HEARTLAND
New Zealand Limited

*NZX Release*

**CREDIT RATINGS UNCHANGED BY PLANNED ACQUISITION OF SENTINEL NEW ZEALAND AND AUSTRALIAN SENIORS FINANCE**

17 February 2014

Heartland New Zealand Limited (NZX: HNZ) advises that on 14 February 2014 Standard & Poor's Rating Services announced "Heartland Bank rating Affirmed on Planned Acquisition Of Sentinel New Zealand And Australian Seniors Finance".

On 17 February Fitch Ratings announced "No Rating Impact on NZ's Heartland Bank from Parent's Acquisition". The full releases from both agencies are attached to this announcement.

- Ends -

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**Research Update:**

# Heartland Bank Rating Affirmed On Planned Acquisition Of Sentinel New Zealand And Australian Seniors Finance

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Research Update:

# Heartland Bank Rating Affirmed On Planned Acquisition Of Sentinel New Zealand And Australian Seniors Finance

## Overview

- On Feb. 14, 2014 Heartland New Zealand Ltd. (HNZL) announced its intention to acquire the Sentinel New Zealand (Sentinel) and Australian Seniors Finance (ASF) businesses from Seniors Money International Ltd. (SMI); both businesses specialise in home equity reverse (HER) mortgages.
- We believe that the acquisition will have a neutral impact on our assessment of the group credit profile (GCP) of HNZL and the stand-alone credit profile (SACP) of Heartland Bank Ltd. (HBL) if the acquisition is progressed as planned.
- The issuer credit rating of HBL is affirmed and the outlook remains on developing.

## Rating Action

On Feb. 14, 2014 Standard & Poor's Rating Services affirmed its 'BBB-/ A-3' issuer credit ratings on HBL; the outlook remains developing.

## Rationale

On Feb. 14, 2014 HNZL announced its intention to acquire Sentinel and ASF from Seniors Money International Ltd.

The key features of the transaction are as follows:

- The total acquisition price of NZ$87 million acquisition would be funded by a NZ$38.7 million share issue to the vendor, NZ$20 million in cash from a private placement and share repurchase plan, and NZ28.3 million in cash funded by a loan from HBL.
- The total assets acquired amounts to about NZ$760 million.
- Sentinel and ASF will reside under Heartland Financial Services Ltd, outside of the banking group.
- Sentinel HER mortgages will migrate to HBL over time.

We are of the view that the acquisition is in line with HNZL's "Hero Product" strategy. In this regard we note that:

- The product is a specialised product;
- The product has low contestability; and
- Sentinel has a dominant market share in New Zealand, and ASF has a 20%

market share in Australia.

In our view the acquisition if progressed as planned would have a neutral impact on the GCP assessment of HNZL and SACP assessment of HBL; consequently the ratings of HBL is unaffected by the acquisition. We furthermore believe that the rating of HBL is not insulated from the GCP as the bank's financial performance and funding are highly dependent from that of the group. Therefore, should the group GCP estimate fall below the bank SACP, the rating of HBL might be negatively affected.

In our view the businesses acquired by HNZL are complementary to the group's current product suite and would provide further product, geographic, and revenue diversification (both on a HNZL and HBL level). We note that HNZL's strategy is to occupy niche markets that have low contestability, such as invoice financing, livestock financing, motor vehicle financing, and home equity reverse mortgages (i.e. markets in which New Zealand major banks are not active).

In our opinion, post the acquisition, the group's risk-adjusted capital ratio is also likely to remain in the "very strong" range after taking into account the impact of the acquisition on HNZL in terms of additional assets acquired, goodwill upon acquisition, and the proposed capital injection. That said, we believe that management would restore the group's capital position to the "very strong" range in a timely manner should a shortfall exist.

We believe that the complexity and higher-risk nature of HER mortgages, compared to residential mortgages, are already factored into our assessment of the bank and the group's "moderate" risk position assessments.

We note that Commonwealth Bank of Australia (AA-/Stable/A-1+), SMI's existing primary banker, has agreed to continued to provide committed facilities to Sentinel and ASF for a period of five-and-a-half years. In our assessment of HBL's funding and liquidity, we factor in an expectation that the facility will be successfully arranged and that HBL's funding and liquidity assessment will not be adversely affected by an unexpected inclusion of any financial covenants or call triggers.

## Outlook

The outlook assigned to HBL remains developing. The ratings could be raised or lowered due to two different but similarly probable scenarios within the next two years.

We note that the rating could be raised if HBL were to successfully further develop its business position in the next three-to-nine months and economic vulnerabilities were not to worsen. In this scenario, we expect to raise the rating and the outlook would likely be revised to negative to reflect current credit concerns relating to New Zealand's economic vulnerabilities.

The rating could be lowered if credit concerns relating to New Zealand's economic vulnerabilities (including its material dependence on external borrowings, persistent current account deficits, and recent strong growth in house prices), which underpinned our outlook revision on May 16, 2013, escalated before any upward revision of our business position assessment for HBL. In that scenario, we expect we'd lower the rating and revise the rating outlook to positive, reflecting the trend of HBL's strengthening business profile.

Lastly, the potential also exists for the business position assessment of HBL and economic risk score assessment of New Zealand being revised simultaneously. If this were to occur the rating of HBL would be affirmed.

## Related Criteria And Research

### Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology & Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

## Ratings List

Ratings Affirmed

| | |
|---|---|
| Heartland Bank Ltd. | |
| Counterparty Credit Rating | BBB-/Developing/A-3 |

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Tagging Info

# Fitch: No Rating Impact on NZ's Heartland Bank from Parent's Acquisition

Ratings Endorsement Policy
16 Feb 2014 5:20 PM (EST)

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Fitch Ratings-Sydney-16 February 2014: Heartland Bank Limited's (HBL) ratings have not been impacted by the announcement of an acquisition by its parent, Heartland New Zealand Limited (HNZ). HNZ has announced its intention to acquire the New Zealand and Australian Home Equity Release mortgage business of Seniors Money International Limited (SMI) on 14 February 2014.

HNZ plans to acquire Sentinel New Zealand (Sentinel) and Australian Seniors Finance, including their respective Home Equity Release mortgage portfolios, operational infrastructures, and funding arrangements for NZD87m. The transaction will be funded by cash (NZD48.3m, of which NZD20m will be raised through the issuance of equity to existing HNZ shareholders) and the issuance of NZD38.7m of HNZ shares to SMI's shareholders. The aggregated value of the assets is approximately NZD760m, and will account for 30% of HNZ's total assets. HNZ's intention is to transfer Sentinel's New Zealand mortgages into HBL over the next two to three years, while the Australian mortgage book will remain with HNZ.

Sentinel is New Zealand's largest provider of Home Equity Release mortgages, with a market share of 80%. Its acquisition and the step-by-step transfer into HBL follow the bank's strategy of being a major player in niche products in New Zealand. The size of Sentinel's New Zealand book is NZD340m, and the transfer will be funded through the growth in customer deposits. As most of New Zealand's population holds its wealth and future pension in property, Fitch believes there is reasonable potential for further growth. Potential risks are mostly, but not exclusively, of an operational nature. HBL has put in place tight guidelines to limit these risks and protect its reputation. Fairly strict loan-to-value (LVR) limits should protect HBL from any potential house price corrections. However, longer life expectancy could create repayment pressure.

As the transfer will take place over time, the impact on HBL's capital should be manageable, and Fitch expects HBL will improve its retained earnings. The loan book is well seasoned and diversified, with Sentinel's average LVR standing at 32.7% in December 2013. The Australian Home Equity Release mortgage book will remain on HNZ's balance sheet, funded exclusively by Commonwealth Bank of Australia's (AA-/Stable) funding arrangements. The acquisition is still subject to certain conditions, including SMI shareholders consent.

HBL's ratings are as follows:
Long-Term IDR: 'BBB-'; Outlook Stable;
Short-Term IDR: 'F3';
Viability Rating: 'bbb-';
Support Rating: '5'; and
Support Rating Floor: 'NF'.

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Applicable criteria, "Global Financial Institutions Rating Criteria", dated 31 January 2014 are available at www.fitchratings.com.

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Additional information is available at www.fitchratings.com.

**Applicable Criteria and Related Research:**
Global Financial Institutions Rating Criteria