NZX/ASX release
28 February 2023

Heartland announces strong half year profit and Heartland Bank considers offer of subordinated notes

Heartland Group Holdings Limited (**Heartland**) (**NZX/ASX: HGH**) is pleased to announce a net profit after tax (**NPAT**) of $48.7 million for the six-month period ended 31 December 2022 (**1H2023**), an increase of $1.1 million (2.4%) compared with the six-month period ended 31 December 2021 (**1H2022**)[1]. On an underlying[2] basis, 1H2023 NPAT was $54.7 million, an increase of $7.6 million (16.2%) compared with the 1H2022 underlying NPAT.

Heartland Bank Limited (**Heartland Bank**) is considering making an offer of up to $75 million (with the right to accept oversubscriptions of up to an additional $50 million at Heartland Bank's discretion) of unsecured subordinated notes (**Notes**) to New Zealand investors and certain overseas institutional investors. See page 12 for more detail.

Highlights for 1H2023

Financial highlights

- NPAT of $48.7 million, up 2.4% ($1.1 million). Underlying NPAT of $54.7 million, up 16.2% ($7.6 million) on 1H2022 underlying NPAT.
- One-off items had a $6.0 million net[3] impact on NPAT.
- Gross finance receivables (**Receivables**)[4] of $6.5 billion, up 10.1%[5] ($264.5 million).
- Underlying return on equity (**ROE**) of 12.1%, down 7 basis points (**bps**).[6]
- Net interest margin (**NIM**)[7] of 3.97%, down 34 bps. Underlying NIM of 4.02%, down 29 bps.
- Net interest income (**NII**) of $138.9 million, up 12.1%. Underlying NII of 140.8 million, up 13.6%.

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[1] All comparative results are based on the unaudited half year consolidated financial statements of Heartland and its subsidiaries (the **Group**) for 1H2022.
[2] Financial results in this announcement are presented on a reported and underlying basis. Reported results are prepared in accordance with NZ GAAP and include the impacts of one-offs, both positive and negative, which can make it difficult to compare performance between periods. Underlying results (non-GAAP financial information) exclude any impacts of fair value changes on equity investments held, the de-designation of derivatives, and other one-offs. This is intended to allow for easier comparability between periods, and is used internally by management for this purpose. Refer to *Profitability* on page 5 for a summary of reported and underlying 1H2023 results. A detailed reconciliation between reported and underlying financial information, including details about 1H2023 one-offs, is set out in *Appendix 3* on page 41 of the accompanying 1H2023 investor presentation. General information about the use of non-GAAP financial measures is set out on page 2 and 5 of that presentation.
[3] Includes tax impact on one-offs.
[4] Receivables includes Reverse Mortgages.
[5] Annualised 1H2023 growth excluding the impact of changes in foreign currency exchange (**FX**) rates.
[6] Underlying ROE refers to ROE calculated using underlying results. When calculated using reported results, ROE was 10.6%, down 166 bps. See page 5 of the accompanying 1H2023 investor presentation for more information about the use of ROE, a supplementary, non-GAAP measure.
[7] NIM is calculated based on average gross interest earning assets.

- Underlying cost to income (**CTI**) ratio of 42.7%, down 40 bps.[8]
- Impairment expense as a percentage of average Receivables decreased from 0.33% in 1H2022 to 0.29% in 1H2023, benefitting from an improved book quality.
- 1H2023 interim dividend of 5.5 cents per share (**cps**), flat on 1H2022.
- Earnings per share (**EPS**) of 7.3 cps, down 0.8 cps. Underlying EPS of 8.2 cps, up 0.2 cps from 1H2022.

Strategic highlights

- $198.6 million raised through 2022 equity raise to retire bridge debt and fund growth ambitions for existing businesses.
- Substantially completed the integration of StockCo Australia into Heartland, and repaid a A$158 million acquisition finance facility using proceeds from the equity raise.
- Signed a share purchase agreement for the purchase of Challenger Bank Limited (**Challenger Bank**) on 20 October 2022, conditional only on obtaining regulatory approvals.
- Australian Reverse Mortgages business increased market share to 35.9%.[9]
- Heartland Bank experienced the highest growth rate in retail deposits of all main and domestic banks in New Zealand for the first quarter (**Q1**) of the financial year ending 30 June 2023 (**FY2023**).[10]

Strategic vision

Heartland's strategic vision is to create sustainable growth and differentiation through best or only products delivered through scalable digital platforms. Underpinning this are four strategic pillars:

1. Business as Usual Growth (reported on in *Business performance* from page 8)
2. Frictionless Service at the Lowest Cost
3. Expansion in Australia
4. Acquisitions.

Frictionless Service at the Lowest Cost

Digitalisation of product platforms enables Heartland to deliver enhanced customer experience by reducing customer friction and creating scale without costly processes.

Through 1H2023, Heartland continued to develop new functionality and automated solutions for its digital platforms to enable increased self-service by customers. As a result, calls per customer to Heartland's Motor, Deposits and Business teams reduced by 7% from July to December 2022. Further, the number of users of Heartland Bank's Mobile App continued to increase, up 46% from July 2022.

Despite short-term volatility, the CTI ratio is a measure of efficiency. On an underlying basis, the CTI ratio reduced from 43.1% in 1H2022 to 42.7% in 1H2023.[8] Heartland remains committed in the long term to reductions in the CTI ratio.

The banking industry has yet to harness the full benefit of technology. Heartland's objective is to differentiate through a continuous focus on reducing its cost of onboarding and customer service via

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[8] Underlying CTI ratio refers to the CTI ratio calculated using underlying results. When calculated using reported results, the CTI ratio was 44.8%, up 94 bps. See page 5 of the accompanying 1H2023 investor presentation for more information about the use of the CTI ratio, a supplementary, non-GAAP measure.
[9] Based on Australian Prudential Regulation Authority (**APRA**) authorised deposit-taking institution (**ADI**) Property Exposure and Heartland Finance data as at 30 September 2022.
[10] Based on balance sheet data from the Reserve Bank of New Zealand (**RBNZ**) for Q1 of FY2023.

automation and self-service. This will drive an easier and faster customer experience, and contribute to reductions in the CTI ratio.

The upgrade of Heartland Bank's core banking system is almost complete. This upgrade will be an enabler for greater automation and digitalisation, positioning Heartland for increased scalability in the future.

Expansion in Australia

Heartland's focus for expansion in Australia is on:

1. growing its existing Australian Reverse Mortgages business
2. growing Livestock Finance following the recent acquisition of StockCo Australia
3. seeking other opportunities to expand Heartland's 'best or only' strategy into Australia.

The Australian market presents Heartland with the opportunity for growth in areas underserviced by the larger banks such as livestock finance and reverse mortgages.

The Australian Government's Home Equity Access Scheme (previously known as the Pension Loan Scheme) has contributed to a greater awareness of home equity release options, including reverse mortgages. Non-bank participation has contributed to greater awareness and acceptance of reverse mortgages as the product continues to be normalised through promotion. Heartland has maintained its position as the largest active provider, with market share of 35.9% at 30 September 2022 (up from 30.9% at 30 September 2021)[11].

StockCo Australia's livestock finance allows cattle and sheep producers across Australia to maximise their capital. StockCo Australia offers finance to cover up to 100% of the livestock purchase, with no repayments required until the livestock is sold. While the portfolio experienced some adverse weather impacts in 1H2023, the outlook for the second half of the financial year ending 30 June 2023 (**2H2023**) is positive. See page 10 for more detail.

The purpose of the Challenger Bank acquisition is to fuel expansion in Australia through access to retail deposits and by creating the opportunity for expansion into new product areas.

Acquisitions

On 20 October 2022, Heartland announced it had signed a conditional share purchase agreement for the purchase of Challenger Bank from Challenger Limited (**ASX: CGF**). Completion under the share purchase agreement remains subject to obtaining the requisite regulatory approvals.

Based in Melbourne, Australia, Challenger Bank is an established authorised deposit-taking institution (**ADI**) and offers customers a range of savings and lending products. The benefits of this acquisition include:

- access to a deep and efficient pool of funding to support ongoing growth
- potential uplift in margin, to the extent that retail funding rates are less than wholesale rates
- a platform to extend Heartland's 'best or only' strategy in Australia.

Heartland's vision is to create a sustainable and profitable digital bank serving sectors of the Australian market which Heartland considers are under-serviced by major banks (including older Australians, rural Australia, and small businesses). Heartland already holds strong positions in Australia with Reverse Mortgages and Livestock Finance. Further expansion is intended by leveraging

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[11] Based on APRA ADI Property Exposure and Heartland Finance data as at 30 September 2021 and 30 September 2022.

Heartland's experience and expertise in New Zealand to offer additional products in the Australian market (including Auto Finance, Asset Finance and Online Home Loans).

Additional transaction costs are expected in 2H2023 in relation to obtaining an ADI licence, including for the completion of the Challenger Bank acquisition. Heartland will provide further information to the market on the Challenger Bank acquisition as updates become available.

Operating environment

1H2023 was affected by rising inflation and the cost of living. The 2023 calendar year is expected to have similar challenges. New Zealand's annual inflation rate remains at a 30-year high, while Australia's continues to rise. Rising household costs and high interest rates are being felt in both countries.

Notwithstanding these pressures, Heartland's loan portfolios have performed well. Overall credit quality remains good, benefitting from Heartland's continued move towards higher quality and lower risk assets.

As an example, the Reverse Mortgage portfolios have remained resilient to economic conditions, particularly to changes in house prices and rising interest rates, with conservative loan-to-value ratios (**LVRs**). The weighted average current LVRs for New Zealand and Australian Reverse Mortgages respectively were 19.7% and 20.0% at 31 December 2022. In New Zealand, 97.7% of loans had an LVR under 40% on an index adjusted valuation basis, and no loans had an LVR over 60%. In Australia, 98.1% of loans had an LVR under 40% on an index adjusted valuation basis, and 0.1% of loans had an LVR over 60%.

Heartland experienced an increase in arrears in its Motor portfolio in the first four months of 1H2023, as rising costs impacted household budgets. This was reflected in the percentage of the Motor book in arrears increasing from 3.17% at 30 June 2022 to 3.99% at 31 October 2022. However, this has since moderated with the percentage of the Motor book arrears falling to 3.73% by 31 December 2022, reflecting the return to pre-COVID-19 levels of arrears at this point in the financial year for the portfolio. The subsequent seasonal increase experienced in January 2023 was at a similar level to January 2022.

Heartland is focused on supporting its vulnerable customers and those who may be experiencing temporary difficulties. In response to the rising interest rate environment, Heartland intentionally delayed passing the full impact of these increases onto some borrower customers, and did not pass the full increase onto New Zealand or Australian Reverse Mortgage customers – this was believed to be the socially responsible approach.

The recent flooding and severe weather in the upper North Island had a devastating impact on many households and businesses. Heartland has been supporting its customers and employees who have been affected and will continue to do so. Heartland commenced a proactive call programme to all customers in the impacted regions to understand customer impact and how Heartland can assist them. Support has included deferred loan repayments, interest only payments, additional funding or other solutions determined on a case-by-case basis.

Heartland's Economic Overlay of $8.0 million taken in the financial year ended 30 June 2022 (**FY2022**) remains unchanged at 31 December 2022. The Economic Overlay is considered a sufficient buffer against the potential impacts of a future deterioration in the economic environment.

Financial results

Profitability

NPAT was $48.7 million, a $1.1 million (2.4%) increase on 1H2022. Underlying NPAT was $54.7 million, a $7.6 million (16.2%) increase on 1H2022.

Underlying ROE was 12.1%, down 7 bps from 1H2022.[12]

EPS was 7.3 cps, down 0.8 cps from 1H2022. Underlying EPS was 8.2 cps, up 0.2 cps from 1H2022.

1H2023 reported results include StockCo Australia earnings contribution of $4.8 million[13], and one-off items which should be considered when analysing the underlying result.[14]

Significant one-off items included in Heartland's 1H2023 reported results are outlined below.

1. Legacy hedge accounting impacts: a $3.6 million loss contributed by the derivatives that were de-designated from their prior hedge accounting relationships in FY2022. The de-designation resulted in a mark-to-market (**MTM**) accounting gain on these derivatives being recognised in FY2022. This MTM gain is subsequently unwound as a loss as the cashflows from these derivatives are realised.
2. Fair value loss on equity investment in Harmoney Corp Limited (**Harmoney**): a $2.4 million net fair value loss was recognised on investment in Harmoney shares during 1H2023. The fair value as at 31 December 2022 is determined based on the closing mid-market price of Harmoney shares on the Australian Stock Exchange of A$0.4875, being the last bid/ask price mid-point on 30 December 2022 considering there were no trades on the final trading day of 2022.
3. Interest expense on the bridging loan for the acquisition of StockCo Australia: a $1.9 million interest expense was recognised in 1H2023 in relation to a A$158 million bridging loan taken by Heartland to acquire StockCo Australia. The loan was fully repaid in September 2022 using the proceeds from the recent equity raise.

The impact of one-off items on the respective financial metrics is outlined in the table below.

	Reported			Underlying		
	1H2023	1H2022	Movement	1H2023	1H2022	Movement
NOI[15] ($m)	141.7	130.7	11.0	149.6	130.8	18.8
Operating expenses (**OPEX**) ($m)	63.4	57.3	6.2	63.9	56.4	7.5
NPAT ($m)	48.7	47.5	1.1	54.7	47.1	7.6
NIM	3.97%	4.30%	(34 bps)	4.02%	4.30%	(29 bps)
CTI ratio	44.8%	43.8%	94 bps	42.7%	43.1%	(40 bps)

[12] Underlying ROE refers to ROE calculated using underlying results. When calculated using reported results, ROE was 10.6%, down 166 bps from 1H2022. See page 5 of the accompanying 1H2023 investor presentation for more information about the use of ROE, a supplementary non-GAAP measure.
[13] Represents StockCo Australia's 1H2023 NPAT on a standalone basis.
[14] Refer to *Appendix 3* on page 41 of the accompanying 1H2023 investor presentation for an exhaustive list of 1H2023 one-offs and a detailed reconciliation between reported and underlying financial information.
[15] Net operating income (**NOI**) includes fair value gains/losses on investments.

	Reported			Underlying		
	1H2023	**1H2022**	**Movement**	**1H2023**	**1H2022**	**Movement**
Impairment expense ratio	0.29%	0.33%	(4 bps)	0.29%	0.33%	(4 bps)
ROE	10.6%	12.2%	(166 bps)	12.1%	12.1%	(7 bps)
EPS	7.3 cps	8.1 cps	(0.8 cps)	8.2 cps	8.0 cps	0.2 cps

Income

Total NOI was $141.7 million, an increase of $11.0 million (8.4%) from 1H2022.

Underlying NOI was $149.6 million, $18.8 million (14.4%) higher than in 1H2022, $11.5 million of which was contributed by StockCo Australia. This was largely due to a $16.9 million (13.6%) increase in NII, driven by $1,238.3 million (21.7%) higher average interest earning assets in 1H2023 than in 1H2022, and a 29 bps decrease in underlying NIM compared with 1H2022.

The contraction in NIM was partly due to a continued shift in portfolio mix toward higher quality assets, and margin compression in individual portfolio NIMs.

The change in portfolio composition was a result of the continued run off in higher risk portfolios, with personal lending and unsecured small-to-medium enterprise (**SME**) lending both reducing, and Business and Rural Relationship lending experiencing larger repayments of higher risk exposures. At the same time, there has been strong growth in higher quality portfolios, such as Reverse Mortgages and Online Home Loans. The impacts of this compression were partly offset following the acquisition of StockCo Australia, a higher NIM portfolio.

After being at record lows for a long period of time, the cash rates in New Zealand and Australia have seen a rapid and sharp increase, rising from 0.75% and 0.10% at December 2021, to 4.25% and 3.10% at December 2022 respectively – creating a difficult environment to manage margins. Heartland intentionally delayed passing the full impact of these increases onto some borrower customers, and, in the case of Reverse Mortgages in New Zealand and Australia, did not pass on the full increases. With depositors, Heartland was quick to pass on the benefits of the rising cash rate. It is believed that while this did not maximise potential NIM, it was the socially responsible and more sustainable approach.

Furthermore, competitor activity in Heartland's key portfolios, primarily Asset Finance and Motor, intensified with aggressive pricing from smaller competitors attempting to grow their market share. Heartland proactively managed pricing to remain competitive, while protecting its market position.

Through proactive portfolio pricing and margin management, the compression in NIM has stabilised. Heartland's underlying NIM recorded an 8 bps decrease on the six months to 30 June 2022 (**2H2022**) and is expected to remain stable going forward.

Unlike other banks in New Zealand, Heartland Bank did not have the benefit of participating in the RBNZ's Funding for Lending Programme (**FLP**) as the assets required for use as collateral did not match Heartland Bank's lending book. The FLP was introduced in December 2020 and allowed eligible banks to borrow directly from the RBNZ at the Official Cash Rate (**OCR**) with the borrowing rate adjusting over the term of the transaction as the OCR changes. At 31 December 2022, $19 billion had been drawn by eligible banks[16], allowing them to benefit from the low OCR during this period.

Underlying other operating income increased by $2.0 million (28.3%) mainly driven by an increase in upfront Reverse Mortgage income.

Expenses

OPEX was $63.4 million, an increase of $6.2 million (10.8%) on 1H2022. Excluding the impact of one-offs, the underlying OPEX was $7.5 million (13.3%) higher compared with 1H2022.

Higher underlying OPEX was primarily due to the acquisition of StockCo Australia which contributed $4.5 million to 1H2023 OPEX. The remaining underlying OPEX increase is $3.0 million (5.3%), which was mainly driven by a 4.8% increase in staff expenses, a 27.9% increase in upfront Reverse Mortgages expenses completely offset by an increase in upfront Reverse Mortgages income, and the balance from increased administration costs.

The underlying CTI ratio decreased to 42.7%, down 40 bps compared with 1H2022.[17]

Impairment expense

Impairment expense was $9.2 million, $0.7 million (8.3%) up on 1H2022. Impairment expense ratio decreased to 0.29% in 1H2023, downs 4 bps compared with 1H2022. While the Receivables portfolio recorded strong growth during 1H2023, impairment expense benefitted from an improved book quality as a result of the continued tilt of the portfolio mix towards lower risk assets.

Financial position

Total assets increased by $347.6 million (4.9%) during 1H2023, driven by a $264.5 million (10.1%)[18] increase in Receivables and a $69.6 million (11.9%) increase in liquid assets.

Receivables growth was experienced primarily in Australian Reverse Mortgages, New Zealand Reverse Mortgages, Motor, Asset Finance and Online Home Loans, partly offset by decreases in Business, Rural Relationship and the Harmoney originated personal loans channel.

Heartland operates in resilient parts of the market that are relatively insulated against current economic challenges – such as Livestock (driven by global demand for protein), Asset Finance (driven by demand in the transport industry) and Reverse Mortgages (driven by demographics). As such, the majority of Heartland's portfolios experienced strong growth despite a number of economic uncertainties and challenges in 1H2023. The increasing cost of funds, alongside the Receivables portfolio mix continuing to tilt towards higher quality and lower risk assets, contributed to a margin contraction during 1H2023. These margin pressures were, however, partially relieved through proactive pricing and portfolio margin management. As previously expected, the improved book quality also benefitted 1H2023 impairment expense – the lower cost origination model is expected to contribute further benefits in the future.

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[16] According to RBNZ 'Influences on settlement cash' data.

[17] Underlying CTI ratio refers to the CTI ratio calculated using underlying results. When calculated using reported results, the CTI ratio was 44.8%, up 94 bps compared with 1H2022. See page 5 of the accompanying 1H2023 investor presentation for more information about the use of the CTI ratio, a supplementary, non-GAAP measure.

[18] Annualised 1H2023 growth excluding the impact of changes in FX rates (where applicable).

Borrowings[19] increased by $158.3 million (2.6%). Deposits increased by $478.0 million (13.3%), partially offset by a decrease in other borrowings of $319.7 million (12.4%) during 1H2023. See further information under *Funding and liquidity* on page 11.

Net assets increased by $207.1 million to $1,015.9 million. Net tangible assets (**NTA**) increased by $205.5 million to $772.3 million, primarily as a result of a $198.7 million equity raise completed in September 2022, resulting in an NTA per share of $1.09 (30 June 2022: $0.96).

Business performance

New Zealand

Asset Finance

Asset Finance NOI was $14.9 million, a decrease of $0.8 million (4.8%) compared with 1H2022. Asset Finance Receivables increased $42.7 million (13.4%)[18] to $676.3 million.

Asset Finance NIM deteriorated due to the impact of interest rate changes required to maintain competitive pricing in an aggressive market, and the lag in time taken to fully reprice fixed rate loans. NOI is expected to improve once market rates stabilise.

Sustained growth stemmed from demand in Heartland's core asset segments of trucks, trailers and yellow goods. Weaker demand from the logging sector was offset by strong activity in logistics and further expansion of Heartland's intermediary partnership model.

Business

Business NOI was $15.8 million, an increase of $0.3 million (1.6%) compared with 1H2022.

Business Receivables decreased $34.7 million (10.9%)[18] to $595.5 million. The negative movement was driven by lower floorplan utilisation as stock inventory levels remained impacted by global supply chain and erratic shipping conditions. Heartland expects this position to improve in 2H2023 as stock arrivals continue through 2023. The portfolio is also expected to benefit as larger legacy loans run down, contributing to a book that is lower risk, with low cost origination and superior margins.

Open for Business

Open for Business (**O4B**) NOI was $6.7 million, a decrease of $0.5 million (6.8%) compared with 1H2022.

O4B Receivables decreased $8.2 million (11.5%)[18] to $133.0 million. A strategy reset occurred in the second quarter of FY2023 from 1 October 2022 to 31 December 2022 (**Q2**), following a change in the demand profile for O4B through COVID-19. This also reflects the sensitivities that SMEs are experiencing due to changing macro-economic conditions. Amortisation is expected to outperform growth for the remainder of FY2023.

Motor Finance

Motor Finance NOI was $32.7 million, a decrease of $3.6 million (9.9%) compared with 1H2022.

Motor Finance Receivables increased $75.9 million (10.9%)[18] to $1.46 billion as early repayments slowed due to customers being less inclined to refinance at higher rates or top-up their mortgages as interest rates rose.

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[19] Includes retail deposits and other borrowings.

NIM was impacted by competitor activity, and by the change in portfolio mix of business, where 75% of business came from the quality end of the market. This is expected to have a positive impact on impairments in 2H2023.

Growth has been a product of market share gains at the higher quality end of the market, and, as mentioned above, an extension of the Motor book as early repayments slowed. This includes through branded partners such as Peugeot, Citroen and OPEL (each under the iOWN brand), Kia and Jaguar Land Rover, and other key partnerships.

In 1H2023, the total new and used car sales in the New Zealand market declined by 8.6%[20] compared with 1H2022. Whereas Heartland's Motor portfolio experienced 10.9% growth. Motor is expected to continue to outperform the market in 2H2023.

This is a pleasing result considering the ongoing challenges of the changes made to the New Zealand Credit Contracts and Consumer Finance Act 2003 and the Credit Contracts and Consumer Finance Regulations 2004 (together, the **CCCFA**) which came into effect in December 2021 with additional amendments effective in July 2022 and further amendments expected to be effective in March 2023.

Ongoing development and enhancements to the Motor digital platforms are expected to contribute to improved efficiency, customer experience and growth for the portfolio in 2H2023.

Personal Lending

Personal Lending includes loans originated directly through Heartland Bank, and those originated by Harmoney in New Zealand and Australia. Heartland's Harmoney personal loans channel is closed to new business and running down.

Personal Lending NOI was $3.4 million, a decrease of $1.9 million (35.4%) compared with 1H2022.

Personal Lending Receivables decreased by $2.3 million (6.9%)[18] to $62.8 million. Harmoney Receivables decreased by $11.4 million (73.3%)[18], made up of a decrease in the New Zealand Harmoney channel of $6.8 million (73.6%) to $11.6 million, and a decrease in the Australian Harmoney channel of $4.6 million (72.8%)[18] to $7.9 million. This is partially offset by Heartland originated personal lending which increased by $9.1 million (52.9%)[18] to $43.4 million.

Online Home Loans[21]

Online Home Loans NOI was $2.1 million, an increase of $1.5 million (267.2%). Online Home Loans Receivables increased $27.6 million (19.9%)[18] to $302.3 million.

The reduction in the rate of book growth was driven by the sharp decline in property sales and new mortgage volumes in New Zealand. The number of properties sold during the second half of the 2022 calendar year was the lowest observed in over a decade. The market outlook remains subdued, with 'days to sell' at elevated levels.[22] Similarly, the number of new mortgages has been the lowest observed since at least 2014 (when the RBNZ began collating this data).[23]

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[20] Based on data from the Motor Industry Association of New Zealand on new and used vehicle sales from motor vehicle dealers.
[21] Excludes legacy Retail Mortgages.
[22] Based on data from the Real Estate Institute of New Zealand.
[23] Based on RBNZ data on new residential mortgage lending by borrower type.

Conversion rates improved towards the end of 1H2023 due to platform updates made off the back of the CCCFA amendments which came into effect in July 2022. These updates have increased approval automation and reduced the friction involved in verifying approvals.

Additionally, the Online Home Loans criteria was expanded in Q2 to permit lending against terraced homes and townhouses. This change is expected to support a 10% uplift in lending volumes compared with the previous restriction to standalone homes only.

Rural

Rural lending NOI was $16.9 million, an increase of $1.4 million (9.2%) compared with 1H2022.

Overall Rural portfolio Receivables decreased by $13.3 million (3.8%)[18] to $675.8 million. This was driven from the normal seasonal fluctuations in Heartland's Livestock Receivables which decreased by $32.6 million (37.7%) to $139.0 million, offset in part by Rural Receivables increasing by $19.4 million (7.4%)[18] to $536.8 million.

Strong pasture growth late in the season is expected to support cattle restocking, and additional intermediary partnerships are expected to push utilisation up into 2H2023. Activity in Rural Receivables continues to be mainly targeted to Heartland's niche Rural Direct segments (providing finance specifically for sheep, beef and dairy farmers).

New Zealand Reverse Mortgages

New Zealand Reverse Mortgages NOI was $20.5 million, an increase of $5.1 million (33.4%) compared with 1H2022. Receivables increased $87.4 million (24.0%)[18] to $808.7 million.

The business continues to experience strong demand and growth due to:

- a reverse mortgage being a solution to the ongoing strain placed on older home owners by cost of living pressures
- increased awareness and acceptance of reverse mortgages
- nurturing of a lead pool which has been built over a decade
- Heartland being recognised as New Zealand's leading reverse mortgage provider.

The outlook for New Zealand Reverse Mortgages remains positive, with additional demand from cost of living pressures more than offsetting the impact of lower house prices and higher interest rates.

Australia

StockCo Australia

StockCo Australia NOI was $13.4 million in 1H2023. Receivables increased $12.5 million (6.7%)[18] to $385.6 million, supported by strong onboarding of new clients, and increased facility limit requirements and usage. StockCo Australia's key distribution partner, Elders Limited, also experienced an increase in new clients and facility limit usage, contributing to the overall growth of the portfolio.

Growth in 1H2023 slowed due to adverse weather conditions, the rising interest rate environment, and stock value. Weather conditions across eastern Australia impacted on livestock movement and activity in 1H2023, while rising interest rates contributed to a reduction in profitability as customer interest rates were managed to ensure competitiveness. The value of livestock softened during late 2022, resulting in lower dollars per head on the StockCo Australia balance sheet. While stock value was offset by higher unit numbers, this had an impact on growth. However, as experienced in the past, these temporary market price volatilities are not expected to have a material impact on the quality of the book. Historically, the impact of the variation in price has, in most cases, been more than offset through livestock weight gains. Additionally, StockCo Australia has options available to support clients should they need help to return to a profitable position.

The 2022 calendar year saw export volumes at a 19-year low, and slaughter production down approximately 27% from 2021 volumes. Low export demand, driven by COVID-19 lockdowns across China, is expected to ease during 2023 and result in strong demand for protein as people return to pre-COVID-19 activities.

Australian producers' concerted effort to retain female stock to rebuild the herd post the 2019 drought also contributed to low export volumes. The USA drought breaking is expected to see an effort by the USA to rebuild their herd, resulting in a reduced volume of beef on the export market. This will likely benefit the volume and value of Australian exports, especially into Europe and parts of Asia.

Work is underway to develop a white label offering to complement StockCo Australia's existing distribution strategy and support ongoing growth through 2H2023.

Australian Reverse Mortgages

Australian Reverse Mortgages NOI was $23.1 million, an increase of $4.1 million (21.5%) compared with 1H2022.

Australian Reverse Mortgages Receivables increased by $128.0 million (19.9%)[18] to $1.40 billion, driven primarily by:

- increased debt consolidation and cost of living requests due to the current economic environment
- customers looking to enjoy retirement with modest lifestyle spending (such as holidays or a new car) following the relaxation of COVID-19 lockdowns in Australia
- growing acceptance of the use of reverse mortgages to age in place (for a person to remain in their home and make it more retirement-friendly as they age)
- targeted marketing to new and existing customers to increase uptake and interest at key seasonal points across the year, leading to record settlements in key months.

Growth is expected to continue in 2H2023 as ongoing improvements and efficiencies are made to the application, approval and loan maintenance process.

Funding and liquidity

Heartland increased borrowings by $158.3 million (2.6%) to $6,329.1 million.

New Zealand

Heartland Bank increased borrowings by $249.7 million (5.7%) to $4,596.3 million.

Deposits[24] grew $480.5 million (13.4%) during 1H2023 to $4,077.7 million, which was driven by competitive pricing on targeted products, including Heartland's Notice Saver offerings which both received Canstar New Zealand recognition in the half. Heartland Bank's 32-day Notice Saver won a 5-Star Rating and the 90-day Notice Saver achieved a Rising Star Rating with all the makings of a 5-star account in the future. Heartland Bank was awarded Canstar New Zealand's Bank of the Year –

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[24] Includes intercompany deposits received by Heartland Bank (31 December 2022: $7.1 million; 30 June 2022: $4.6 million).

Savings for the fifth year in a row.[25] In Q1 of FY2023, Heartland Bank experienced the highest growth rate in retail deposits of all main and domestic banks in New Zealand.[26]

Notice Saver increased by $311.5 (60.7%) million. Term deposits increased by $256.2 million (11.7%), while call deposits decreased by $87.2 million (9.7%) during 1H2023. The call to total deposit ratio decreased to 20% as at 31 December 2022 (30 June 2022: 25%).

Other borrowings decreased by $230.8 million (30.8%), largely due to the maturity of a $150 million retail bond, as well as the amount drawn down in Heartland Bank's committed auto warehouse facility decreasing by $76.6 million.

Heartland Bank's total liquidity (including liquid assets and available committed lines) strengthened further in the half, increasing by $146.9 million (23.4%) to $774.8 million, well in excess of regulatory minimums. Regulatory liquidity ratios remained strong.

Heartland Bank's regulatory capital ratio reduced to 13.15% as at 31 December 2022 (30 June 2022: 13.49%) following the removal of any bank dividend restrictions by the RBNZ on 1 July 2022. Heartland Bank continues to operate significantly in excess of regulatory minimums and is well positioned to meet the RBNZ's future higher capital requirements. These requirements are for a core capital ratio of 11.50% and a total capital ratio of 16.00% by 1 July 2028. In order to accelerate this journey, diversify its capital base and accommodate future projected growth, Heartland Bank is considering an offer of Tier 2 Capital notes (discussed below).

Australia

Heartland Australia (comprising Heartland Australia Holdings Pty Ltd and its subsidiaries) increased borrowings by A$167.8 million (14.0%) to A$1,368.0 million.

Heartland Australia continues to successfully execute on its strategic funding programme to cater for strong growth in its portfolios. A A$30 million tap issue was completed in August 2022 and a further A$50 million Medium Term Note (**MTN**) was issued in October 2022, taking the aggregate outstanding issuance under Heartland Australia's MTN programme to A$360 million as at 31 December 2022.

Maturity of Reverse Mortgage securitisation warehouses were extended by two and three years, and aggregate senior limits were expanded by A$50 million, providing additional headroom to fund future growth in the portfolio. This provides Heartland Australia with access to A$1.49 billion of committed funding in aggregate.

StockCo Australia (comprising StockCo Australia Management Pty Ltd, StockCo Holdings 2 Pty Ltd and their subsidiaries) increased borrowings by A$15.0 million (4.6%) to A$344.2 million.

Heartland Bank considers offer of subordinated notes

Heartland Bank is considering making an offer of up to $75 million (with the right to accept oversubscriptions of up to an additional $50 million at Heartland Bank's discretion) of unsecured Notes to New Zealand investors and certain overseas institutional investors.

The Notes are expected to constitute Tier 2 Capital for Heartland Bank's regulatory capital

[25] Awarded July 2022.

[26] Based on balance sheet data from the RBNZ.

requirements. The Notes are expected to have a 10-year maturity date, but may be redeemed early in some circumstances. If certain conditions are met, Heartland Bank may redeem the Notes after 5 years or on any quarterly Interest Payment Date after that date, or on any quarterly Interest Payment Date for tax or regulatory reasons.

The Notes are expected to have a credit rating of BB+ from Fitch Australia Pty Limited (**Fitch**). Heartland Bank has a long-term unsecured credit rating of BBB (stable) from Fitch.

It is expected that full details of any offer will be released in mid-March 2023.

Heartland Bank has appointed Westpac Banking Corporation (ABN 33 007 457 141) (acting through its New Zealand branch) (**Westpac**) as Arranger, and Bank of New Zealand (contact 0800 284 017), Craigs Investment Partners Limited (contact 0800 226 263), Forsyth Barr Limited (contact 0800 367 227) and Westpac (contact 0800 772 142) as Joint Lead Managers in relation to the offer. Investors can register their interest in the offer by contacting a Joint Lead Manager or their usual financial advice provider. Indications of interest will not be an obligation or commitment to buy the Notes.

No money is currently being sought and applications for the Notes cannot currently be made. If Heartland Bank offers the Notes, the offer will be made in accordance with the Financial Markets Conduct Act 2013. The Notes are expected to be quoted on the NZX Debt Market.

Regulatory update

Heartland continues to monitor the significant volume of regulatory change.

Initial changes to the CCCFA came into force on 1 December 2021, with additional changes announced in June 2022 (effective 7 July 2022). Heartland Bank implemented new processes and technologies to enable it to comply with these changes, and continues to refine them. Following the completion of the New Zealand Government's investigation into the impact of the December 2021 changes, further amendments which seek to reduce the unintended impacts of the initial changes are expected to be implemented in March 2023.

The Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 (**Conduct Act**) was passed in June 2022, and is planned to come into force in early 2025, following a transitional period. The Conduct Act applies to registered banks, licensed insurers and licensed non-bank deposit takers, and is regulated by the Financial Markets Authority (**FMA**). The Conduct Act introduces a new conduct licensing regime, the requirement to establish, implement, maintain and comply with a fair conduct programme, and the regulation of incentives (via new regulations which are yet to be published). Incentives regulations will apply both to Heartland Bank and its intermediaries involved in the distribution of its products.

The Deposit Takers Bill (**DT Bill**) was introduced to Parliament on 22 September 2022 and had its first reading on 27 September before being referred to the Select Committee. The DT Bill:

1. strengthens the regulatory framework for all institutions that take deposits (including Heartland Bank) through the strengthening of the RBNZ's supervision and enforcement powers
2. introduces a new depositor compensation scheme, overseen by the RBNZ.

Heartland has begun considering the impact of the DT Bill on Heartland's operations and is actively participating in industry submissions on the bill.

In July 2021, the New Zealand Government announced it would implement a legislative framework for a new consumer data right (**CDR**), with a decision announced in November 2022 to designate banks into the new regime first. A consumer data right in the banking sector (in other words, 'open banking') would allow customers to consent to share their banking data with third parties. Work is now underway by the Government on the design and cost of the CDR and this is intended to be completed later in 2023. Following this, an exposure draft of a data sharing Bill is anticipated to be released for industry feedback.

Work is underway to meet the climate-related disclosures obligations introduced through the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021, with Heartland's first climate statement required as part of reporting for its financial year ending 30 June 2024.

Sustainability update

Heartland's sustainability strategy is built on three pillars: environmental conservation, social equity and economic prosperity. Key progress in 1H2023 is outlined below. For more detail, visit heartlandgroup.info/sustainability.

Environmental conservation

- Heartland's unaudited FY2022 Greenhouse Gas (**GHG**) inventory shows a 56% absolute reduction from Heartland's FY2019 base year in GHG emissions generated from operations, near doubling Heartland's reduction target of 35% by 2025. While partly due to COVID-19 restrictions during FY2022, this also shows the effects of Heartland's continuous transition to low emitting new generation vehicles, using carbon neutral paper and renewable electricity within New Zealand offices.
- New generation vehicle lending increased from 5% in 1H2022 to 14% in 1H2023 as distributors reported a higher ratio of EV, PHEV and HEV sales to internal combustion engine sales.
- Heartland launched a green vehicle rate to dealers and customers in December 2022 and will continue this through 2H2023.
- Heartland introduced a guaranteed future value product across the Opel range, including two dedicated EVs.
- Heartland undertook Australian and New Zealand Standard Industrial Classification (**ANZSIC**) code analysis to understand Heartland's exposure to customers in high emitting industries, and industries susceptible to governmental regulations in New Zealand's journey to carbon-zero by 2050, with the aim to educate identified customers on how they can directly reduce their emissions and mitigate the risks climate change poses to their business.

Social equity

- The Manawa Ako internship programme recently concluded its sixth year, welcoming 25 Māori and Pasifika interns to Heartland Bank in December 2022. More than 110 rangatahi (young people) have participated in the programme since inception.
- Heartland Bank was pleased to renew its Rainbow Tick accreditation and deliver several LGBTTQIA+ education workshops to its employees across New Zealand.
- The diversity of Heartland's people was celebrated through various events, which included opportunities to raise cultural awareness and understanding. Celebrations included Te Wiki o Te Reo Māori (Māori Language Week), Diwali and several Pasifika language weeks.

Economic prosperity

- Heartland Bank consistently offered market leading and competitive deposit rates, enabling New Zealanders to grow their savings in a high cost of living environment. Of all main and domestic banks in New Zealand, Heartland Bank experienced the greatest percentage of retail deposit growth in Q1 of FY2023, up 9.3%.

- A refix comparison calculator was developed for Online Home Loans, allowing potential applicants to see how much could be saved by refinancing their mortgage with Heartland Bank.
- An 18-month fixed term rate was also introduced, providing New Zealand home owners with more options to suit their financial needs when setting or refixing their mortgage.

Interim dividend

Heartland is pleased to declare a 1H2023 interim dividend of 5.5 cps, flat on 1H2022. Heartland's interim dividend yield of 8.7%[27] compares with 7.4%[28] in 1H2022.

The interim dividend will be paid on Wednesday 22 March 2023 (**Payment Date**) to shareholders on the company's register as at 5.00pm NZDT on Wednesday 8 March 2023 (**Record Date**) and will be fully imputed.

Heartland has a Dividend Reinvestment Plan (**DRP**), giving eligible shareholders the opportunity to reinvest some or all of their dividend payments into new ordinary shares. The DRP will apply to the interim dividend with a 2.0% discount.[29] The DRP offer document and participation form is available on Heartland's website at heartlandgroup.info/investor-information/dividends.

Looking forward

The pleasing result in 1H2023 highlights the resilience of Heartland's product portfolios despite the ongoing current economic challenges in New Zealand and Australia. Strong growth continued in core portfolios, though softened elsewhere due to suppressed credit demand.

It is currently anticipated that 2H2023 will deliver a similar result to 1H2023 on an underlying basis. In particular, continued growth is expected in Motor through white label and key partnerships, and in Asset Finance which has become one of Heartland's fastest growing portfolios. Usual seasonal fluctuations are expected to contribute to a better half for StockCo Australia and Heartland Bank's Rural portfolio in New Zealand. Further, increased demand is expected for Reverse Mortgages in both countries where the product has proven to offer a good solution for many seniors wanting to live a more comfortable retirement, especially as the cost of living rises.

Heartland's NIM is expected to stabilise at its current level as Heartland continues to proactively manage portfolio pricing and margin in competitive markets.

Efficiencies through digitalisation and the upgrade of Heartland Bank's core banking system are critical pathways to a lower CTI ratio. As the results demonstrate, Heartland continues to grow its revenue line, contributing favourably to its CTI ratio. However, ultimate efficiency requires that costs are also addressed. This will remain a focus of Heartland's through 2H2023.

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[27] Total fully imputed dividends for 1H2023 (interim) and 2H2022 (final) divided by the closing share price as at 24 February 2023 of $1.75.
[28] Total fully imputed dividends for 1H2022 (interim) and 2H2021 (final) divided by the closing share price as at 14 February 2022 of $2.35.
[29] That is, the strike price under the DRP will be 98.0% 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 the Heartland DRP offer document dated 10 December 2018.

The remainder of the 2023 calendar year will be significant for Heartland as it progresses towards the completion of the acquisition of Challenger Bank, therefore becoming an ADI in Australia, and realises the benefits this will provide its existing Australian businesses Heartland Finance and StockCo Australia – as well as future product opportunities.

Heartland expects NPAT for FY2023 to be within the guidance range of $109 million to $114 million, excluding any impacts of fair value changes on equity investments held and the impact of the de-designation of derivatives.

– ENDS –

The person(s) who authorised this announcement:

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About Heartland

Heartland Group Holdings Limited (**Heartland**) is a financial services group with operations in Australia and New Zealand. Heartland has a long history with roots stretching back to 1875, and is listed on the New Zealand and Australian stock exchanges (NZX/ASX: HGH) with a market cap in excess of NZ$1 billion.

Heartland's New Zealand business, Heartland Bank, provides customers with savings and deposit products, Online home loans, reverse mortgages, business loans, car loans and rural loans. In Australia, Heartland's main business is currently in reverse mortgages through Heartland Finance which is a market leader. Heartland also operates StockCo Australia, a specialist livestock financier, which was acquired by Heartland in May 2022.

Heartland's point of differentiation is its 'best or only' strategy – where it focuses on providing products which are the best or only of their kind through scalable digital platforms. Heartland is committed to delivering financial solutions through speed and simplicity, particularly via digital platforms which reduce the cost of onboarding and make it easier for customers to open accounts or apply for funds when they need it.

More about Heartland: heartlandgroup.info