

### Research Update:

## Outlook On Heartland Building Society Ltd. Revised To Negative, On Asset Quality And Earnings Pressure

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## Research Update:

# Outlook On Heartland Building Society Ltd. Revised To Negative, On Asset Quality And Earnings Pressure

## Overview

- We have affirmed the 'BBB-/A-3' issuer credit ratings.
- We have revised the outlook on Heartland Building Society Ltd.'s (HBS) ratings to negative from stable.
- The outlook revision recognises our view that HBS asset quality and earnings profile are not consistent with the current rating, and are weaker compared to other similarly rated peers.

## Rating Action

On Aug. 12, 2011, Standard & Poor's Ratings Services affirmed its 'BBB-/A-3' issuer credit ratings on New Zealand Based-based Heartland Building Society Ltd. (HBS). We revised the outlook on the ratings to negative from stable.

## Rationale

The outlook revision reflects the slower-than-anticipated stabilisation and improvement in HBS's key asset quality indicators and earnings profile, which are assessed as being weaknesses to the current 'BBB-/A-3' issuer credit rating. Headwinds in the commercial property market and the general operating environment have contributed to our view that it will now take longer for HBS to restore its asset quality and earnings profiles to levels supportive of the rating and comparable to other, similarly rated, peers.

The counterparty credit ratings on Heartland Building Society (HBS) reflect our favorable view of the company's business risk profile, which is supported by its small but good market position in the New Zealand nonbank deposit-taker sector, and its good business and geographic diversity. The adequate enterprise risk management framework also underpins the business risk profile. In addition, the ratings incorporate our positive view of HBS's strategic initiatives and management team, which has to date effectively executed the operational merger of MARAC Finance Limited (Marac, 'BBB-/A-3'), Canterbury Building Society (CBS, unrated), and Southern Cross Building Society (CBS, unrated).

## Short-term credit factors

The short-term rating on HBS is 'A-3'. As a merged group, HBS's funding position is stronger than the three individual companies, stemming from its access to retail deposits (cheque, savings, and term deposits), retail NZDX listed bonds, a NZ\$375 million securitisation program, and NZ\$200 million in

committed undrawn bank facilities. Reinvestment rates have help up, and averaged at around 80%. About half of the deposit base consisted out of non-guaranteed deposits, with the remainder being guaranteed deposits.

## Outlook

The negative outlook reflects financial risk pressures stemming from HBS's high level of nonperforming loans and low core earnings. The ratings could be lowered if asset quality metrics were to deteriorate further, and if this deterioration caused an adjustment in Standard & Poor's overall view of the group's credit profile; or if HBS were unable to improve key asset-quality metrics and achieve core earnings that were consistent with its current rating over the next 12 months. The rating outlook could return to stable if HBS were successful in managing down its nonperforming asset level and improve core earnings to a sustainable level more supportive of current ratings.

## Related Criteria And Research

- Criteria Financial Institutions Banks: Bank Rating Analysis Methodology Profile, March 18, 2004

## Ratings List

Ratings Affirmed

MARAC Finance Ltd.

|                           |      |
|---------------------------|------|
| Senior Secured (1 issue)  | A-3  |
| Senior Secured (2 issues) | BBB- |

Ratings Affirmed; CreditWatch/Outlook Action

|                            | To                | From            |
|----------------------------|-------------------|-----------------|
| Heartland Building Society |                   |                 |
| MARAC Finance Ltd.         |                   |                 |
| Counterparty Credit Rating | BBB-/Negative/A-3 | BBB-/Stable/A-3 |

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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