limited
DDI 09 927 9149

FITCH RATES NEW ZEALAND'S HEARTLAND BANK 'BBB-'/STABLE

Fitch Ratings-Sydney-04 November 2013: Fitch Ratings has assigned Heartland Bank Limited (HBL) Long-Term and Short-Term Issuer Default Ratings (IDR) of 'BBB-' and 'F3' respectively. The Outlook on the Long-term IDR is Stable. A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS - IDRs & Viability Rating (VR)

HBL's Long- and Short-Term IDRs and VR reflect the bank's niche business model, strong net interest margin (NIM), solid core asset quality, adequate capitalisation in light of its risks, and improving funding position. They also take into account improving prospects for HBL's cost efficiency and profitability, albeit from a weak position relative to peers, and its exposure to and execution of the exit strategy for the non-core legacy assets.

The weak asset quality performance of HBL's non-core property assets remains a drag on profitability and capital. A change in strategy to reduce these loans, which totalled NZD107m at financial year end 30 June 2013 (FY13), is likely to support a faster run-off. Provisioning of the portfolio is high, covering a significant proportion of impaired assets. Should further provisioning be needed, HBL benefits from sound pre-impairment operating profits, providing some absorption capacity. Fitch views the legacy property portfolio as one of the main constraint to a higher rating.

HBL's focus on niche banking products and services where it can achieve a leading market share allows it to compete effectively against the larger New Zealand banks. It offers motor vehicle finance, invoice and shorter-term asset finance for businesses and livestock for farmers in New Zealand. These are niche products in which HBL has been able to gain greater market share and price-setting powers. This in turn supports a strong NIM relative to peers, providing capacity to absorb potential adverse credit developments in its core loan book. Cost management is an area that could, if improved, support pre-impairment operating profitability further in FY14.

Capitalisation is considered adequate and likely to be boosted as a result of the run-off of the higher risk weighted non-core property exposures. Funding has improved due to strong deposit growth, providing HBL with a growing proportion of deposit funding from households.

However, current liquidity levels are also viewed as a constraint on ratings. Fitch notes HBL's liquidity position is evolving, with levels of on-balance sheet liquidity (cash and cash equivalents, and high quality liquid assets) increasing during 2013. Fitch places greater weight on these forms of liquidity relative to off-balance sheet sources, such as warehouse facilities. HBL's small and declining residential mortgage portfolio means contingent liquidity sources are more limited than for peers as the bank is unable to execute material internal securitisations.

RATING SENSITIVITIES - IDRs & VR

HBL's IDRs and VR are sensitive to changes in New Zealand's operating environment which, should it weaken, could place negative pressure on HBL's asset quality and/or funding and liquidity positions. Positive rating action could follow should HBL manage to run-off its non-core problematic property portfolio in line with projections, avoiding any additional profit and capital impact, while also strengthening the bank's overall asset quality, and limiting management distraction. On-going improvements in on balance sheet liquidity would also support higher ratings.

KEY RATING DRIVERS & RATING SENSITIVITIES - SUPPORT RATING AND SUPPORT RATING FLOOR

HBL's Support Rating and Support Rating Floor reflect that while support from the New Zealand sovereign is possible, it cannot be relied upon. In Fitch's view, the introduction of the Open Bank Resolution Scheme (OBR) from 1 July 2013 reduces the propensity of the sovereign to support its banks. The OBR allows for the imposition of losses on depositors and senior debt holders to make up capital shortfalls if a deposit-taking institution has failed.

The rating actions are as follows:

Heartland Bank Limited (HBL):

Long-Term IDR assigned at 'BBB-'; Outlook Stable;

Short-Term IDR assigned at 'F3';

Viability Rating assigned at 'bbb-';

Support Rating assigned at '5'; and

Support Rating Floor assigned at 'NF'.

Contact:

Primary Analyst

Andrea Jaehne

Director

+61 2 8256 0343

Fitch Australia Pty. Ltd., Level 15, 77 King Street, Sydney NSW 2000

Secondary Analyst

Tim Roche

Senior Director

+61 2 8256 0310

Committee Chairperson

Mark Young

Managing Director

+65 6796 7229

Applicable criteria, "Global Financial Institutions Rating Criteria", dated 15 August 2012 is available at www.fitchratings.com.

Media Relations: Iselle Gonzalez, Sydney, Tel: +61 2 8256 0326, Email: iselle.gonzalez@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686181

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