NZX/ASX Release

Fitch Long-Term and Short-Term Ratings

29 October 2019

Fitch Ratings (**Fitch**) has affirmed the Long-Term Issuer Default Ratings (IDR) of Heartland Group Holdings Limited (NZX/ASX: HGH) (**Heartland Group**) and Heartland Bank Limited (NZX: HBL) (**Heartland Bank**) at 'BBB' and the Long-Term IDR of Heartland Australia Group Pty Ltd (**Heartland Australia**) at 'BBB-'. The Outlooks are Stable.

Fitch has downgraded the Short-Term IDR on Heartland Group and Heartland Bank to 'F3' from 'F2'. This follows a change in Fitch's ratings criteria.

Fitch's press release is attached.

- Ends -

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Fitch Ratings

Fitch Affirms Heartland at 'BBB'; Downgrades Short-Term IDR to 'F3'

Fitch Ratings - Sydney - 24 October 2019:

Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDR) of Heartland Group Holdings Limited (HGL) and Heartland Bank Limited (HBL) at 'BBB' and the Long-Term IDR of Heartland Australia Group Pty Ltd (HAG) at 'BBB-'. The Outlooks are Stable.

At the same time, Fitch has downgraded the Short-Term IDRs on HGL and HBL to 'F3' from 'F2' because the funding and liquidity mid-point of 'bbb', which feeds into the Viability Rating, is below the minimum level required to maintain the Short-Term IDR at 'F2' under Fitch's cross-sector Short-Term Ratings Criteria. The Short-Term IDR has been removed from Under Criteria Observation, under which it was placed in May 2019 following the publication of the new criteria.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Heartland Australia Group Pty Ltd	LT IDR BBB- Affirmed		BBB-
	ST IDR F3 Affirmed		F3
	Support 2 Affirmed		2
Heartland Group Holdings Limited	LT IDR BBB Affirmed		BBB
	ST IDR F3 Downgrade		F2
	LC LT IDR BBB Affirmed		BBB
	LC ST IDR F3 Downgrade		F2
	Viability bbb Affirmed		bbb
Heartland Bank Limited	LT IDR BBB Affirmed		BBB
	ST IDR F3 Downgrade		F2
	LC LT IDR BBB		BBB

	Affirmed		
	LC ST IDR F3 Downgrade		F2
	Viability bbb Affirmed		bbb
	Support 5 Affirmed		5
	Support Floor NF Affirmed		NF
senior unsecured	LT BBB Affirmed		BBB
senior unsecured	ST F3 Downgrade		F2

Key Rating Drivers

IDRS AND VIABILITY RATINGS FOR HGL and HBL

The ratings on HGL and HBL are driven by the group's consolidated risk profile, which reflects the close correlation between failure and default probabilities of the two entities and the group's higher risk appetite relative to peers, although this is mitigated by its stronger profitability. HBL accounted for 85% of the consolidated group's total assets as at the financial year ending June 2019 (FY19).

Risk appetite remains the key driver of the ratings, particularly the group's underwriting standards. The group's underwriting standards have improved over time and its systems and underwriting processes have benefited from ongoing investment. However, we expect the group's financial profile to be more vulnerable to economic shocks given the higher-risk nature of its loan book.

Group profitability continues to compare favourably against that of peers, benefiting from the higher margins of its loan book and sound cost-to-income ratio. This provides adequate buffers to absorb larger impairment charges during a downturn. Fitch believes the continued investment in platforms and increased focus on compliance could pressure costs for the next year, but these should remain manageable.

Asset quality is sound and the impaired loan ratio has remained consistent, but trails that of most domestic peers due to differing exposure types. An increase in the impaired loan ratio in FY19 was largely due to the adoption of IFRS9 and Fitch's adoption of Stage 3 loans, where disclosed, as the impaired loan figure when calculating the ratio. We expect the group's asset quality ratios to remain around current levels for the next year, supported by the low interest-rate environment.

The group's funding profile has been generally stable over the last few years, despite reliance on confidence-sensitive wholesale funding remaining higher than for domestic peers. We believe the group's strong interest margin will improve flexibility should the group need to attract more deposits. The liquidity profile is satisfactory, although the group has less contingent liquidity sources compared with peers, as its reverse mortgage book is not repo-eligible and therefore cannot be securitised to provide additional liquidity.

The senior unsecured debt ratings are driven by the same rationale as the Viability Ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR FOR HBL

The Support Rating and Support Rating Floor of HBL reflect Fitch's view that while support for the group from the New Zealand sovereign is possible, it cannot be relied on. We believe the group's small size and the existence of the open bank resolution scheme lowers the propensity of the sovereign to support its banks. The scheme allows for the imposition of losses on depositors and senior debt holders to recapitalise a failed institution.

HAG

HAG's IDRs are driven by institutional support from its parent, HGL, which fully owns HAG. We believe HAG, which holds the group's Australia business, is a strategically important part of HGL and has strong management synergies with the parent and benefits from being part of the wider group.

HAG's IDR is notched down once from the parent to reflect our view that while HAG is important to the group, its small size means that it is not a key and integral part of the business. HAG's Support Rating of '2' reflects Fitch's view that there is high probability of support from HGL.

RATING SENSITIVITIES

IDRS AND VIABILITY RATING FOR HGL and HBL

The IDRs and Viability Rating of HGL and HBL are sensitive to a change in Fitch's assessment of the group's risk appetite. Aggressive expansion by the group into new or existing market segments that compromise its risk-management practices would be negative for the ratings. Looser underwriting or sustaining a more aggressive growth strategy over a long 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 remain equalised with those of HBL over the next two years. However, bottom-up analysis of the group will be required for HGL's ratings should HAG become a more material part of the group.

SUPPORT RATING AND SUPPORT RATING FLOOR FOR HBL

The Support Rating and Support Rating Floor of HBL are sensitive to any change in assumptions around the propensity or ability of the New Zealand government to provide timely support.

HAG

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

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

Additional information is available on www.fitchratings.com

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Applicable Criteria

Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)
Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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