

Nelson Building Society

Update

Ratings

Foreign Currency

Long-Term IDR	BB+
Short-Term IDR	B

Local Currency

Long-Term IDR	BB+
Short-Term IDR	B

Viability Rating

Support Rating	bb+
Support Rating Floor	5

Sovereign Risk

Foreign-Currency Long-Term IDR	AA
Local-Currency Long-Term IDR	AA+

Outlooks

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

Financial Data

Nelson Building Society

	31 Mar 16	31 Mar 15
Total assets (USDm)	386	344
Total assets (NZDm)	559	460
Total equity (NZDm)	36	31
Operating profit (NZDm)	4	4
Published net income (NZDm)	3	3
Comprehensive income (NZDm)	3	3
Operating ROAA (%)	0.75	0.82
Operating ROAE (%)	11.46	12.61
Internal capital generation (%)	7.58	6.28
Fitch Core Capital/weighted risks (%)	12.83	13.01
Tangible common equity/tangible assets (%)	6.45	6.59

Related Research

[Nelson Building Society - Ratings Navigator \(September 2016\)](#)

[Peer Review: New Zealand Regional Lenders \(September 2016\)](#)

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Key Rating Drivers

Franchise Constrains Rating: Nelson Building Society (NBS) is a small, mutual and regionally concentrated financial institution with limited pricing power relative to its larger peers. NBS holds less than 1% of total system lending however benefits from strong local community support within its home region, providing some competitive advantage. The society operates a simple business model and has been able to grow its membership base and assets over the last four years supported by favourable operating environment in its home region.

Growth to Squeeze Capitalisation: Despite experiencing double digit growth over the last four years, NBS has been able to maintain a relatively stable capital position through the issuance of preference shares. These preference shares cannot exceed 50% of the capital base (FYE16: 49%) and there is limited capacity for the society to issue more. Fitch believes continued levels of strong growth will lead to deterioration in NBS's capitalisation which is already towards the lower end of regional peers.

Conservative Risk Appetite: NBS adopts a relatively conservative risk appetite. The majority of the loan book is comprised of residential mortgages, most of which have a loan-to-value ratio of less than 80%. Underwriting assessment and borrower serviceability testing appears more conservative than most domestic peers. This provides an offset to the society's risk controls which are less developed than larger peers. Growth has been achieved organically and mainly within NBS's home market.

Profitability Headwinds Increasing: Fitch expects moderate earnings and profitability growth for NBS in FY17. However, the rate of growth is likely to be impacted by the easing interest rate cycle, continued competition for assets and increased competition for deposits which could result in margin compression. Despite strong growth, NBS's cost-to-income ratio remains stable due to ongoing increases in regulatory and compliance costs which has been experienced throughout the industry, but particularly amongst smaller institutions such as NBS.

Stable Depositor Base: NBS's funding structure is sound. The society's lending activities are wholly funded by its customer deposits and Fitch does not expect a material change to NBS's funding composition in the short term. NBS continues to benefit from its loyal customer base resulting in a high deposit retention rate of around 90%. NBS does not utilise any wholesale funding or have access to the central bank repo facility.

Robust Asset Quality: Fitch expects NBS's asset quality ratios to remain strong and below peer levels in FY17 reflective of its conservative risk appetite, focus on residential mortgages and effective arrears management. The potential for deterioration in the operating environment could see a modest uptick in impairments but would remain at manageable levels.

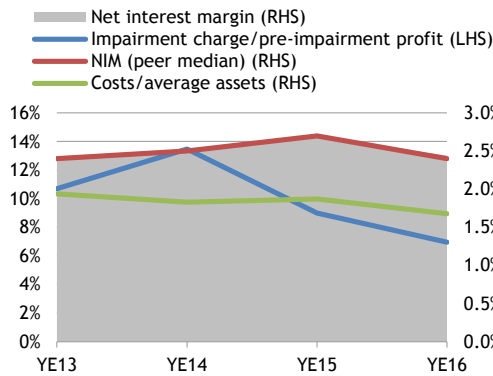
Rating Sensitivities

Weakened Risk Appetite: NBS's IDRs and VR would be sensitive to a weakening in its risk appetite, possibly from weakening underwriting criteria or aggressive growth resulting in a deterioration of its asset quality, profitability or material erosion in its capitalisation.

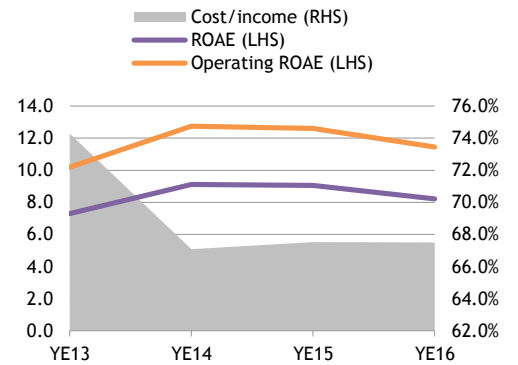
Limited Upgrade Potential: Positive rating action in the short-to-medium term is unlikely due to NBS's small franchise, small absolute capital base and limited access to additional liquidity sources such as the central bank repo facility.

Source: Company data; Fitch.

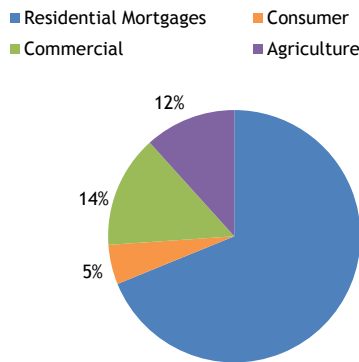
Margins



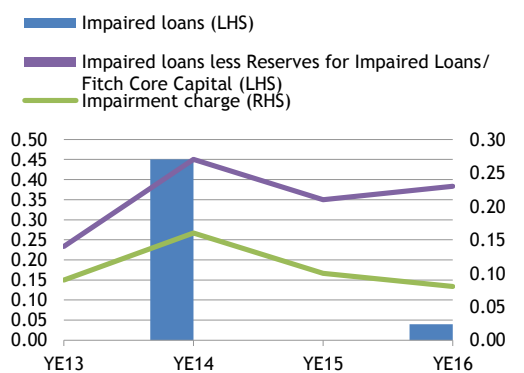
Key Profitability Metrics



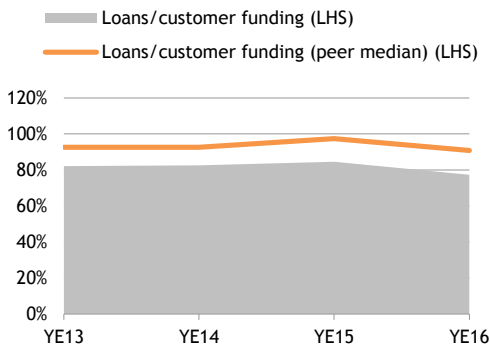
Loan Book



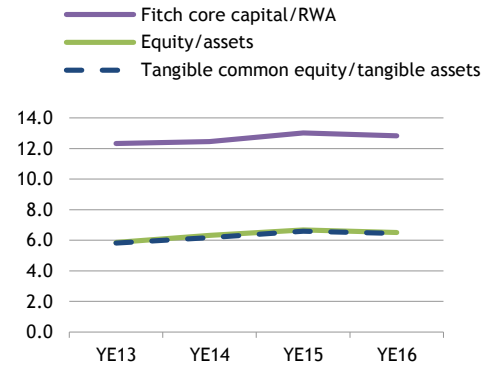
Credit Quality (as % of gross loans)



Funding Dependencies



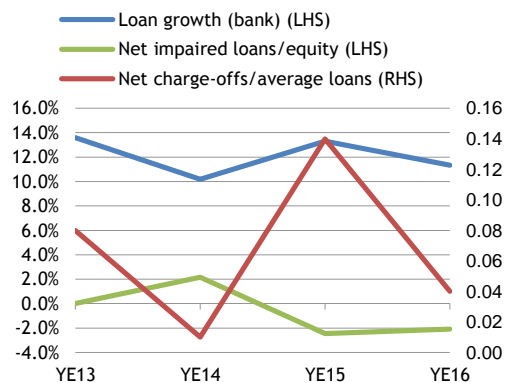
Capital & Leverage



Fitch Core Capital (in NZD 000's)

	YE16
Reported equity	36,323
+ Fair value effect of own debt	0
- Non-controlling interests	0
- Deferred tax assets	0
- Goodwill and intangibles	297.5
- Embedded value of insurance	0
- First loss tranches of off-balance-sheet securitisations	0
Fitch core capital	36,026

Credit



Related Criteria

[Global Bank Rating Criteria \(July 2016\)](#)

Nelson Building Society
Income Statement

	31 Mar 2016			31 Mar 2015		31 Mar 2014		31 Mar 2013	
	Year End USDm Audited - Report Not Seen	Year End NZDth Report Not Seen	As % of Earning Assets d - Unqualified	Year End NZDth	As % of Earning Assets d - Unqualified	Year End NZDth	As % of Earning Assets Report Not Seen	Year End NZDth	As % of Earning Assets
1. Interest Income on Loans	18.0	26,090.8	4.74	23,734.3	5.24	21,263.8	5.20	19,996.4	5.39
2. Other Interest Income	3.5	5,066.1	0.92	4,145.6	0.92	3,768.6	0.92	3,169.1	0.85
3. Dividend Income	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
4. Gross Interest and Dividend Income	21.5	31,156.9	5.66	27,879.9	6.16	25,032.4	6.12	23,165.5	6.25
5. Interest Expense on Customer Deposits	13.1	18,944.8	3.44	16,307.6	3.60	14,849.0	3.63	14,176.9	3.82
6. Other Interest Expense	n.a.	n.a.	-	n.a.	-	408.3	0.10	418.5	0.11
7. Total Interest Expense	13.1	18,944.8	3.44	16,307.6	3.60	15,257.3	3.73	14,595.4	3.93
8. Net Interest Income	8.4	12,212.1	2.22	11,572.3	2.56	9,775.1	2.39	8,570.1	2.31
9. Net Gains (Losses) on Trading and Derivatives	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
10. Net Gains (Losses) on Other Securities	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
11. Net Gains (Losses) on Assets at FV through Income Statement	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
12. Net Insurance Income	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
13. Net Fees and Commissions	0.1	172.2	0.03	281.8	0.06	697.9	0.17	568.2	0.15
14. Other Operating Income	0.2	316.9	0.06	278.9	0.06	295.0	0.07	195.6	0.05
15. Total Non-Interest Operating Income	0.3	489.1	0.09	560.7	0.12	992.9	0.24	763.8	0.21
16. Personnel Expenses	2.3	3,393.6	0.62	3,294.5	0.73	3,127.5	0.77	2,975.5	0.80
17. Other Operating Expenses	3.6	5,179.6	0.94	4,897.5	1.08	4,095.3	1.00	3,958.6	1.07
18. Total Non-Interest Expenses	5.9	8,573.2	1.56	8,192.0	1.81	7,222.8	1.77	6,934.1	1.87
19. Equity-accounted Profit/ Loss - Operating	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
20. Pre-Impairment Operating Profit	2.9	4,128.0	0.75	3,941.0	0.87	3,545.2	0.87	2,399.8	0.65
21. Loan Impairment Charge	0.2	287.1	0.05	354.4	0.08	477.8	0.12	256.8	0.07
22. Securities and Other Credit Impairment Charges	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
23. Operating Profit	2.7	3,840.9	0.70	3,586.6	0.79	3,067.4	0.75	2,143.0	0.58
24. Equity-accounted Profit/ Loss - Non-operating	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
25. Non-recurring Income	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
26. Non-recurring Expense	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
27. Change in Fair Value of Own Debt	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
28. Other Non-operating Income and Expenses	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
29. Pre-tax Profit	2.7	3,840.9	0.70	3,586.6	0.79	3,067.4	0.75	2,143.0	0.58
30. Tax expense	0.8	1,087.5	0.20	1,009.5	0.22	874.1	0.21	608.6	0.16
31. Profit/Loss from Discontinued Operations	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
32. Net Income	1.9	2,753.4	0.50	2,577.1	0.57	2,193.3	0.54	1,534.4	0.41
33. Change in Value of AFS Investments	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
34. Revaluation of Fixed Assets	0.1	125.8	0.02	n.a.	-	0.0	0.00	0.0	0.00
35. Currency Translation Differences	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
36. Remaining OCI Gains/(losses)	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
37. Fitch Comprehensive Income	2.0	2,879.2	0.52	2,577.1	0.57	2,193.3	0.54	1,534.4	0.41
38. Memo: Profit Allocation to Non-controlling Interests	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00
39. Memo: Net Income after Allocation to Non-controlling Interests	1.9	2,753.4	0.50	2,577.1	0.57	2,193.3	0.54	1,534.4	0.41
40. Memo: Common Dividends Relating to the Period	n.a.	n.a.	-	648.6	0.14	435.0	0.11	398.6	0.11
41. Memo: Preferred Dividends Related to the Period	n.a.	n.a.	-	n.a.	-	0.0	0.00	0.0	0.00

Exchange rate

USD1 = NZD1.44660

USD1 = NZD1.33510

USD1 = NZD1.15420

USD1 = NZD1.19500

Nelson Building Society

Summary Analytics

	31 Mar 2016	31 Mar 2015	31 Mar 2014	31 Mar 2013
	Year End	Year End	Year End	Year End
A. Interest Ratios				
1. Interest Income on Loans/ Average Gross Loans	6.84	6.98	6.99	7.35
2. Interest Expense on Customer Deposits/ Average Customer Deposits	4.00	4.01	4.02	4.23
3. Interest Income/ Average Earning Assets	6.21	6.47	6.42	6.56
4. Interest Expense/ Average Interest-bearing Liabilities	4.00	4.01	4.13	4.35
5. Net Interest Income/ Average Earning Assets	2.44	2.69	2.51	2.43
6. Net Int. Inc Less Loan Impairment Charges/ Av. Earning Assets	2.38	2.60	2.39	2.36
7. Net Interest Inc Less Preferred Stock Dividend/ Average Earning Assets	2.44	2.69	2.51	2.43
B. Other Operating Profitability Ratios				
1. Non-Interest Income/ Gross Revenues	3.85	4.62	9.22	8.18
2. Non-Interest Expense/ Gross Revenues	67.50	67.52	67.08	74.29
3. Non-Interest Expense/ Average Assets	1.68	1.87	1.83	1.94
4. Pre-impairment Op. Profit/ Average Equity	12.31	13.86	14.72	11.42
5. Pre-impairment Op. Profit/ Average Total Assets	0.81	0.90	0.90	0.67
6. Loans and securities impairment charges/ Pre-impairment Op. Profit	6.95	8.99	13.48	10.70
7. Operating Profit/ Average Equity	11.46	12.61	12.74	10.20
8. Operating Profit/ Average Total Assets	0.75	0.82	0.78	0.60
9. Operating Profit / Risk Weighted Assets	1.37	1.54	1.50	1.21
C. Other Profitability Ratios				
1. Net Income/ Average Total Equity	8.21	9.06	9.11	7.30
2. Net Income/ Average Total Assets	0.54	0.59	0.55	0.43
3. Fitch Comprehensive Income/ Average Total Equity	8.59	9.06	9.11	7.30
4. Fitch Comprehensive Income/ Average Total Assets	0.57	0.59	0.55	0.43
5. Taxes/ Pre-tax Profit	28.31	28.15	28.50	28.40
6. Net Income/ Risk Weighted Assets	0.98	1.11	1.07	0.86
D. Capitalization				
1. FCC/FCC-Adjusted Risk Weighted Assets	12.83	13.01	12.45	12.33
2. Tangible Common Equity/ Tangible Assets	6.45	6.59	6.16	5.82
3. Tier 1 Regulatory Capital Ratio	n.a.	n.a.	n.a.	n.a.
4. Total Regulatory Capital Ratio	10.17	10.33	9.80	9.69
5. Common Equity Tier 1 Capital Ratio	n.a.	n.a.	n.a.	n.a.
6. Equity/ Total Assets	6.50	6.68	6.31	5.85
7. Cash Dividends Paid & Declared/ Net Income	n.a.	25.17	19.83	25.98
8. Internal Capital Generation	7.58	6.28	6.72	5.16
E. Loan Quality				
1. Growth of Total Assets	21.53	10.98	10.10	10.68
2. Growth of Gross Loans	11.33	13.30	10.19	13.60
3. Impaired Loans/ Gross Loans	0.04	0.00	0.45	n.a.
4. Reserves for Impaired Loans/ Gross Loans	0.23	0.21	0.27	0.14
5. Reserves for Impaired Loans/ Impaired Loans	606.67	n.a.	60.38	n.a.
6. Impaired loans less Reserves for Impaired Loans/ Fitch Core Capital	(2.11)	(2.48)	2.21	n.a.
7. Impaired Loans less Reserves for Impaired Loans/ Equity	(2.09)	(2.44)	2.16	n.a.
8. Loan Impairment Charges/ Average Gross Loans	0.08	0.10	0.16	0.09
9. Net Charge-offs/ Average Gross Loans	0.04	0.14	0.01	0.08
10. Impaired Loans + Foreclosed Assets/ Gross Loans + Foreclosed Assets	0.04	0.00	0.45	n.a.
F. Funding and Liquidity				
1. Loans/ Customer Deposits	77.26	84.50	82.51	82.07
2. Interbank Assets/ Interbank Liabilities	n.a.	n.a.	n.a.	n.a.
3. Customer Deposits/ Total Funding (excluding derivatives)	100.00	100.00	100.00	100.00
4. Liquidity Coverage Ratio	n.a.	n.a.	n.a.	n.a.
5. Net Stable Funding Ratio	n.a.	n.a.	n.a.	n.a.

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