NZX/ASX release
14 December 2023

Heartland FY2024 performance update

(based on unaudited results to 30 November 2023)

Heartland Group Holdings Limited (**Heartland**) (NZX/ASX: HGH) has achieved YTD Receivables[1] growth of 4.7%[2], with Australian and New Zealand Reverse Mortgages notably achieving YTD growth of 20.4% and 17.8%, respectively. Despite this, Heartland has experienced a slower than expected start to the financial year ending 30 June 2024 (**FY2024**). This is due to:

- a decrease in the purchase of new cars, with motor consumers expected to defer purchases until the 2024 calendar year due to expected policy changes
- adverse Australian climactic conditions continuing to impact livestock purchases and
- later than expected repayments of lower yielding loans and a tighter deposit market delaying net interest margin (**NIM**) recovery.

A stronger second half of FY2024 (**2H2024**) is expected, particularly as the anticipated backlog of stalled car purchases clears, and through the impact of now more favourable climactic conditions in Australia. Heartland continues to expect NIM to improve in calendar year 2025 as the deposit market eases and lower yielding loans are repaid.

Heartland has gone through a process of revising its FY2024 net profit after tax (**NPAT**) guidance to reflect the following:

- short-term operational performance challenges – which have an impact of $8 million to $10 million
- Heartland Bank Limited's (**Heartland Bank**) proactive response to issues affecting a subset of legacy lending via a post-COVID-19 overlay, a non-cash item – which has an impact of $11.5 million, and
- the expected FY2024 impact on underlying[3] NPAT related to the acquisition of Challenger Bank Limited (**Challenger Bank**)[4], positioning Heartland for its next stage of growth (**Challenger Bank NPAT**) – which has an impact of A$3.5 million.

Heartland now expects NPAT to be in the range of $93 million to $97 million, excluding any impacts of fair value changes on equity investments held and the impact of the de-designation of derivatives. Excluding the impact of the (non-cash) post-COVID-19 overlay and Challenger Bank NPAT, the range is $108 million to $112 million, reflecting Heartland's underlying operational performance. The guidance range was previously $116 million to $122 million, excluding any impacts of fair value changes on equity investments held, the impact of the de-designation of derivatives, and any costs related to the acquisition of Challenger Bank.

[1] Gross Finance Receivables (**Receivables**) includes Reverse Mortgages.
[2] All financial results in this announcement are based on the unaudited financial statements of Heartland and its subsidiaries for the five months to 30 November 2023 (**YTD**). Relative growth rates are annualised and include the impact of changes in foreign currency exchange rates.
[3] Underlying results (which are non-GAAP financial information) exclude any impacts of one-offs.
[4] Subject to receipt of the requisite regulatory approvals.

Operational performance

Motor Finance

Pre-election announcements to repeal the clean car discount scheme, and the consequent removal of internal combustion engine taxes on new vehicles from 31 December 2023, is believed to have caused consumers to delay new vehicle buying decisions until the 2024 calendar year. Despite this, Motor Finance Receivables increased 8.1% and stronger Motor Finance performance is expected in 2H2024 as vehicle purchases increase.

Australian Livestock Finance

Livestock prices continued to fall in the first five months of FY2024 due to adverse weather conditions and drought concerns. Many producers destocked or consolidated debt from selling livestock at lower rates, while others retained livestock for longer periods to gain weight and recoup value. The resulting impact has seen growth challenges and compressed NIM for Heartland's Australian Livestock Finance portfolio.

Heartland expects these issues to dissipate in 2H2024, with good recent rain fall across the eastern states and the chance of prolonged drought now reduced. Livestock prices are up 35% in recent weeks and, given grass growth, a strong start in calendar year 2024 is expected.

Net interest margin

Heartland Bank's lower NIM Motor Finance and Asset Finance loans are rolling off, but these are taking longer to repay than anticipated as borrowers hold assets for longer in the current economic environment.

Rising interest rates in New Zealand and Australia have created a more challenging environment in which to manage margins. Heartland intentionally delayed passing the full impact of these increases onto some borrower customers, specifically in the case of New Zealand Reverse Mortgages and Australian Livestock Finance. While this did not maximise potential NIM, it was considered the socially responsible and more sustainable approach.

In addition, heightened competition is being seen in the deposit market, impacting Heartland Bank's cost of funds. Heartland Bank expects this to continue through calendar year 2024 as participants in the Funding for Lending Programme[5] replace this funding with deposit funding.

NIM improvement is anticipated in calendar year 2025 as the deposit market eases and low yielding Motor Finance and Asset Finance loans are repaid.

Post-COVID-19 overlay

Overall, Heartland Bank's asset quality, credit origination standards and capital and liquidity positions remain strong. There is a good pipeline across its four core lending portfolios (Reverse Mortgages, Motor Finance, Asset Finance and Livestock Finance) and portfolio composition continues to shift towards lower risk exposures.

However, Heartland Bank has determined it appropriate to proactively respond to issues affecting a subset of legacy lending described below via a post-COVID-19 overlay of $16 million (pre-tax) which, whilst required out of prudence, may not be utilised in full.

[5] One of the monetary policy tools used by the Reserve Bank of New Zealand (**RBNZ**) during the COVID-19 pandemic, which allowed eligible banks to borrow directly from the RBNZ at the official cash rate, to lower the funding costs for eligible banks.

- *Legacy Business and Relationship lending* – Economic conditions have impacted on these older Legacy Business and Relationship loans in segments of the market to which Heartland Bank no longer lends, decreasing confidence in their collectability. In response to this, Heartland Bank has conservatively taken a $5.5 million overlay.

- *Longer standing Motor Finance loans* – As post-COVID-19 economic conditions have become more challenging for borrowers, a subset of arrears has emerged in longer standing Motor Finance loans, which pre-date Heartland Bank's shift to higher quality assets. Post-COVID-19 staff turnover, illness and a focus on the core system upgrade (which is now complete) in Heartland Bank's Collections & Recoveries area have resulted in collection efforts being constrained. These challenges are being actively resolved, but coupled with the passage of time, confidence in the collectability of these arrears has been eroded and Heartland Bank considers it appropriate to take a $10.5 million overlay.

Overall, impairments continue to perform within expectations with a YTD impairment expense ratio (annualised impairment expense as a percentage of average Receivables) of 0.35% (1H2023: 0.29%). In respect of the Motor Finance portfolio, loans originated in the 2023 calendar year are performing better than prior years.

Strategic update – Challenger Bank acquisition

Over the last decade, Heartland has built a significant Australian business lending to parts of the market which are traditionally underserved. In Australia, Heartland is the leading provider of reverse mortgages and, through its 2022 acquisition of StockCo, is a leading specialist provider of livestock finance.

To support continued growth in Australia, Heartland Bank is seeking to acquire Challenger Bank, an Australian Deposit Taking Institution (**ADI**). The acquisition, which remains subject to regulatory approval, will be a significant milestone for Heartland, making Heartland Bank the first New Zealand registered bank to acquire an ADI.

When FY2024 guidance was provided, it excluded any costs related to the acquisition of Challenger Bank. As the acquisition nears completion, it is appropriate that guidance is updated to reflect the impact of Challenger Bank becoming part of Heartland. The impact to underlying NPAT for FY2024 is expected to be a net loss of A$3.5 million, reflecting underlying NPAT of Challenger Bank. This is expected to transition quickly to a profit-making position as material deposit raising occurs.

An additional A$3 million (pre-tax) of transaction related costs are expected to be expensed in FY2024 which are one-off, non-recurring in nature and do not impact underlying performance.

Looking forward

A stronger 2H2024 than the first half of FY2024 is expected as overall performance continues to demonstrate the resilience of Heartland's portfolios and 'best or only' product strategy.

While the regulatory approval process continues, Heartland is hopeful that the Challenger Bank acquisition will be completed by 31 March 2024 – positioning Heartland well for its next stage of growth. Heartland will provide a further update to the market in due course.

– ENDS –

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