

## UDC Finance Ltd.

### Rationale

The 'AA/A-1+' counterparty credit ratings on UDC Finance Ltd. reflect the company's core status with its 100% owner, ANZ National Bank Ltd. (ANZ National; AA/Stable/A-1+), which is the New Zealand operation of Australia and New Zealand Banking Group Ltd. (ANZ Group; AA/Stable/A-1+). Although UDC is not explicitly guaranteed by ANZ National, operationally, UDC receives support in its systems, practices, and processes from the broader ANZ Group. UDC also operates in business segments compatible to ANZ National and attracts a loyal debenture funding base, of which a material portion are also ANZ National customers. At March 31, 2008, UDC had total assets of NZ\$2.1 billion, making it one of the largest asset financiers and debenture issuers in New Zealand.

Although UDC represents only a small portion of ANZ National's total equity of NZ\$9.4 billion, Standard & Poor's Ratings Services considers UDC to be a core subsidiary of ANZ National; therefore we have equalized the UDC rating with that on the parent. UDC's profile benefits from the company's sound market and business position as a leading asset financier in New Zealand. UDC's asset-writing and debenture issuance leverage off the company's relatively broad distribution platform, supplemented by access to ANZ National's branch network across the country. Asset quality is of a good standard, and UDC's loan portfolio is well spread among retail and commercial loans, with the latter well diversified across New Zealand industries. Capital adequacy is of a good quality and consistent with its risk profile.

UDC is better placed to grow its loan book than many non-bank competitors who have become more cautious due to tightening credit conditions and reduced investor appetite. The company appears to be riding out this more challenging period better than peers as evidenced by higher reinvestment rates than most New Zealand peers. However, it is noted that the debenture book has been declining for the last few years—in 2006 and 2007—which was a deliberate strategy as the loan book was reduced at that time. The company has also demonstrated recently that it has been able to arrest a three-year deterioration in some key financial metrics such as its interest margins and cost-to-income ratios, attributed

#### Counterparty Credit Rating

AA/Stable/A-1+

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to the change in its business model at around 2004. Even after excluding the one-off sale of its leasing subsidiary Truck Leasing Ltd., UDC's loan book experienced good underlying growth in fiscal 2007 and the first six months of fiscal 2008.

Moderating rating factors include UDC's susceptibility to any weakening in credit quality, given its exposure to higher-risk asset-based finance segments in the New Zealand finance industry. Staff turnover has also been relatively high, in excess of 20% annually.

#### *Short-term credit factors*

At March 31, 2008, UDC's on-balance-sheet liquidity position had declined materially to 3.85% of total assets from 10.5% of total assets as at Sept. 30, 2007. Liquidity is managed on an ANZ Group basis, and Standard & Poor's believes that support would be forthcoming from ANZ Group if UDC were to require additional support. UDC has a committed credit line of NZ\$100 million with ANZ National, which was unutilized as at March 31, 2008. Total liquidity, which takes into account undrawn credit lines, is considered reasonable at 8.7% as at March 31, 2008 but not as robust as it had been over the last three years.

## Outlook

The stable outlook reflects primarily that of its ultimate parent, ANZ Group, and the close integration with its immediate parent ANZ National. A weakened commitment to asset finance by ANZ Group will lessen Standard & Poor's view on the importance of UDC to the group's future strategy, which will likely result in a lower rating. Given that UDC successfully reversed the trend in declining profits and underlying loan growth in the last financial year, UDC is likely to have solidified itself as a core operation of ANZ National, particularly as there now appears to be more upside potential in UDC's performance in the current environment.

On a stand-alone basis, the stable outlook on UDC reflects Standard & Poor's expectation that UDC will continue to soundly manage risks, underpinned by a predominately organic growth strategy. Also incorporated in the outlook is UDC's ability to maintain its sound market and business position.

The stand-alone credit quality could be strengthened by further loan growth, improved non-interest income and cost control, and continued sound underwriting standards in a less competitive lending environment but tighter funding environment. A significant improvement in its earnings profile as a result of its strategic initiatives, and its ability to leverage off ANZ Group's capabilities are equally important to strengthen the rating.

Conversely, the stand-alone credit profile may weaken if there were a significant deterioration in asset quality, a lowering of liquidity ratios below March 2008 levels, and an unexpected decline in interest margins or capital adequacy. Any material acquisition that will erode liquidity levels, or materially reduce capital ratios may also weaken the current stand-alone credit profile.

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