NZX and Media Release

HEARTLAND POSTS HALF YEAR PROFIT OF $31.1M

20 February 2018

Heartland Bank Limited (**Heartland**) (NZX: HBL) achieved a net profit after tax (**NPAT**) of $31.1m for the half year ended 31 December 2017, an increase of seven percent from the half year ended 31 December 2016 (previous corresponding reporting period). The increase in profitability was primarily driven by growth in receivables.

Highlights for the half year ended 31 December 2017 include:[1]

- Increase in profitability of 7%
- Strong growth in receivables of 13% (annualised)
- Return on equity (**ROE**) of 10.8%
- $150m Retail Notes Issue successfully completed
- $59m Rights Issue successfully completed
- *Open for Business* online working capital platform grew by 45%

FINANCIAL PERFORMANCE

Profitability

NPAT was $31.1m for the half year ended 31 December 2017. This is up $2.0m (7%) from $29.1m NPAT for the previous corresponding reporting period.

Earnings for the half year ended 31 December 2017 resulted in a ROE of 10.8%, lower than the 11.6% for the full year ended 30 June 2017 due to increased equity following share issues in 2017.

Earnings per share for the six months ended 31 December 2017 was 6 cents per share, consistent with the 2017 financial year.

[1] This announcement is based on the 31 December 2017 unaudited consolidated interim financial statements of Heartland Bank Limited. For more detailed analysis and explanation please refer to the attached interim financial statements. All profitability measurements are compared to the previous corresponding reporting period being the six months ended 31 December 2016.

Balance sheet

Net finance receivables increased by $237.2m (13% annualised) to $3.8b during the reporting period which included foreign currency translation gains of $24.3m. Excluding these gains, net finance receivables increased by $212.9m (12% annualised). Total assets increased by $273.0m due to the increase in net finance receivables and an increase in cash and cash equivalents.

Major movements during the reporting period included:

- Household net receivables increased $165.7m excluding foreign currency translation gains, with reverse mortgages, motor vehicle loans and personal loans (including Harmoney) increasing $82.4m, $62.0m and $24.8m respectively, and residential mortgages reducing by $3.5m.
- Net receivables for the Business and Rural divisions increased $46.0m and $1.2m respectively.
- Cash and cash equivalents and investments increased by $35.8m.
- Borrowings increased by $203.7m reflecting the movement in total assets.
- Share capital increased by $66.7m as a result of the $59m Rights Issue together with shares issued as part of the Dividend Reinvestment Plan.

During the reporting period, Net Assets increased by $71.7m to $641.3m. Net Tangible Assets (**NTA**) increased by $72.8m to $563.3m. On a per share basis, NTA was $1.01 at 31 December 2017 compared to $0.95 at 30 June 2017 and $0.91 at 31 December 2016.

Net Operating Income

Net Operating Income (**NOI**) was $93.9m, up $10.9m (13%) compared to the previous corresponding reporting period. The increase in NOI was primarily attributable to the increased level of receivables.

Heartland's Net Interest Margin (**NIM**) for the six months ended 31 December 2017 was 4.44% compared to 4.45% for the six months ended 30 June 2017.

BUSINESS PERFORMANCE

Household (Consumer, Reverse Mortgages and Residential Mortgages)

Net operating income was $50.3m, an increase of $4.8m (10%) from the previous corresponding reporting period. During the six months, net receivables for the Household division increased by $190.0m to $2.1b.

Net operating income from the Consumer division (which includes motor vehicle loans, personal loans and lending through the Harmoney platform) increased $1.1m (4%) from the previous corresponding reporting period to $31.5m. Consumer net receivables grew $86.8m (19% annualised) to $1.0b during the current reporting period. The strong growth in net receivables was not reflected in net operating income due to a large proportion of the new business coming from lower risk, lower margin loans.

Motor vehicle net receivables continued to grow strongly, increasing by $62.0m (15% annualised) to $886.3m as at 31 December 2017.

Strong growth in personal lending was also achieved with net receivables for personal loans and Harmoney increasing by $24.8m (52% annualised) to $119.6m as at 31 December 2017.

Net operating income from reverse mortgages increased $3.7m (26%) from the previous corresponding reporting period to $18.0m. Particularly strong growth was experienced in Australia during the current reporting period with net receivables growing by $82.5m including foreign currency translation gains of $24.3m to $598.0m. Growth was 22% (annualised) excluding foreign currency translation gains. This was driven by continued broadening of the broker distribution network and favourable market conditions. Net receivables in New Zealand reverse mortgages grew by $24.3m (12% annualised) during the current reporting period to $429.6m.

Business

Net operating income was $26.3m, an increase of $3.2m (14%) from the previous corresponding reporting period. The increase in net operating income was driven by growth in net receivables, which increased by $46.0m (9% annualised) to $1.0b as at 31 December 2017. This growth was achieved through continued focus on the small business market, extending our reach through intermediaries and Heartland's *Open for Business* online origination platform which is dedicated to supporting the working capital needs of SME owners and which grew by 45%.

Rural

Net Operating Income was $16.3m, an increase of $2.4m (17%) from the previous corresponding reporting period that was also driven by receivables growth. Net receivables for the Rural division increased by $1.2m (0.4% annualised) to $676.6m during the current reporting period following a strong period of growth in the preceding six months.

COSTS

Operating costs were $40.2m, an increase of $4.3m (12%) from the previous corresponding reporting period. This increase was partly due to depreciation of the new core banking system as well as additional expenditure incurred in relation to the implementation of this system. The operating expense ratio was 42.9% compared to 43.3% in the previous corresponding reporting period.

IMPAIRMENTS

Impaired asset expense increased by $3.5m to $10.4m for the six months ended 31 December 2017, compared to $6.9m in the previous corresponding reporting period.

Impairment expense in the Household division was up $1.7m compared to the previous corresponding reporting period. This was primarily the result of growth, although the underlying impairment rate in the motor book also increased due to an intentional adjustment to risk settings in previous years which has resulted in a gradual but expected increase in impairment levels.

In addition, impairments were impacted by operational issues experienced immediately after the introduction of Heartland's new banking system, which resulted in an increase in arrears levels. These issues have since been addressed and it is expected that arrears levels will reduce in the second half of financial year 2018.

Impairment expense in the Business division was up $0.8m compared to the previous corresponding reporting period. The increase was largely attributable to a $1.2m insurance recovery in the previous corresponding reporting period. The underlying impairment rate reduced for the six months offset by the overall growth in receivables.

Impairment expense in the Rural division was up $1.0m compared to the very low previous corresponding reporting period. The impairment rate in the Rural book remains acceptable at 0.40%.

Net impaired and past due loans over 90 days increased by $6.2m as at 30 June 2017 to $44.5m as at 31 December 2017, although as a percentage of net receivables the amount was 1.2%, which is comparable to the 1.1% in the previous corresponding reporting period.

CORE BANKING SYSTEM

A new core banking system was implemented in May 2017. While the implementation was a success, additional expenditure has occurred in relation to resolving post-implementation teething issues.

FUNDING AND LIQUIDITY

Funding and liquidity remains strong. Retail deposits grew $129.3m (10% annualised) to $2.7b during the six months. The market continues to respond well to Heartland's term deposit and call account offerings which give customers competitive interest rates and unlimited on call access to their money.

In September 2017, Heartland successfully completed a five year, unsecured, unsubordinated, medium term, fixed rate notes offer. The offer closed with the final amount being issued totalling $150m at a fixed interest rate of 4.50% reflecting a margin of 1.88% over the underlying five year swap rate. The notes were issued on 21 September 2017 with a maturity date of 21 September 2022 and are quoted on the NZX Debt Market.

RIGHTS ISSUE

In December 2017, Heartland completed a successful 1 for 15 rights issue, which raised $59m to support continued growth in its loan portfolio and strengthened its balance sheet. The offer included a shortfall bookbuild open to both retail and institutional shareholders.

Allowing retail shareholders to participate in the bookbuild meant that Heartland was able to allocate additional shares to its loyal shareholder base. It was also able to save costs for all shareholders by not having the offer underwritten, given its size and the strong support from shareholders.

The bookbuild price was set at $2.02 per share, which represented a premium of $0.32 per share above the issue price of $1.70 per share under the rights issue. The new shares were issued and commenced trading on the NZX Main Board on 14 December 2017.

STRATEGIC PRIORITIES

Digital

The focus for the last six months was a continuation of Heartland's two-pronged strategy: To use technology and partnerships with intermediaries to help it to reach more customers; and continue to offer "best or only" products in the markets in which it operates (i.e. through products the major banks don't offer or products where it can offer better features).

Heartland has made excellent progress to-date, having launched a number of digital platforms including the *Open for* Business online origination platform, which grew by 45% in the last six months.

The focus for the remaining six months of FY18 is to continue to grow *Open for Business,* increase lending through peer-to-peer lender, Harmoney and launch a mobile app for depositors, which is the first part of its end-to-end, fully automated online deposit platform.

Financial model

Heartland continued its focus on identifying niche markets where it can obtain attractive margins. Heartland's net interest margin of 4.44% is more than twice that of the New Zealand bank sector average.[2]

While this can result in a higher proportion of non-performing loans, it continues to deliver an acceptable level of risk vs. return as well as delivering both balance sheet and earnings growth.

Australia

Heartland has a successful reverse mortgage business in Australia, Heartland Seniors Finance, which continues to grow strongly. Off the back of this success, Heartland is exploring opportunities to expand its product offering in Australia, including further development of its relationship with Spotcap, an innovative lender for small and medium-sized businesses, and launching *Open for Business* to serve the Australian SME market. Heartland is also accessing the Australian personal lending market through Harmoney.

Heartland's people

Heartland is committed to becoming a more diverse and inclusive place of work. Heartland CEO Jeff Greenslade joined Champions for Change in November 2017. Champions for Change is a group of New Zealand Chairs and CEOs who are committed to raising the value of diversity and inclusion within their

[2] KPMG's Financial Institutions Performance Survey, February 2018.

organisations, and to actively promote the concept among their peers and the wider business community.

Heartland's first priority areas are gender and ethnic diversity.

Heartland has made good progress in recent years. The CEO's Senior Management Group is split 50/50 male/female and the Leadership Team is currently sitting at 40 percent female. The focus for the next six months is to look for ways to attract and retain female leaders and improve gender balance throughout the business.

Heartland has a goal to increase Māori representation with an objective, over time, of becoming the employer of choice for emerging Māori talent.

In December and January, Heartland ran a successful internship programme with a group of Māori students from the InZone Education Foundation. Through the Heartland Trust, Heartland supports InZone, which aims to enhance the educational outcomes of Māori youth by providing them with access to high-performing state schools.

INTERIM DIVIDEND

The directors of Heartland have resolved to pay an interim dividend of 3.5 cents per share. The interim dividend will be paid on 3 April 2018 to shareholders on the company's register as at 5.00pm on 16 March 2018 (**Record Date**) and will be fully imputed.

The Dividend Reinvestment Plan (**DRP**) will apply to the interim dividend with a 2.5% discount[3]. While participation in the DRP is entirely optional, shareholders are encouraged to participate in order to support Heartland's capital needs given its strong asset growth. Shareholders who do not currently participate in the DRP but wish to do so should make a participation election in one of the ways specified in the DRP offer document by 16 March 2018.

LOOKING FORWARD

Looking forward, underlying asset growth is expected to continue, with strong Household, Business and Rural volumes projected through execution of Heartland's strategy, in particular the expansion of customer reach through digital and intermediary channels, and expansion in Australia.

Heartland expects its NPAT for the year ending 30 June 2018 to be at the upper end of its previously advised range of $65.0m to $68.0m.

ENDS

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[3]That is, the strike price under the DRP will be 97.5% of the volume weighted average sale price of Heartland shares over the five trading days following the Record Date. For the full details of the DRP and the Strike Price calculation, refer to Heartland's DRP offer document dated 1 April 2017.