



*NZX/ASX Release*

**Fitch affirms credit rating of Heartland Group companies**

2 November 2018

Heartland Group Holdings Limited (NZX/ASX:HGH) (**Heartland Group**) is pleased to announce that Fitch Australia Pty Ltd (Fitch) has affirmed its long term issuer default rating of the following Heartland Group companies:

Heartland Group Holdings Limited (HGH)	BBB (Outlook Stable)
Heartland Bank Limited (HBL)	BBB (Outlook Stable)
Heartland Australia Group Pty Ltd (HAG)	BBB- (Outlook Stable)

The full report from Fitch is attached to this announcement.

- Ends -

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## Fitch Affirms Heartland Bank; Assigns Ratings to 2 Heartland Entities

Fitch Ratings - Sydney - 01 November 2018: Fitch Ratings has affirmed the ratings on New Zealand-based Heartland Bank Limited (HBL) and assigned Heartland Group Holdings Limited (HGL) a Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'BBB' and Heartland Australia Group Pty Ltd (HAG) a Long-Term Foreign-Currency IDR of 'BBB-'. The Outlooks are Stable.

The rating actions follow a corporate restructuring that resulted in the creation of bank holding company HGL, with HBL as the main operating subsidiary that accounted for 82% of total assets at the end of the year to June 2018 (FYE18), and HAG as the operator of the Australian business.

The affirmation of the ratings on HBL and the new ratings reflect our view that the restructuring will not have a material impact on the credit profile of the group. The group is likely to continue to perform solidly over the next year or two, absent a significant acquisition. The group's franchise benefits from niche positions in some products, which has facilitated a strong net interest margin relative to peers. Fitch has observed improvements in underwriting standards and risk controls in recent years, which is important, considering some of the higher-risk segments the group focuses on.

### RATING ACTIONS

ENTITY	RATING	PRIOR
Heartland Bank Limited	Support 5 Affirmed	5
	Viability bbb Affirmed	bbb
	Support Floor NF Affirmed	NF
	LC ST IDR F2 Affirmed	F2
	LC LT IDR BBB ● Affirmed	BBB ●
	ST IDR F2 Affirmed	F2
	LT IDR BBB ● Affirmed	BBB ●

senior unsecured	ST F2 Affirmed		F2
senior unsecured	LT BBB Affirmed		BBB
Heartland Australia Group Pty Ltd	Support 2 New Rating		
	ST IDR F3 New Rating		
	LT IDR BBB- ● New Rating		
Heartland Group Holdings Limited	LT IDR BBB ● New Rating		
	ST IDR F2 New Rating		
	LC LT IDR BBB ● New Rating		
	LC ST IDR F2 New Rating		
	Viability bbb New Rating		

## KEY RATING DRIVERS

### IDRS AND VIABILITY RATINGS

#### HBL and HGL

The ratings on the demerged bank and the top-level holding company are driven by the consolidated risk profile of the group. This reflects the very close correlation between failure and default probabilities at HBL and HGL.

The consolidated risk profile reflects the group's higher risk appetite compared with its peers, as well as its sound profitability and capitalisation. The bank focuses on higher-risk products where it has a competitive advantage and does not need to compete with the major banks. The higher risk of its products is evident from the weaker collateral compared with the residential mortgage books of other New Zealand banks. The group's underwriting standards and lending profile have improved over time and have led to faster and better decision making.

The improvements in the group's underwriting standards and controls and the benign operating environment have contributed to relatively stable asset quality in recent years. However, Fitch expects the group's financial profile to be more vulnerable to deterioration relative to its peers, albeit still adequate, through a full credit cycle. This is owing to the bank's stronger-than-domestic-peer net interest margin and improved cost efficiency. Both provide sufficient buffers to absorb larger impairment charges in an economic downturn.

The group's strong asset growth could result in deterioration in its risk-weighted capital ratios, although capitalisation and leverage continue to have satisfactory buffers over regulatory minimums. The group has proven in recent years that it is able to access the equity markets for fresh capital to support growth.

The group's funding is confidence sensitive and the funding profile remains more reliant on wholesale funding markets than that of peers. The group has some cushion should it need to reprice deposits to attract depositors, given the wider margin on its loans. Liquidity may become less stable during periods of stress, but the group generally has lower maturity mismatches than domestic peers.

#### HAG

HAG's IDR is ultimately driven by institutional support from HGL, based on HAG's role in the group. HAG provides similar products, has common management, and shared services with the rest of the group. The group will also leverage from experiences in its home market to introduce products and concepts into the Australian market to support growth and product diversification. HAG is 100% owned by HGL, its management is deeply integrated with its parent's and they share board members. HAG also makes use of corporate services offered by the group, further cementing its role in the group.

However, due to its small size, Fitch sees HAG as complementing the group rather than as a key and integral part of the group. As such, Fitch classifies HAG as a strategically important subsidiary and rates it one notch lower than the group's ratings.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

##### HBL

The Support Rating and Support Rating Floor on HBL reflect Fitch's view that while support from the New Zealand sovereign (AA/Stable) is possible, it cannot be relied on. We believe the Open Bank Resolution (OBR) framework reduces the propensity of the sovereign to support its banks. The OBR framework allows for the imposition of losses on depositors and senior debt holders to make up capital shortfalls if a deposit-taking institution fails.

##### HAG

HAG's Support Rating reflects Fitch's view that there is a high probability of support from HGL.

#### DEBT RATINGS

HBL's senior unsecured notes and commercial paper programme are rated at the same level as its Long- and Short-Term Foreign-Currency IDRs, respectively, in accordance with Fitch's criteria.

### **RATING SENSITIVITIES**

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##### IDRS AND VIABILITY RATINGS

##### HBL and HGL

The IDRs and Viability Ratings are most sensitive to a change in Fitch's assessment of the group's risk appetite. An aggressive expansion by the group into new or existing market segments while compromising its risk-management practices would be negative for the ratings. Excessive growth over a sustained period could weaken the consolidated financial profile, including funding and liquidity, and pressure the ratings. There is little scope for the ratings to be upgraded unless the

franchise were to strengthen significantly relative to peers, which is not probable without increasing its risk appetite. Fitch expects HGL's ratings to continue to be equalised with those of HBL over the next two years.

#### HAG

Any change in the propensity or ability of the group to provide support to HAG is likely to result in changes to the entity's IDRs and Support Rating.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

##### HBL

The Support Rating and Support Rating Floor are sensitive to any change in assumptions around the propensity of the New Zealand sovereign to provide timely support to the bank.

#### HAG

The Support Rating is sensitive to any change in the ability or propensity of HGL to provide support.

#### DEBT RATINGS

The ratings on HBL's senior unsecured notes and commercial paper programme are sensitive to the same factors as the IDRs and Viability Rating.

#### DATE OF RELEVANT COMMITTEE

31 October 2018

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

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#### Applicable Criteria

Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018) ([/site/re/10044407](https://www.fitchratings.com/site/re/10044407))

Bank Rating Criteria (pub. 12 Oct 2018) ([/site/re/10044408](https://www.fitchratings.com/site/re/10044408))

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