

Kiwibank Limited

Subordinated Tier 2

MATT STURMER AFA

matt.sturmer@forsythbarr.co.nz

+64 4 495 8204

Kiwibank Limited ("Kiwibank") is undertaking an offer of up to NZ\$275m of unsecured, subordinated, loss absorbing notes ("Notes"). The Notes will constitute Tier 2 regulatory capital for Kiwibank. If a Non-Viability Trigger Event occurs before the start of the Reserve Bank of New Zealand's (RBNZ) transition date (1 July 2021), all or some of the Notes will be written off.

This investment is riskier than a bank deposit. The Subordinated Notes are complex financial products that are not suitable for many investors. If you do not fully understand how they work or the risks associated with them, you should not invest in them. You should read the Limited Disclosure Document before deciding to invest in the Subordinated Note.

Figure 1. Issue details

Issuer	Kiwibank Limited	Optional Redemption date	11-Dec-2025	Maturity date	11-Dec-2030
Security	Unsecured subordinated	Credit rating (issuer)	A1 (Moody's), A (S&P), AA (Fitch)	Open	30-Nov-20
NZDX code	KWB010	Credit rating (issue)	Baa3 (Moody's)	Rate set	4-Dec-20
Indicative coupon*	2.32% to 2.47%	Min holdings	NZ\$5k, 1k	Close	4-Dec-20
Amount on issue	Up to NZ\$275m	ISIN	NZKIWD1230L2	Issue	11-Dec-20
Interest Payments	Quarterly	Registry	Link Market Services	Expected quotation	14-Dec-20
Indicative margin	1.90% to 2.05%	Supervisor	n/a	First Interest pymt	11-Mar-21

Source: Forsyth Barr analysis, *based on swap rates as at 30 Nov 2020

Capital required to fund growth and regulatory commitments

Despite a COVID-19 impacted year, Kiwibank continues to grow both its lending and funding books. In the year to 30 June 2020, Kiwibank grew its lending book by +9% and its deposits also saw strong growth of +13%. Net profit after tax, however, was negatively impacted by COVID-19 and the subsequent credit provisioning. Rising operating costs also impacted profitability. The first quarter of FY21 (July to Sept) has seen solid growth with net lending growth up +104% on the pcp. Kiwibank's net interest margin (NIM) is also improving to sit just under 2.0% as at the end of September.

Capital review & transition date (1 July 2021)

Over the last couple of years the RBNZ has undertaken a review of bank capital. In particular, the amount and type of capital a New Zealand registered bank must hold against its risk weighted assets (i.e. loans). The new 'rules' were released in December 2019 requiring each bank to hold more capital and ruling out the use of loss absorbing Tier One and Tier 2 securities **in the future**. The RBNZ has provided the banks with a 7 year transition timetable to reach the new capital requirements, which was set to begin on 1 July 2020. The RBNZ has pushed out the start of the transition until 1 July 2022 due to the impacts of COVID-19. However, the rules around Capital Securities (such as a capital haircut of -12.5% p.a. for old style instruments) remain unchanged and are set to begin on 1 July 2021.

As it currently stands, in order to qualify as Tier 2 capital a security must be able to absorb losses, either by conversion into ordinary equity or write off. However, new capital security rules being considered by the RBNZ are expected to be in place by 1 July 2021. The features that absorb losses will no longer be required and therefore the Non-Viability Trigger **only applies until 1 July 2021**.

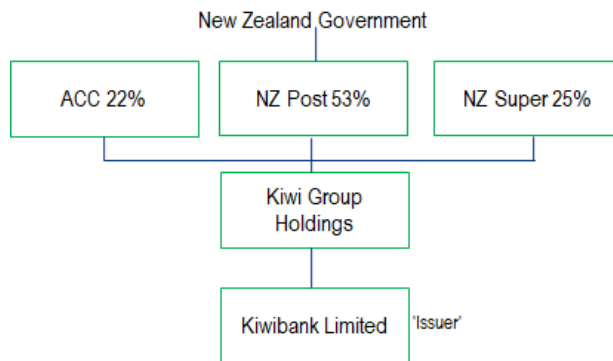
Forsyth Barr Limited has been appointed as a Joint Lead Manager to the offer and will receive fees for undertaking this role including a fee based on the amount of Notes subscribed for by its clients. The offer is only being offered to investors who are resident in New Zealand. Full details of the offer are contained in the Limited Disclosure Document. Potential investors should read the Limited Disclosure Document thoroughly.

Kiwibank

In October 2016 The New Zealand Superannuation Fund (NZ Super) and Accident Compensation Corporation (ACC) acquired 47% of Kiwi Group Holdings (KGHL – the owner of Kiwibank from NZ Post). NZ Super paid NZ\$263m for its 25% stake and the ACC paid NZ\$231m for its 22% stake.

Alongside the investments from NZ Super and the ACC, the New Zealand Government provides an NZ\$300m uncalled capital facility to KGHL supporting both liquidity and capital to Kiwibank. The cost of this facility is NZ\$3.0m per year.

Figure 2. Ownership



Source: Forsyth Barr analysis, Kiwibank bond presentation

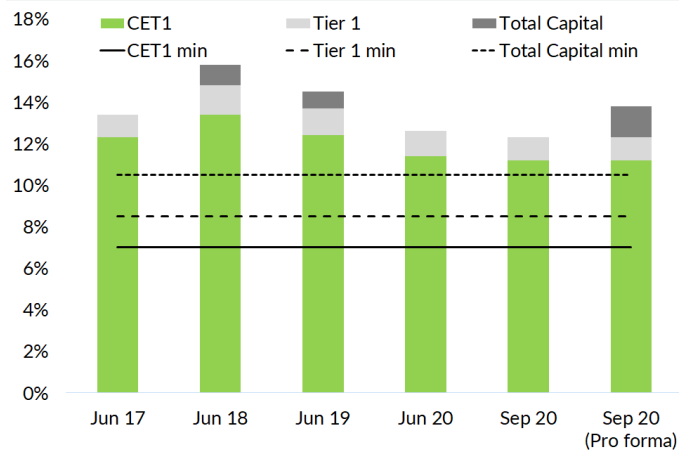
Capital reforms delayed but not for Capital Securities

The impact of COVID-19 has forced the RBNZ to delay the start of its seven year transition period to increase the capital buffers of New Zealand registered banks. The seven year transition period was set to start on 1 July 2020, however, that was pushed initially to 1 July 2021 and again to 1 July 2022. Kiwibank has also been halted from redeeming its Additional Tier one capital security until at least 31 March 2021. The market is currently being consulted on new rules around eligible capital securities and these new rules are expected to be in place prior to 1 July 2021, which may change this particular security's features (i.e. remove loss absorption).

If the issue is successful and NZ\$275m is raised, Kiwibank's capital will increase by NZ\$198m (72% being the proportion of the Notes recognised as Tier 2 by the RBNZ).

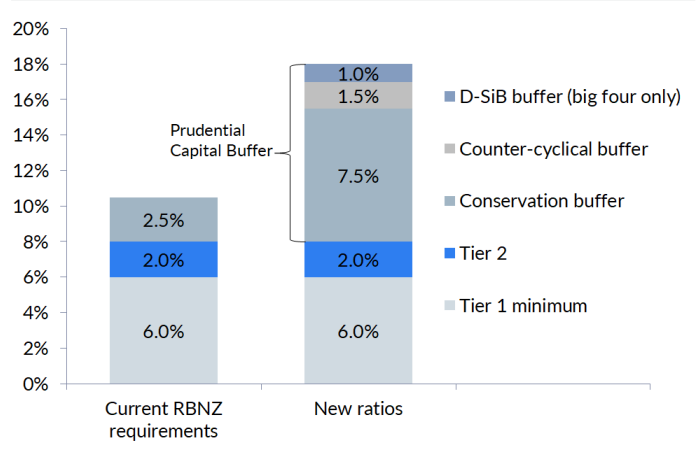
In terms of the capital ratios Kiwibank (The Banking Group) had a Common Equity Tier One (CET1) ratio of 11.4% (RBNZ minimum is, Tier One capital ratio of 12.6% and a total capital ratio of 12.6%).

Figure 3. Kiwibank Capital ratios



Source: Forsyth Barr analysis

Figure 4. RBNZ new capital ratios



Source: Forsyth Barr analysis

Loss Absorbing Features

The features are there for now

The Notes contain the ability to absorb losses should a Non-Viability Trigger Event occurs. This feature, however, cannot occur after the RBNZ's Transition Date being 1 July 2021.

A Non-Viability Trigger Event occurs if:

- The RBNZ gives a direction under section 113 of the Reserve Bank Act that Kiwibank must write-off the Notes
- Kiwibank is placed into statutory management and the Statutory Manager decides that Kiwibank must write-off the Notes.

If some but not all of a class of capital instruments (including the Notes) are required to be converted into equity or written off then Kiwibank must first write-off such a number of its Additional Tier One security, KCFHA.

In response to COVID-19, the RBNZ stopped Kiwibank (and all other New Zealand registered banks) from redeeming its Additional Tier One security, KCFHA and from paying ordinary dividends at least until 31 March 2021.

Why would the Notes be written off?

Section 113 of the RBNZ Act gives the RBNZ powers to instruct Kiwibank to write-off some or all of the Notes if Kiwibank experiences:

- Actual or likely insolvency
- The suspension of or inability to meet payment obligations
- Affairs of Kiwibank being conducted in a manner prejudicial to the financial system
- Circumstances of Kiwibank being prejudicial to the soundness of the financial system
- Business of Kiwibank not being conducted in a prudent manner

Changes can be made

With new rules around capital securities currently being considered by the RBNZ and the wider financial markets, Kiwibank has included the possibility of making amendments should it be required to.

Kiwibank may amend the terms of the Notes without consent if, subject to certain limitations, it is necessary to allow the Notes to continue to qualify as Tier 2 capital with effect from the Transition Date (1 July 2021).

However, any amendments to the terms of the Notes cannot change payment dates, reduce amounts payable to Holders, remove express rights of Holders or impose new obligations on Holders.

Credit rating

The Notes will be rated Baa3 by Moody's Investors Service. It is expected that post the Transition Date when the loss absorbing features are removed, the credit rating on the Notes will be lifted by one notch to Baa2 (S&P equivalent is BBB).

Figure 5. Credit Rating

The Credit Rating of the Notes	
Kiwibank Issuer Credit Rating	A1
Deduction for removing Group support	Three notches
Kiwibank baseline Credit Assessment	Baa1
Deduction for subordination	One Notch
Deduction for explicit loss absorption	One Notch
Subordinated Notes credit rating	Baa3

Source: Forsyth Barr analysis

Figure 6. Bank credit ratings

	S&P	Fitch	Moody's
Kiwibank	A	AA	A1
ANZ	AA-	A+	A1
ASB	AA-	A+	A1
BNZ	AA-	A+	A1
WBC	AA-	A+	A1

Source: Forsyth Barr analysis, RBNZ

Five year call date

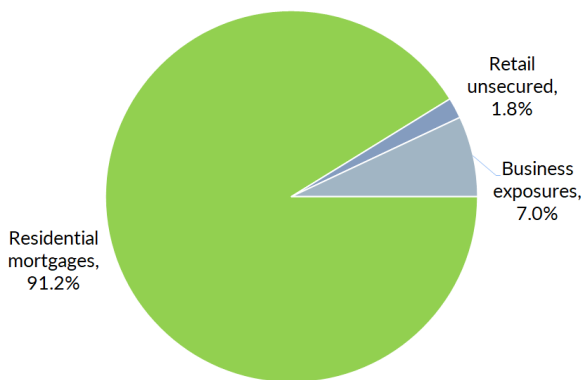
The Notes have a legal maturity of 10 years, however, there is also an Optional Redemption Date 5 years after issuance (11 December 2025). If not called, Kiwibank can redeem the Notes on any interest payment date thereafter or at anytime if there is a tax or regulatory event. Any redemption prior to the Optional Redemption Date will be at the higher of market and face value. Any redemption post the Optional Redemption Date will be at face value (plus accrued).

Lending

Mortgages, mortgages, mortgages

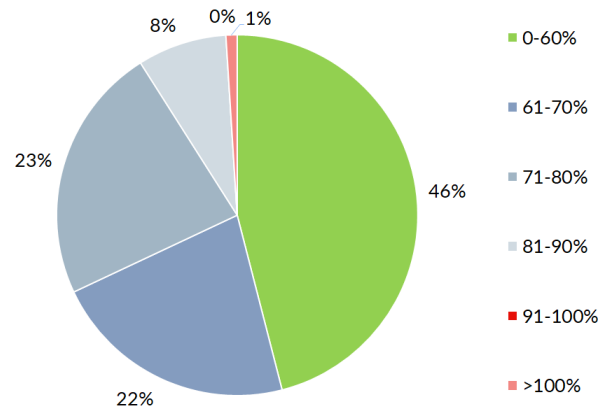
Kiwibank is predominately a mortgage bank with the majority of its lending situation in Auckland (38.4%). Both Wellington and Christchurch also feature heavily at 17.6% and 13.3% respectively. Kiwibank is also a selected provider of Welcome Home Start loans which usually have high loan-to-value ratios but these loan are guaranteed by Kainga Ora (Housing NZ). Kiwibank is, however, keen to continue to support small and medium businesses (SME), a sector which it grew +39% over FY19.

Figure 7. Net loans & advances (June 2020)



Source: Forsyth Barr analysis

Figure 8. Residential mortgages – LVR split



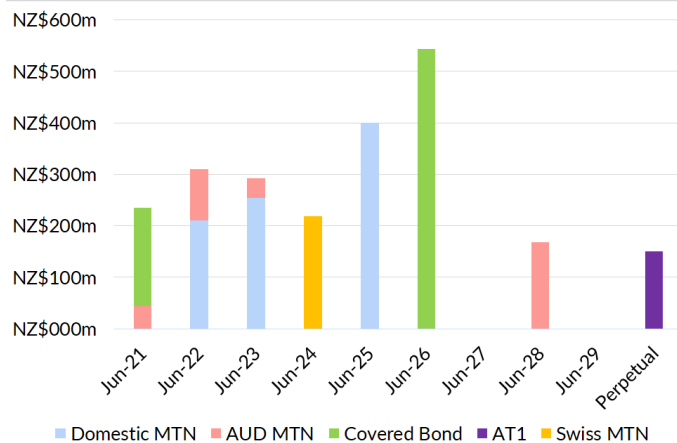
Source: Forsyth Barr analysis

Funding

Kiwi's hoarding cash

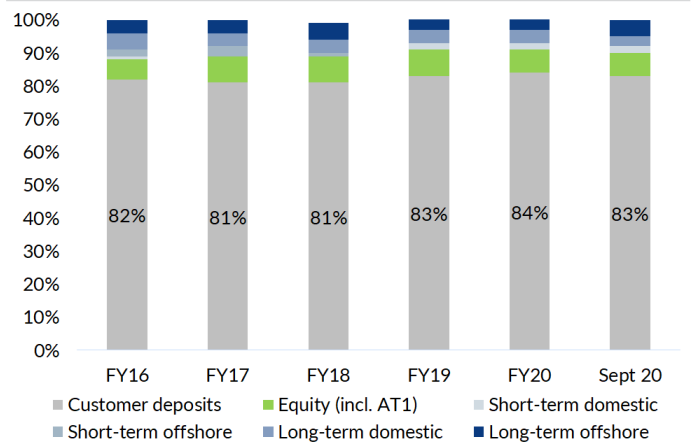
Similar to other New Zealand banks Kiwibank is funded predominately via customer deposits, both term and call deposits. Kiwibank also has a covered bond programme and funding bonds issued in AUD and Swiss Francs. Over the year to 30 June 2020, Kiwibank grew its deposits/borrowing by +13% with large growth seen in on demand deposits and interest bearing deposits i.e. not term deposits.

Figure 9. Term funding maturity profile (30 Sep 2020)



Source: Forsyth Barr analysis, AT1 can be called after 31 March 2020 if RBNZ permits

Figure 10. Funding composition



Source: Forsyth Barr analysis

Interest rate floor at 0%

If the interest rate on the Notes is reset at year five, it will be the sum of the issue margin plus the five year swap rate, but will be not less than 0%. Therefore, the coupon cannot be lower than 0%.

Pricing

While this is the first capital security to be issued in New Zealand for a number of years, the Australian market is very active providing a number of pricing points. All of the Australian securities contain loss absorbing features and are predominately issued to the wholesale market as opposed to retail. None of the bonds are quoted on the ASX.

Figure 11. Recent Tier 2 issuance

Issuer	Issue Date	Size	Issue Spread	Call date	Maturity	S&P	Moody's	Fitch	Current spread
Kiwibank	11 Dec 2020	NZ\$275m	1.90%-2.05%	11 Dec 2025	11 Dec 2030		Baa3		1.90% to 2.05%
Bendigo	11 Nov 2020	A\$150m	1.95%	19 Nov 2025	19 Nov 2030	BBB-	Baa3	BBB-	1.91%
NAB	10 Nov 2020	A\$1.25bn	1.70%	18 Nov 2025	18 Nov 2030	BBB+	Baa1	A-	1.66%
CBA	10 Sep 2020	A\$1.4bn	1.80%	10 Sep 2025	10 Sep 2030	BBB+	Baa1	A-	1.65%
Suncorp	1 Sep 2020	A\$250m	2.25%	1 Dec 2025	1 Dec 2035	BBB		A-	2.12%
ANZ	26 Aug 2020	A\$1.25bn	1.85%	26 Feb 2026	26 Feb 2031	BBB+	Baa1	A-	1.69%
Macquarie	28 May 2020	A\$750m	2.90%	28 May 2025	28 May 2030	BBB	Baa3		1.96%

Source: Forsyth Barr analysis, Bloomberg

These Notes carry similar risks to shares but do not have the same opportunity for growth as shares. If Kiwibank experiences financial difficulty, the Notes can be written off completely. This means you could lose all of your investment.

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("Analysts") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.