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## Kiwibank Ltd.

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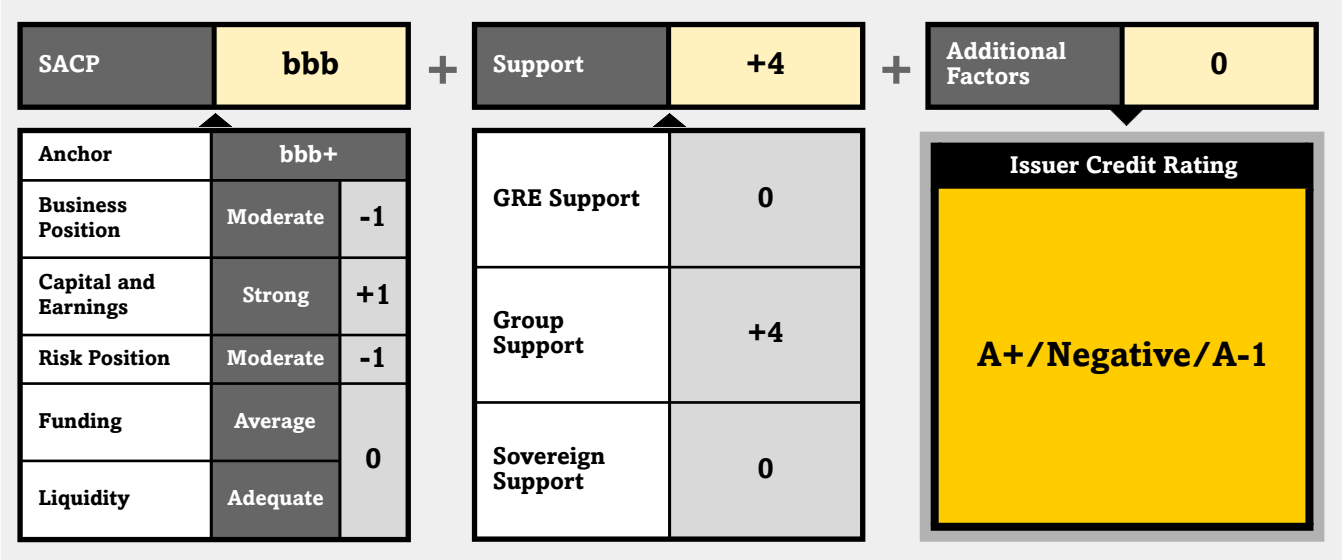
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# Kiwibank Ltd.



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Support through unconditional guarantee from New Zealand Post Ltd., the 100% parent</li> <li>• Supportive risk-based capitalization ratios</li> <li>• Good retail-funding position</li> </ul>	<ul style="list-style-type: none"> <li>• Strong growth appetite has the potential to moderate earnings, capital, and asset quality</li> <li>• Concentrated product suite</li> </ul>

## Rationale

The ratings and outlook on Kiwibank Ltd. mirror our ratings and outlook on the bank's parent, New Zealand Post Ltd. (NZ Post, A+ / Negative / A-1). Our ratings on Kiwibank are currently equalized with those on NZ Post, reflecting the benefit of NZ Post's unconditional guarantee for all of the bank's senior obligations. We note that a weakening in Kiwibank's stand-alone credit profile (SACP) itself could be a trigger for lowering the rating on NZ Post, given that Kiwibank forms a material part of the NZ Post group.

Our assessment of Kiwibank's SACP reflects the anchor SACP for a bank operating only in New Zealand; plus Kiwibank's "moderate" business position, "strong" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity.

### Anchor:

Our bank criteria use our Banking Industry Country Risk Assessment economic and industry risk scores to determine a bank's SACP, the starting point in assigning an issuer credit rating. Our anchor SACP for a bank operating only in New Zealand is 'bbb+', based on an economic risk score of "3" and an industry risk score of "4".

We view New Zealand as an open, resilient, and well-developed economy benefitting from flexible labor and product markets. We believe that a weakening in the country's macroeconomic factors could heighten the risk of a sharp correction in property prices in the country, which would likely trigger increased credit losses for the banks. We consider that this risk is heightened by New Zealand's material dependence on external borrowings and persistent current account deficits, against the backdrop of an uncertain short-to-medium term outlook for global economic recovery, and recent growth in house prices in some of the larger cities. We consider private sector debt to be high, although supported by high income levels, conservative underwriting, and a creditor-friendly legal framework. Our assessment of industry risk in the New Zealand banking sector is underpinned by the country's conservative regulation and the sector's restrained risk appetite, which are partly offset by limited funding support from customer deposits and a material dependence on net external borrowings.

The SACP for Kiwibank is 'bbb'.

**Table 1**

<b>Kiwibank Ltd. Key Figures</b>					
	<b>--Year-ended June 30--</b>				
<b>(Mil. NZ\$)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Adjusted assets	15,145.0	14,696.0	13,827.7	12,190.9	10,327.9
Customer loans (gross)	13,274.0	12,536.0	11,581.9	10,438.0	8,504.2
Adjusted common equity	641.0	568.0	449.2	436.7	380.2
Operating revenues	446.0	419.0	353.0	301.4	301.7
Noninterest expenses	287.0	257.0	226.1	203.7	201.7
Core earnings	105.2	86.0	28.3	61.1	68.3

### **Business position:**

We assess Kiwibank's business position as "moderate".

In our view Kiwibank's business position is showing early signs of benefitting from a sizeable market share in residential home loans of about 7% of locally incorporated registered banks. We also consider that the "Kiwibank" franchise benefits from its NZ Post ownership and guaranteed payment obligations. The bank currently operates a joint national distribution platform together with its parent; in the future we expect that the ownership of the distribution network would gradually shift towards Kiwibank, further strengthening the bank's business position profile. We are of the view that in the future these factors could potentially contribute to improved revenue and business stability relative to peers.

That said we note that Kiwibank remains concentrated in terms of product, with residential mortgage loans constituting about 80% of its credit risk exposures. However, we observe that progress is made in diversifying the product revenue streams through the bank's revision of its business banking strategy, with the intention of expanding capacity to serve the SME business segment and establish a reputation as a creditable, professional business bank. We are of the view that the successful roll-out of the revised business banking strategy would have a positive impact on the bank's product diversification; in addition, new business lending is targeted away from commercial property loans, resulting in a broader cross section of SME customers by business type. We observe that the revised business banking strategy will have strong links to Kiwibank's potential future core banking system replacement project.

We view the bank's corporate governance and risk-management structures as being adequate for the nature and extent of Kiwibank's activities. In our opinion, Kiwibank's management structure has remained fairly constant, with structural changes at executive level mainly reflecting a rationalization of direct reports to the chief executive officer.

**Table 2**

<b>Kiwibank Ltd. Business Position</b>					
	<b>--Year-ended June 30--</b>				
<b>(%)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Total revenues from business line (currency in millions)	446.0	419.0	353.0	301.4	312.9
Retail banking/total revenues from business line	60.1	60.4	60.4	63.6	66.5

### Capital and earnings:

Our assessment that Kiwibank's capital and earnings are "strong" reflects our expectation that the bank's risk-adjusted capital (RAC) ratio will remain in the 11.5%-12.5% range over the next 12-24 months. Our forecasted RAC ratio takes into account, among other things, Kiwibank's: potential future investment in a core-bank replacement project treated as a non-servicing intangible and deducted from total adjusted capital; Kiwibank growing its loan exposures at a rate higher than the system average; no dividend payments to NZ Post until 2017, as earnings are reinvested into the bank; and possible capital injections from NZ Post over the forecasting period.

Capital support is also available for Kiwibank from the New Zealand government, through a committed NZ\$300 million uncalled capital facility. We note, however, that the committed uncalled capital facility is only available for restoring the prudential capital and liquidity ratios in specific circumstances.

We are of the view that Kiwibank comfortably meets the minimum regulatory requirements post the implementation of the Basel III framework in New Zealand. Kiwibank is also in the process of transitioning to the Basel II advanced ratings based approach for the measurement of its credit risk exposures with the possibility of freeing up further capital and increasing Kiwibank's capital ratios further above the regulatory minima.

In our view, Kiwibank has a satisfactory capital structure that includes a NZ\$150 million hybrid instrument--which is assessed as having "intermediate" equity content under Standard & Poor's hybrid debt rating criteria. We believe that this instrument will be replaced with a Basel III-compliant instrument if the call option is exercised in 2015.

**Table 3**

<b>Kiwibank Ltd. Capital And Earnings</b>					
	<b>--Year-ended June 30--</b>				
<b>(%)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Tier 1 capital ratio	10.4	10.4	9.0	9.8	7.7
Adjusted common equity/total adjusted capital	81.1	79.2	75.2	75.2	100.0
Net interest income/operating revenues	61.9	61.3	54.2	44.3	54.2
Fee income/operating revenues	38.1	37.5	41.1	43.7	47.4
Market-sensitive income/operating revenues	0.0	1.2	4.6	12.0	(1.5)
Noninterest expenses/operating revenues	64.3	61.3	64.0	67.6	66.9
Provision operating income/average assets	1.1	1.1	1.0	0.9	1.1
Core earnings/average managed assets	0.7	0.6	0.2	0.5	0.8

**Risk position:**

Our risk-position assessment for Kiwibank is "moderate". We are of the view the Kiwibank's risk appetite remains more aggressive than that of the other major banks, reflected in the bank's higher-than-peer-average growth in loans and advances in the past, and projected for the future. In addition, we are also of the view that should the core banking replacement project go ahead, the project of such a scale might introduce additional operational risks. We therefore regard the risks emanating from higher growth and core banking replacement project as not being fully captured in our standard assumptions under our capital and earnings assessment.

In our view, Kiwibank is not disproportionately exposed to concentration risks such as single-name concentration and geographic concentration compared to peers with a similar economic risk score and operating in New Zealand.

From a complexity point of view, we are of the opinion that Kiwibank's business operations are relatively simple and uncomplicated.

**Table 4**

<b>Kiwibank Ltd. Risk Position</b>					
	<b>--Year-ended June 30--</b>				
<b>(%)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Growth in customer loans	5.9	8.2	11.0	22.7	52.3
Total managed assets/adjusted common equity (x)	23.7	26.0	30.9	28.0	27.3
New loan loss provisions/average customer loans	0.1	0.3	0.7	0.2	0.2
Net charge-offs/average customer loans	0.2	0.3	0.1	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.5	1.0	1.2	0.6	0.5
Loan loss reserves/gross nonperforming assets	101.4	75.8	62.8	28.9	28.7

**Funding and liquidity:**

Kiwibank's funding is assessed as "average" and liquidity as "adequate". The funding assessment recognizes Kiwibank's stable funding ratio of 101% and long term-funding ratio of 93%, which are higher than those of its peers. Kiwibank's loan-to-deposit ratio of 109% is lower than the average of the peers. Compared to peers, Kiwibank also has a significant core deposit funding base. In addition, we note that Kiwibank's funding profile benefits from a stronger franchise, supported by NZ Post, its shareholder and guarantor.

In our view, Kiwibank has adequate capacity to meet its liquidity needs, supported by its balance-sheet holdings of liquid assets, good and stable cash flows from amortising loans, and its large and reasonably stable retail deposit base. The bank's liquidity position also benefits from management's active and comprehensive liquidity-management practices, which include specific policies and plans to manage liquidity in a range of market or name-stress scenarios.

**Table 5**

<b>Kiwibank Ltd. Funding And Liquidity</b>					
	<b>--Year-ended June 30--</b>				
<b>(%)</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Core deposits/funding base	85.9	84.0	81.5	90.8	85.8
Customer loans (net)/customer deposits	108.9	107.6	108.6	101.2	102.7
Long term funding ratio	92.9	90.1	87.8	95.7	88.5

**Table 5**

<b>Kiwibank Ltd. Funding And Liquidity (cont.)</b>					
Stable funding ratio	100.6	99.4	96.8	104.0	97.5
Short-term wholesale funding/funding base	7.5	10.4	12.7	4.5	11.8
Broad liquid assets/short-term wholesale funding (x)	1.3	1.0	0.9	2.5	1.1
Short-term wholesale funding/total wholesale funding	49.4	60.8	64.7	42.5	83.1

**Table 6**

<b>Kiwibank Risk-Adjusted Capital Framework</b>					
	<b>Exposure*</b>	<b>Basel II RWA</b>	<b>Average Basel II RW (%)</b>	<b>Standard &amp; Poor's RWA</b>	<b>Average Standard &amp; Poor's RW (%)</b>
<b>Credit risk</b>					
Government and central banks	1,059,789,946	15,511,910	1	43,036,267	4
Institutions	583,256,617	122,051,325	21	134,510,873	23
Corporate	139,152,373	69,285,975	50	114,800,708	83
Retail	13,650,873,865	5,794,533,125	42	4,497,569,169	33
Of which mortgage	12,814,283,146	4,957,942,400	39	3,870,126,130	30
Securitization§	0	0	0	0	0
Other assets	315,559,403	188,263,100	60	180,306,082	57
Total credit risk	15,748,632,204	6,189,645,435	39	4,970,223,098	32
<b>Market risk</b>					
Trading book market risk	--	308,777,063	--	463,165,594	--
Total market risk	--	308,777,063	--	463,165,594	--
<b>Insurance risk</b>					
Total insurance risk	--	--	--	0	--
<b>Operational risk</b>					
Total operational risk	--	951,075,300	--	735,750,000	--
<b>Diversification adjustments</b>					
RWA before diversification		8,024,497,798		6,169,138,692	100
Total Diversification/Concentration Adjustments		--		1,944,629,109	32
RWA after diversification		8,024,497,798		8,113,767,801	132
		<b>Tier 1 capital</b>	<b>Tier 1 ratio (%)</b>	<b>Total adjusted capital</b>	<b>Standard &amp; Poor's RAC ratio (%)</b>
<b>Capital ratio</b>					
Capital ratio before adjustments		774,393,822	9.7	790,000,000	12.8
Capital ratio after adjustments‡		774,393,822	9.7	790,000,000	9.7

\*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework.

‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of June. 30, 2013, Standard & Poor's.

## Outlook: Negative

The outlook reflects that on Kiwibank's parent, NZ Post. The negative outlook on NZ Post reflects: 1) rising economic risks in New Zealand that could affect the credit standing of NZ Post's subsidiary, Kiwibank; and 2) weak profitability of the postal operations, which are highly reliant on effective cost restructuring to offset structurally declining revenue trends.

The rating on Kiwibank could be lowered if we lower the rating on NZ Post (for more details on the downside scenario please refer to the NZ Post outlook).

The rating on Kiwibank could be revised to stable if we revised the outlook on NZ Post back to stable (for more details please refer to the NZ Post outlook).

We consider the main factors that could impact Kiwibank's SACP as being:

- A weakening in Kiwibank's SACP as a result of an increase in economic risks in New Zealand and the lowering of the anchor SACP for banks operating in New Zealand; ultimately also impacting the rating on NZ Post.
- Although a less likely scenario, a strengthening of Kiwibank's SACP, due to: its business position benefitting from a strengthening of the distribution network; the successful replacement of the core banking system; and Kiwibank maintaining its current growth trajectory while the operating performance of the bank remains intact.

## Related Criteria And Research

- Group Rating Methodology, May 7, 2013
- 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

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Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

### Ratings Detail (As Of November 11, 2013)

#### Kiwibank Ltd.

Counterparty Credit Rating	A+/Negative/A-1
Certificate Of Deposit	
<i>Local Currency</i>	A-1
Junior Subordinated	BB+
Subordinated	A

#### Counterparty Credit Ratings History

21-May-2013	A+/Negative/A-1
30-Oct-2012	A+/Stable/A-1
31-Jan-2012	AA-/Negative/A-1+

#### Sovereign Rating

New Zealand	
<i>Foreign Currency</i>	AA/Stable/A-1+
<i>Local Currency</i>	AA+/Stable/A-1+

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.



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