

Nelson Building Society

Key Rating Drivers

Pandemic to Dent Profit: The ratings of Nelson Building Society (NBS) are underpinned by sound profitability and asset quality, which benefit from the society's larger franchise relative to peers. Nonetheless, Fitch Ratings believes the coronavirus pandemic will significantly damage New Zealand's economy, which will weaken NBS's financial profile, especially profitability and asset quality, over the next two years.

Weakening Operating Environment: Fitch has revised the outlook on the 'a-' operating environment score for New Zealand non-bank deposit takers (NBDT) to negative, from stable, to reflect the significant downside risk posed by the measures undertaken to slow the spread of the pandemic. We may revise this outlook to stable if our base case of a recovery starting in 2H20 eventuates. However, an outcome that is significantly weaker than our base case is likely to result in a lowering of the score to 'bbb+'.

Non-Performing Loans to Rise: NBS has moderate exposure to business lending, including agriculture and property investments. The society is focused on quality borrowers with established records, which should help maintain its asset quality. However, we expect the non-performing loan ratio to rise sharply in late 2020 or early 2021 once repayment holidays end.

Profitability Pressure: NBS's profitability is stronger than that of other New Zealand NBDTs, supported by its larger franchise and sound asset quality. Nevertheless, low interest rates and rising impairment charges could weigh on profitability over the next two years. Credit growth may also slow in the short-term due to weak consumer sentiment.

Satisfactory Capitalisation: We expect NBS's capital ratios to remain satisfactory over the next two years due to its sound internal capital generation and ability to issue perpetual preference shares to support capitalisation. Weakened profitability should be largely offset by the slowdown in credit growth.

Generally Stable Funding Profile: We believe the pandemic will have a limited impact on NBS's funding profile. The society's liquidity position is sound and may strengthen as credit growth slows. We expect deposit growth to be in line with credit growth over the medium term. NBS is fully deposit funded, but does not have access to the central bank as a lender of last resort, similarly to other NBDTs.

Rating Sensitivities

Negative Rating Action: The IDRs and Viability Rating could be downgraded if the economic environment deteriorates beyond our base-case scenario. We would lower the operating environment score for New Zealand NBDTs to 'bbb+' under this downside scenario, which would result in a lowering of our assessment of many financial profile factors. The Short-Term IDRs would only be downgraded if the Long-Term IDRs were downgraded to 'CCC+' or below.

The ratings may also be downgraded, even if the operating environment score remains unchanged, if the society substantially increases its risk appetite, resulting in a deterioration of its financial profile. This includes: stage 3 loans/gross loans rising to above 8% for a sustained period; operating profit/risk-weighted assets falling below 0.5% for a sustained period; or its total capital ratio declining to below 9.5% without a credible plan to replenish regulatory capital buffers.

Positive Rating Action: Positive rating action is not probable in the short-term given the challenges from the economic recession. It would also require a substantial improvement in the society's franchise and capitalisation, with no compromise in risk appetite or other key financial metrics. The Short-Term IDRs would be upgraded if the Long-Term IDRs were to be upgraded to at least 'BBB-'.

Ratings

Foreign Currency

Long-Term IDR	BB+
Short-Term IDR	B

Local Currency

Long-Term IDR	BB+
Short-Term IDR	B

Viability Rating	bb+
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Support Rating	5
Support Rating Floor	NF

Sovereign Risk

Long-Term Foreign-Currency IDR	AA
Long-Term Local-Currency IDR	AA+
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Long-Term Local-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Positive
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

[Bank Rating Criteria \(February 2020\)](#)

Related Research

[Nelson Building Society - Ratings Navigator \(May 2020\)](#)

[Fitch Affirms Nelson Building Society at 'BB+'; Outlook Stable \(May 2020\)](#)

[Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases – Update \(April 2020\)](#)

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Summary Financials and Key Ratios

	31 Mar 19		31 Mar 18	31 Mar 17	31 Mar 16
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(NZD 000)	(NZD 000)	(NZD 000)	(NZD 000)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - report not seen
Summary income statement					
Net interest and dividend income	14	20,794.9	17,321.9	14,664.7	12,212.1
Net fees and commissions	-1	-1,760.1	-1,288.7	-502.4	172.2
Other operating income	0	357.0	359.6	321.9	316.9
Total operating income	13	19,391.8	16,392.8	14,484.2	12,701.2
Operating costs	7	10,712.6	9,975.2	9,180.6	8,573.2
Pre-impairment operating profit	6	8,679.2	6,417.6	5,303.6	4,128.0
Loan and other impairment charges	1	782.5	878.6	269.0	287.1
Operating profit	5	7,896.7	5,539.0	5,034.6	3,840.9
Other non-operating items (net)	n.a.	n.a.	n.a.	n.a.	n.a.
Tax	2	2,247.3	1,566.4	1,425.0	1,087.5
Net income	4	5,649.4	3,972.6	3,609.6	2,753.4
Other comprehensive income	n.a.	n.a.	146.5	101.2	125.8
Fitch comprehensive income	4	5,649.4	4,119.1	3,710.8	2,879.2
Summary balance sheet					
Assets					
Gross loans	435	641,832.7	558,355.6	489,511.6	403,498.1
- Of which impaired	1	1,150.9	1,589.8	0.0	150.0
Loan loss allowances	1	1,330.9	1,331.2	711.6	910.0
Net loans	435	640,501.8	557,024.4	488,800.0	402,588.1
Interbank	124	182,265.0	159,659.1	143,409.8	148,943.9
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	n.a.	n.a.	n.a.	n.a.	n.a.
Total earning assets	558	822,766.8	716,683.5	632,209.8	551,532.0
Cash and due from banks	1	2,142.5	2,677.1	2,345.9	3,156.3
Other assets	3	3,907.6	3,667.8	3,925.9	3,978.6
Total assets	562	828,816.9	723,028.4	638,481.6	558,666.9
Liabilities					
Customer deposits	521	767,946.2	671,721.5	594,998.7	520,545.4
Interbank and other short-term funding	n.a.	n.a.	n.a.	n.a.	n.a.
Other long-term funding	n.a.	n.a.	n.a.	n.a.	n.a.
Trading liabilities and derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Total funding	521	767,946.2	671,721.5	594,998.7	520,545.4
Other liabilities	2	2,404.3	2,234.7	1,652.5	1,798.4
Preference shares and hybrid capital	20	29,068.5	24,278.5	20,280.5	17,732.5
Total equity	20	29,397.9	24,793.7	21,549.9	18,590.6
Total liabilities and equity	562	828,816.9	723,028.4	638,481.6	558,666.9
Exchange rate		USD1 = NZD1.473839	USD1 = NZD1.38831	USD1 = NZD1.4304	USD1 = NZD1.4466

Source: Fitch Ratings, Fitch Solutions, NBS

Summary Financials and Key Ratios

	31 Mar 19	31 Mar 18	31 Mar 17	31 Mar 16
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.4	1.2	1.1	1.1
Net interest income/average earning assets	2.7	2.7	2.7	2.7
Non-interest expense/gross revenue	55.2	60.9	63.4	67.5
Net income/average equity	20.9	17.1	18.0	15.8
Asset quality				
Impaired loans ratio	0.2	0.3	0.0	0.0
Growth in gross loans	15.0	14.1	21.3	11.7
Loan loss allowances/impaired loans	115.6	83.7	n.a.	606.7
Loan impairment charges/average gross loans	0.1	0.2	0.1	0.1
Capitalisation				
Common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	5.2	5.1	4.7	5.2
Tangible common equity/tangible assets	3.5	3.4	3.3	3.3
Basel leverage ratio	n.a.	n.a.	n.a.	n.a.
Net impaired loans/common equity Tier 1	n.a.	n.a.	n.a.	n.a.
Net impaired loans/Fitch Core Capital	-0.6	1.1	-3.4	-4.2
Funding and liquidity				
Loans/customer deposits	83.6	83.1	82.3	77.5
Liquidity coverage ratio	n.a.	n.a.	n.a.	n.a.
Customer deposits/funding	96.4	96.5	96.7	96.7
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, NBS

Environmental, Social and Governance Considerations

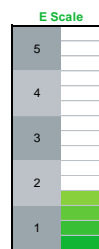
FitchRatings Nelson Building Society

Credit-Relevant ESG Derivation

			Overall ESG Scale	
Nelson Building Society has 5 ESG potential rating drivers				
<ul style="list-style-type: none"> Nelson Building Society has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating. Governance is minimally relevant to the rating and is not currently a driver. 	key driver	0	issues	5
	driver	0	issues	4
	potential driver	5	issues	3
		4	issues	2
	not a rating driver	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality



How to Read This Page

ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

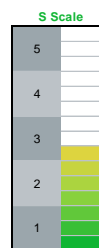
The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board(SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

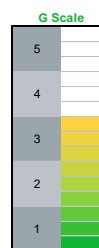
Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile



Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy



CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

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