

S&P raises credit rating on Heartland Bank

22 May 2014

Heartland New Zealand Limited (NZX: HNZ) is pleased to announce that Standard & Poor's (**S&P**) has raised its long term issuer credit rating on HNZ subsidiary Heartland Bank Limited (**Heartland**) to 'BBB' from 'BBB-' and assigned a negative outlook. The rating upgrade reflects S&P's view that:

- Heartland's business position strengthened over the past three years upon the bank's transition toward its core niche markets (such as vehicle asset finance, invoice financing, livestock financing and reverse mortgage loans) and away from non-core assets.
- Contestability in these, typically higher-risk, specialist markets is lower compared to traditional commoditised markets such as the residential mortgage loans market.
- Heartland has made progress in exiting its non-core property portfolio and reducing its residential mortgage lending portfolio.

The negative outlook reflects the negative economic risk trend assigned to the New Zealand banking system and S&P's concerns around economic imbalances, which are not specific to Heartland. S&P's full report is attached.

Heartland is delighted with the raised rating, and in particular with S&P's acknowledgement of a strengthened business position for Heartland.

- Ends -

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Research Update:

Long-Term Rating On Heartland Bank Ltd. Raised To 'BBB'; Outlook Negative

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Research Update:

Long-Term Rating On Heartland Bank Ltd. Raised To 'BBB'; Outlook Negative

Overview

- We are raising the long-term issuer credit rating on Heartland Bank Ltd. (Heartland) to 'BBB' and assigning it a negative outlook.
- The rating upgrade reflects our view that Heartland's business position strengthened over the past three years upon the bank's transition toward its core niche markets and away from non-core assets.
- In our view the contestability in these—typically higher-risk--specialist markets is lower compared to traditional commoditized markets such as the residential mortgage loans market that is serviced by the major and other smaller New Zealand banks.
- The negative outlook reflects the negative economic risk trend assigned to the New Zealand banking system and our concerns around economic imbalances; should New Zealand's economic vulnerabilities worsen within the next two years and we lowered the anchor stand-alone credit profile (SACP) for a bank operating within New Zealand to 'bbb' from 'bbb+', then the rating of Heartland could be lowered by one notch back to 'BBB-' as a result of the lower anchor.

Rating Action

On May 21, 2014, Standard & Poor's Ratings Services raised its long-term issuer credit rating on New Zealand-based Heartland Bank Ltd. (Heartland) to 'BBB' from 'BBB-'. At the same time, we revised the outlook of the rating to negative. The short-term rating is affirmed at 'A-3'.

Further, the long-term issuer credit rating on MARAC Insurance Ltd. (MIL) is raised to 'BBB-' from 'BB+' and the outlook also revised to negative. Under our group-rating methodology, we have assessed MIL as a "strategically important" subsidiary of listed financial services group Heartland New Zealand Ltd. (not rated).

Rationale

The rating upgrade reflects our view that Heartland's business position strengthened over the past three years upon the bank's transition toward its core niche markets and away from non-core assets. In our view the improvement in Heartland's business position is evidenced by:

- The deepening of the bank's position in specialist target market segments such as vehicle asset finance, invoice financing, livestock financing, and reverse mortgage loans. In our opinion the level of contestability in

these--typically higher-risk--specialist target markets are significantly lower compared to commoditized markets such as the residential mortgages lending market that is serviced by New Zealand's major and other locally-owned banks.

- The progress made by Heartland to exit its non-core property portfolio as well as the gradual decline in Heartland's residential mortgages lending portfolio (also a non-core lending area for the bank), where levels of contestability is significantly higher.

We note that the strengthening of Heartland's franchise over the past three years was also assisted by its conversion to a bank, which contributed to retail deposit growth, a lowering of overall funding costs, and the maintenance of high deposit reinvestment rate.

Thus, we are of the view that Heartland's strategy and chosen target market are distinctly different from its peers', whose business positions in traditional high-contestability markets are assessed as "weak"--we assess Heartland's business position as "moderate."

Heartland's short-term issuer credit rating is affirmed at 'A-3'. It is our view that Heartland is more susceptible to confidence and sensitivity risks stemming from its low contestability focus and a customer base that is more prone to negative consumer sentiment.

Outlook

The outlook assigned to Heartland's rating is negative. The negative outlook reflects the negative economic risk trend assigned to the New Zealand banking system and our concerns around economic imbalances.

We are therefore of the view that should New Zealand's economic vulnerabilities worsen within the next two years and we lowered the anchor stand-alone credit profile (SACP) for a bank operating within New Zealand to 'bbb' from 'bbb+', the rating on Heartland could be lowered by one notch to reflect a lower anchor. In parallel we note that the management of the bank has indicated that any potential negative impact of the risk-adjusted capital ratio decreasing to below 15% would be off-set by appropriate capital-management actions within a reasonable timeframe.

Alternatively, should New Zealand's economic vulnerabilities subside over the next two years, the outlook of Heartland would be revised to stable. We note that the revision of the outlook to stable would not automatically result in the revision of the short-term issuer credit rating to 'A-2'.

Related Criteria And Research

Related Criteria

For Heartland Bank:

- Group Rating Methodology, Nov. 19, 2013

Research Update: Long-Term Rating On Heartland Bank Ltd. Raised To 'BBB'; Outlook Negative

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011

For MARAC Insurance:

- Group Rating Methodology, Nov. 19, 2013

Ratings List

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Heartland Bank Ltd.		
Counterparty Credit Rating	BBB-/Negative/A-3	BBB-/Developing/A-3
MARAC Insurance Ltd.		
Counterparty Credit Rating		
Local Currency	BBB-/Negative/--	BB+/Developing/--
Financial Strength Rating		
Local Currency	BBB-/Negative/--	BB+/Developing/--

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