

NZX/ASX release
14 April 2022

Heartland long-term ratings affirmed, Outlooks revised

Fitch Rating (**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-'. (Heartland Group, Heartland Australia and Heartland Bank, together referred to as **Heartland**).

Heartland Bank's Outlook remains Stable. Heartland Bank also continues to be one of just two Australasian banks to have no reduction or adverse change to its ratings or outlook since January 2020, despite the economic impacts of COVID-19.

The Outlook on the IDRs of Heartland Group and Heartland Australia have been revised to Negative from Stable, reflecting a possible change in Fitch's rating approach as a result of the proposed acquisition of StockCo Holdings 2 Pty Ltd (**StockCo Australia**). A ratings action is customary in the event of an acquisition.

In its attached press release, Fitch noted that the acquisition was unlikely to have a material impact on Heartland's risk profile or asset quality, will improve profitability, and increase Heartland Group's exposure to wholesale funding.

– ENDS –

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Fitch Revises Outlook on Heartland Group Holdings to Negative on Proposed Acquisition; Affirms 'BBB'

Fitch Ratings - Sydney - 07 Apr 2022: Fitch Ratings has revised the Outlook on the Long-Term Issuer Default Ratings (IDRs) of Heartland Group Holdings Limited (HGL) and subsidiary Heartland Australia Group Pty Ltd (HAG) to Negative from Stable on the proposed acquisition of StockCo Holdings 2 Pty Ltd (StockCo Australia), and affirmed the ratings at 'BBB' and 'BBB-', respectively.

Fitch has also affirmed Heartland Bank Limited's (HBL) Long-Term IDRs at 'BBB' with a Stable Outlook.

A full list of the rating actions is below.

Fitch is withdrawing HBL's Support Rating of '5' and Support Rating Floor of 'NF' because they are no longer relevant to the agency's coverage following the publication of our updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned a Government Support Rating (GSR) of 'ns' to HBL and HGL.

Fitch is also withdrawing the Support Rating of '2' for HAG because it is no longer relevant to the agency's coverage following the publication of our updated Non-Bank Financial Institutions Rating Criteria on 31 January 2022. In line with the updated criteria, we have assigned a Shareholder Support Rating (SSR) of 'bbb-'

Key Rating Drivers

The Outlook revision on HGL's Long-Term IDRs reflects a possible change in Fitch's rating approach as a result of the proposed acquisition of StockCo Australia. Fitch currently determines Heartland group's Viability Rating (VR) using the consolidated HGL accounts and applies the rating to HBL as the group's core bank. The VR of the holding company, HGL, is equalised with the group VR under Fitch's Bank Rating Criteria.

However, Fitch will consider switching from the current top-down approach to a bottom-up approach to assess the group VR if HBL's total assets fall below around 75% of group assets. This is likely to occur within the next two years after the proposed acquisition. We expect Heartland's non-banking operations in Australia to have weaker financial profile relative to HBL.

The group's VR of 'bbb' is one notch below the implied VR of 'bbb+' because of higher exposure to commercial lending compared with other domestic peers. This could lead to higher volatility on earnings and capitalisation through the cycle. We have applied a negative adjustment on the group VR to reflect the bank's risk profile.

The Outlook revision on HAG's Long-Term IDR reflects similar rating action on HGL, which fully owns HAG. HAG's Long-Term IDR is notched down once from the parent's VR to reflect that it is a strategically important subsidiary.

The Stable Outlook on HBL's Long-Term IDRs reflects our expectation that the standalone credit profile of HBL will remain consistent with its current VR of 'bbb' even if we move to a bottom-up approach to assess the group. We would no longer view HBL as having substantially the same failure risk as the group as a whole in this situation, given the increased size of the Australian operations.

StockCo Australia is a non-bank finance company based in Australia specialising in livestock finance for cattle and sheep farmers. The company, which had total assets of AUD341 million at end-February 2022, is owned by StockCo Australia Holdings Limited (70%) and Elders Rural Service Australia Limited (30%).

We expect the proposed acquisition to have minimal impact on Heartland group's operating environment score, which should continue to be driven by New Zealand's economic performance. The operating environment for New Zealand-registered banks should remain stable and consistent with the 'a' factor score. High household leverage remains a key risk for the country's banking system, particularly in light of strong house-price appreciation in 2020 and 2021, and drives the negative adjustment from the 'aa(cat)' implied operating environment score.

The impact on HGL's business profile is likely to be limited in the next two years, reflecting the acquisition's small size relative to the group. We expect StockCo Australia's business model to be largely consistent with the group, as HGL already has similar product offerings in New Zealand. HGL's market position may benefit slightly on new growth potential in Australia, although these benefits will be modest at the group level initially and are unlikely to materially improve the overall franchise in the short term.

HGL's geographic diversification will increase modestly after the acquisition, especially for the rural exposure. However, the new portfolio would remain a small part of the group and therefore, it would be unlikely to materially affect the group's risk profile, which we score at 'bbb'. We expect StockCo Australia's underwriting standards to be generally consistent with the group's approach to livestock financing.

We believe the acquisition is unlikely to have a material impact on Heartland group's asset quality. This reflects the small size of StockCo Australia's loan book relative to the group and similar underwriting standards for livestock financing.

We expect StockCo Australia's profitability metrics to be stronger than those of HGL. Even so, we believe the group's core metric will remain consistent with its current factor score of 'a-' over the next two years.

Fitch has revised the factor outlook of HGL's capitalisation and leverage to negative from stable, reflecting our expectation of a meaningful weakening in the group's capitalisation metrics following the completion of the acquisition. This weakening will be due in part to the goodwill booked after the

acquisition has been completed, as well as reflecting the weaker capital position of StockCo Australia compared with HGL.

We also expect the acquisition to have a material impact on HGL's funding profile. So we have revised the factor outlook of the group's funding and liquidity score to negative from stable. The score could be lowered to 'bbb-' from 'bbb' if we expect the four-year average of Heartland group's loans/deposits ratio to increase above 150% on a sustained basis.

HGL's funding profile may continue to weaken over the medium term if the Australian operations remain wholly funded by wholesale sources. There could be further pressure on the factor score if the four-year average of the core metric continues to weaken and increases above 180%. Lowering of the factor score to 'bb+' alone is unlikely to lead a downgrade of the group's VR.

The GSRs of HGL and HBL reflect Fitch's view that, while support for the group from the New Zealand sovereign (Long-Term Foreign-Currency IDR: AA/Positive) 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 the banks. The scheme allows for the imposition of losses on depositors and senior debt holders to recapitalise a failed institution.

Fitch continues to equalise HGL's VR with the group VR. However, bottom-up analysis of the group will be used for HGL's ratings should Heartland's Australian operations become a more material part of the group. We believe Heartland has appetite for further acquisition in Australia. This could lead to an increase in the double leverage ratio of the holding company in the short term. However, if it were to rise above 120%, we do not expect it to remain at this level for a sustained period.

Rating Sensitivities

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

The group VR, which is used to derive HGL's VR and IDRs, may be downgraded if the Australian operations became sufficiently material that we switch the rating approach from top-down to bottom-up. This is to reflect that the standalone credit profiles of the two Australian entities (HAG and StockCo Australia) are weaker than that of HBL, which could result in the weighted-average credit assessment being a notch lower than the current group VR of 'bbb'.

We would not expect this change in approach to affect HBL's VR or IDRs because we would no longer consider HBL as having substantially the same failure risk as the group.

The IDRs, VRs and Long-Term senior debt ratings of HBL and HGL (where applicable) could also be downgraded should the group substantially increase its risk profile, possibly in an effort to improve the market position, resulting in significant deterioration of its financial profile during an economic downturn. A combination of the following would likely result in a downgrade:

- stage 3 loans/gross loans of HGL increasing above 4% for a sustained period;

- operating profit/risk-weighted assets of HGL falling below 1% for a sustained period; or
- tangible common equity/tangible assets of HGL declining below 7% for a sustained period; or
- the four-year average of HGL's loans/deposits ratio increasing above 180%.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of HGL's IDRs are unlikely in the near term, unless there is an improvement in the standalone strength of HBL. An upgrade of HBL's VR, IDRs and senior debt ratings is possible if there is a sustained improvement in the bank's risk profile and funding profile while maintaining its other financial metrics.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The proposed acquisition has no impact on the HBL's debt ratings, which are aligned with its Long-Term IDRs.

HAG's guaranteed notes are rated one notch below parent HGL's Long-term IDR, in line with Fitch's Non-Bank Financial Institutions Rating Criteria. Please see ["Fitch Rates Heartland Australia Group's AUD75 Million Guaranteed Medium-Term Notes 'BBB-'"](#) for more details.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

HBL's senior debt ratings will be downgraded if HBL's IDRs are downgraded. The senior debt ratings of HAG's guaranteed debt instruments would be downgraded if HGL's Long-Term IDR is downgraded.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

HBL's senior debt ratings will be upgraded if HBL's IDRs are upgraded. The senior debt ratings of HAG's guaranteed debt instruments would be upgraded if HGL's Long-Term IDR is upgraded.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

HAG's IDRs are driven by our assessment of shareholder support. We believe there is a continued high probability of support from HGL, which owns 100% of HAG. HAG's Long-Term IDR is notched down once from the parent's VR 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.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

A downgrade of HGL's IDRs would be reflected in the ratings of HAG. HAG's IDRs may also be

downgraded if its importance to the group were to decline, although we believe this is unlikely.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of HAG's IDRs and SSR would follow an upgrade of HGL's IDRs as long as HGL's propensity to support remains unchanged. However, an upgrade appears unlikely in the near term.

VR ADJUSTMENTS

The operating environment score has been assigned below the 'aa' category implied score on the following adjustment reason: Level and growth of credit (negative).

The business profile score of 'bbb' has been assigned above the 'bb' category implied score on the following adjustment reason: Business model (positive).

The VR of 'bbb' has been assigned below the 'bbb+' implied score on the following adjustment reason: Risk profile (negative).

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

Sources of Information

The principal sources of information used in the analysis are described in the Applicable Criteria.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

HAG's IDRs are linked to the IDRs of HGL. Senior debt ratings of the guaranteed notes issued by HAG are linked to the Long-Term IDR of HGL.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Heartland Group Holdings Limited	LT IDR	BBB 	Affirmed	BBB 
	ST IDR	F3	Affirmed	F3
	LC LT IDR	BBB 	Affirmed	BBB 
	LC ST IDR	F3	Affirmed	F3
	Viability	bbb	Affirmed	bbb

ENTITY/DEBT	RATING		RECOVERY	PRIOR
	Government Support	ns	New Rating	
Heartland Australia Group Pty Ltd	LT IDR	BBB- 	Affirmed	BBB- 
	ST IDR	F3	Affirmed	F3
	Support	WD	Withdrawn	2
	Shareholder Support	bbb-	New Rating	
• guaranteed	LT	BBB-	Affirmed	BBB-
Heartland Bank Limited	LT IDR	BBB 	Affirmed	BBB 
	ST IDR	F3	Affirmed	F3
	LC LT IDR	BBB 	Affirmed	BBB 
	LC ST IDR	F3	Affirmed	F3
	Viability	bbb	Affirmed	bbb
	Support	WD	Withdrawn	5
	Support Floor	WD	Withdrawn	NF
	Government Support	ns	New Rating	

ENTITY/DEBT	RATING		RECOVERY	PRIOR
• senior unsecured ^{LT}	BBB		Affirmed	BBB
• senior unsecured ST	F3		Affirmed	F3

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◉	◆
STABLE	◉	

Applicable Criteria

[Bank Rating Criteria \(pub.12 Nov 2021\) \(including rating assumption sensitivity\)](#)

[Non-Bank Financial Institutions Rating Criteria \(pub.31 Jan 2022\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Heartland Australia Group Pty Ltd	EU Endorsed, UK Endorsed
Heartland Bank Limited	EU Endorsed, UK Endorsed
Heartland Group Holdings Limited	EU Endorsed, UK Endorsed

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