HEARTLAND GROUP

NZX/ASX Release

Heartland announces net profit after tax of $44.1 million for the six months ended 31 December 2020

(or $43.2 million on an underlying basis after removing the impacts of one-offs)

22 February 2021

Heartland Group Holdings Limited (**Heartland**) (**NZX/ASX: HGH**) achieved a net profit after tax (**NPAT**) of $44.1 million for the six-month period ended 31 December 2020 (**1H2021**), an increase of $4.2 million (10.6%) compared with the six-month period ended 31 December 2019 (**1H2020**). On an underlying basis (which excludes the impacts of one-offs[1]), 1H2021 NPAT was $43.2 million, an increase of $5.1 million (13.4%) compared with 1H2020 underlying NPAT.

Highlights for 1H2021[2]

- NPAT of $44.1 million, up 10.6% ($4.2 million). Underlying NPAT of $43.2 million, up 13.4% ($5.1 million) on 1H2020 underlying NPAT.
- One-off items had a $0.9 million net impact on NPAT, consisting of $5.2 million of one-off gains and $4.3 million of one-off expenses.[3]
- Gross finance receivables[4] of $4.7 billion, up 2.7%[5] ($62.3 million).
- Return on equity of 12.2%, up 54 basis points.
- Net interest margin[6] of 4.28%, up 5 basis points.
- Net operating income of $125.3 million, up 5.6%.
- Cost to income ratio of 48.8%, up 2.8 percentage points. Underlying cost to income ratio of 45.9%, up 0.8 percentage points.
- Impairment expense as a percentage of average receivables decreased from 0.40% in 1H2020 to 0.19% in 1H2021.
- FY2021 interim dividend of 4.0 cents per share, a decrease of 0.5 cents per share from 1H2020 (as a result of Reserve Bank of New Zealand restrictions on distributions by banks).
- Earnings per share of 7.6 cents per share, up 0.7 cents per share.
- In October 2020, Heartland Bank Limited was one of two Australasian banks to have no reduction or adverse change to its ratings or outlook by Fitch Ratings since January 2020.
- $5.2 million fair value gain recognised in Harmoney, which is currently transitioning its funding model from peer-to-peer funding to wholesale securitised funding via warehouse structures.
- Reverse Mortgages awarded Consumer Trusted Accreditation for the fourth year in a row.
- Heartland Bank Limited awarded Canstar awards for savings accounts for consecutive years.
- Further digitalisation of product applications and digital platforms – including digital Home Loans, Sheep & Beef Direct online loans, and a self-service online vehicle loan application.
- 45 participants in the 2020/2021 Manawa Ako internship programme, up from 34 in 2019/2020.
- Launch of Rocket, a mobile-led financial literacy programme for school leavers.

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[1] Underlying results exclude the impacts of one-offs. Refer to Profitability section on page 3 for details.

[2] All financial performance comparatives are based on the 31 December 2019 unaudited interim consolidated financial statements of Heartland and its subsidiaries (the **Group**), and financial position comparatives are based on 30 June 2020 audited full year consolidated financial statements of the Group, unless otherwise noted.

[3] Refer to Profitability section on page 3 for details.

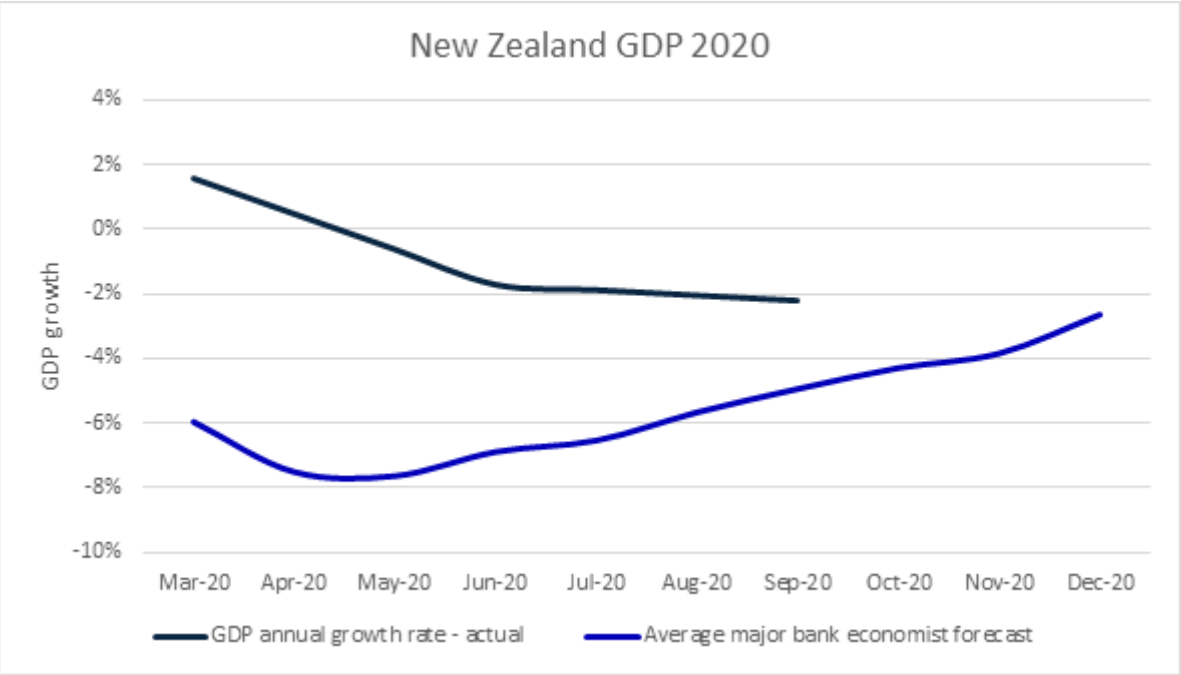
[4] Gross finance receivables include Reverse Mortgages.

[5] Annualised 1H2021 growth excluding the impact of changes in foreign currency exchange (**FX**) rates.

[6] Net interest margin (**NIM**) is calculated based on average gross interest earning assets.

Operating environment

The financial impact of the COVID-19 pandemic on the New Zealand economy has been more subdued than forecast by major bank economists in the early months of 2020, as illustrated in the chart below. Forecasts continued to improve over the course of the year as the economic recovery exceeded expectations[7], assisted by the support measures provided by the New Zealand Government.



During this time, Heartland's loan portfolios showed resilience to the effects of the pandemic as the industries and demographics most affected by COVID-19 are not materially represented in Heartland's core lending or customer base[8]. Reflecting this, in October 2020, Fitch Ratings (**Fitch**) affirmed the Long-Term Issuer Default Ratings (**IDR**) of Heartland and Heartland Bank Limited (**Heartland Bank**) at 'BBB' and the Long-Term IDR of Heartland Australia Group Pty Ltd (**Heartland Australia**) at 'BBB-'. Heartland Bank was one of just two Australasian banks to have no reduction or adverse change to its ratings or outlook despite the economic impacts of COVID-19 since January 2020.

While Heartland experienced continued growth in its core lending portfolios (Motor, Reverse Mortgages, Business Intermediated), overall balance sheet growth has been impacted by the continued reduction in non-core portfolios and higher than forecast repayments. Elevated repayments are believed to have resulted from the extensive economic stimulus provided by the New Zealand Government and Reserve Bank of New Zealand (**RBNZ**), and mortgage repayment holidays by other banks which allowed customers to divert funds normally used to service mortgage repayments to pay off other debt instead. With increased economic confidence emerging and the cessation of mortgage repayment holidays by the other banks, Heartland expects customer repayment behaviour to normalise.

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[7] Actual GDP is annual growth rate for last 12 months (source: Statistics New Zealand). Forecast is average of major bank Economists' point in time GDP projection for 2020 (source: major bank publications).

[8] Heartland's total exposure to the retail, accommodation and transport (excluding road freight transport) industries at 31 December 2020, based on borrower ANZSIC codes, was 2.41%, 2.00% and 1.17% respectively. Heartland's exposure to customers aged 15-24 years (those most affected by heightened unemployment) at 31 December 2020 was 3.32% in Motor and 0.37% in personal lending.

Despite the general improvement in the economic forecasts and evidence of customer resilience to date, uncertainty remains regarding the COVID-19 pandemic's impact on future economic conditions – as discussed in more detail on page 5 (Impact of COVID-19 on provisioning).

Heartland's economic overlay of $9.6 million taken in respect of the financial year ended 30 June 2020 (**FY2020**) has not been utilised, and, as a result of the continued uncertainty, remains available to be applied to any credit losses experienced as a consequence of the economic impact of the pandemic.

Financial results

Profitability

NPAT was $44.1 million, a $4.2 million (10.6%) increase on 1H2020. Underlying NPAT was $43.2 million, a $5.1 million (13.4%) increase on 1H2020.

Return on equity (**ROE**) was 12.2%, up 54 basis points (**bps**) from 1H2020. Underlying ROE was 11.9%, up 80 bps from 1H2020.

Earnings per share (**EPS**) was 7.6 cents per share (**cps**), up 0.7 cps from 1H2020. Underlying EPS was 7.4 cps, up 0.8 cps from 1H2020.

<u>1H2021 one-offs included in the reported result[9]</u>
As described below, the following one-off items are included in the 1H2021 reported result and should be considered when analysing the underlying result.

1. *Fair value gain on equity investment in Harmoney Corp Limited (**Harmoney**)*: A $5.2 million fair value gain was recognised. Harmoney listed on the ASX and NZX in November 2020, with approximately 72% of shares (including those owned by Heartland, other major shareholders, employees and directors) subject to escrow arrangements that restrict the ability to sell the Harmoney shares. The fair value measurement of Heartland's equity investment in Harmoney as at 31 December 2020 takes into consideration observed trading volumes, closing market prices of Harmoney's shares, and the restriction imposed by the escrow arrangements.

2. *Voluntarily accelerated amortisation of intangible assets*: A $4.3 million expense was recognised within operating expenses, reflecting an acceleration of amortisation following a review of software assets held on the balance sheet, taking into account Heartland's current technology strategy.

3. *Write-off and provisioning of aged suspense account items*: $1.7 million of aged legacy suspense account transactions have been conservatively written off or provisioned for within operating expenses where collectability is significantly uncertain.

[9] As disclosed in the previous reporting period, the following one-off items are included in the 1H2020 reported result and should be considered when analysing the underlying result: $2.8 million was recognised in other operating income and $3.3 million recognised in operating expenses due to the required accounting standard change in respect of upfront reverse mortgage income and expenses; A $2.1 million fair value gain was recognised on Heartland's equity investment in Harmoney.

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

	Reported			Underlying		
	1H2021	1H2020	Movement	1H2021	1H2020	Movement
Net operating income (**NOI**)[10] ($m)	125.3	118.6	6.7	120.1	113.7	6.4
NPAT ($m)	44.1	39.9	4.2	43.2	38.1	5.1
NIM	4.28%	4.23%	5 bps	4.28%	4.23%	5 bps
NIM excl. liquid assets[11]	4.65%	4.44%	21 bps	4.65%	4.44%	21 bps
Cost to income ratio (**CTI**)	48.8%	46.0%	2.8 pps	45.9%	45.1%	0.8 pps
Impairment expense ratio	0.19%	0.40%	(21 bps)	0.19%	0.40%	(21 bps)
ROE	12.2%	11.7%	54 bps	11.9%	11.1%	80 bps
EPS	7.6 cps	6.9 cps	0.7 cps	7.4 cps	6.6 cps	0.8 cps

Income

Total NOI was $125.3 million, an increase of $6.7 million (5.6%) from 1H2020.

Excluding the impact of one-offs[12], underlying NOI was $6.4 million (5.6%) higher half-on-half. This was largely due to an $8.0 million (7.6%) increase in underlying net interest income, driven by a $299.8 million (6.1%) higher average interest earning assets in 1H2021 than 1H2020, and a 5 bps increase in NIM compared with 1H2020 to 4.28%. Underlying other operating income decreased by $1.6 million (19.2%) compared with 1H2020, primarily due to a lower treasury result.

Expenses

Operating expenses were $61.1 million, an increase of $6.5 million (12.0%) on 1H2020. Excluding the impact of one-offs (including those described above), the underlying operating expenses were $3.8 million (7.5%) higher compared with 1H2020.

Higher underlying operating expenses were primarily due to the following increased expenses.

1. A $4.5 million (16.5%) increase in staff expenses. Heartland employed 78 more people in permanent or fixed term roles compared with 1H2020 to provide additional support to customers in response to COVID-19, and to support digital and technology capability, enabling Heartland to accelerate its evolution as a digitally-led financial services group. The teams are now well resourced to deliver on Heartland's strategic objectives, and the number of staff employed in response to COVID-19 has been reduced as those fixed term and temporary employment periods come to an end.

2. A $1.1 million (17.8%) increase in IT and communication expenses (as a result of software amortisation and licencing costs for additional full-time equivalent (**FTE**) employees).

The CTI increased to 48.8%, up 2.8 percentage points (**pps**) compared with 1H2020. The underlying CTI increased 0.8 pps to 45.9%.

[10] NOI includes fair value gains/losses on investments.
[11] NIM is calculated based on average gross interest earning assets excluding liquid assets.
[12] 1H2020 one-offs include $2.8 million due to the required accounting standard change in respect of upfront reverse mortgage fees and $2.1 million of fair value gains on equity investments. 1H2021 one-offs include $5.2 million of fair value gains on equity investments.

Impairment expense

Impairment expense decreased by $4.5 million (49.7%) to $4.5 million. Impairment expense as a percentage of average receivables decreased from 0.40% in 1H2020 to 0.19% in 1H2021 and continues to perform strongly in the year-to-date.

Remediation of accounts previously in arrears, and the release of provisions held against those borrowers, has been a significant driver of the reduction in impairment expense. That remediation has largely been due to repayments, refinancing and ordinary restructures, rather than the use of the Heartland Extend product.

As at 31 December 2020:

- of the total Heartland Extend book, approximately 77% comprises refinanced Business Intermediated and Open for Business loans, none of which were non-performing loans (**NPLs**) as at 30 June 2020
- only 24% of Motor loans that were non-performing as at 30 June 2020 had been refinanced with a Heartland Extend product.

However, the use of Heartland Extend can be expected to have assisted borrowers in meeting their obligations going forward, and therefore assisted in controlling impairment expense.

In terms of the performance of the Heartland Extend book, whilst it is early days and remains relatively unseasoned, it is pleasing to note that the secured Business Extend sub-portfolio (representing approximately 70% of the total Heartland Extend book) is performing very strongly when compared with the Heartland portfolio against which it is benchmarked, with early and late stage arrears all below benchmark levels. Whilst the balance of the book is showing some early stage signs of stress, Heartland continues to monitor it closely and note NPLs for those sub-portfolios are below the NPLs of the Heartland portfolios against which they are benchmarked.

Impact of COVID-19 on provisioning

During FY2020, Heartland took a COVID-19 economic overlay of $9.6 million (pre-tax). At the time, Heartland explained that it had no reason to consider that its (then) existing provisions were not adequate – but the overlay was required to allow for the uncertainty created by COVID-19, taking into consideration that traditional indicators of increased credit risk may not have provided an accurate measure of the credit quality of Heartland's book.

The overlay did not represent any losses that Heartland had actually experienced, but was taken to provide a buffer against any future losses that the uncertainty may give rise to.

Heartland has not consumed any of the COVID-19 overlay and still has no reason to consider that its current provisions are not adequate. Heartland now has a more developed understanding of the impact of COVID-19 on the credit quality of Heartland's book. In particular:

a. total NPLs were down year-on-year at 1.96% compared with 2.19% (as at 31 December 2019)
b. the Heartland Extend portfolio is still relatively unseasoned, but NPLs are much lower than NPLs in the equivalent portfolios (as described above)
c. there are currently no NPLs in the Business Finance Guarantee Scheme (**BFGS**) portfolio.

Moreover, the return to Alert Level 3 in Auckland for 20 days in August 2020 (and the rest of New Zealand to Alert Level 2 for 43 days) did not impact the economy as significantly as expected, resulting in a 9% drop in card-based retail spending, with only minor setbacks for businesses.

However, despite those positive indicators and a general improvement in the economic forecast, there remains uncertainty in relation to the impact of the pandemic on the overall credit quality of Heartland's book. In particular, whilst forecasts about future economic conditions have improved, all forecasts make assumptions around important matters such as when New Zealand's border will re-open, the nature and extent of any further lockdowns, when and how effective a vaccination programme may be, and how key markets (such as the used car and primary produce markets) may respond. Until such time as there is more certainty that downside scenarios may not adversely affect Heartland's portfolios, Heartland has decided to retain its COVID-19 overlay.

A further update will be provided as part of the full year financial results announcement.

Financial position

Total assets increased by $119.9 million (2.3%) during 1H2021, driven by a $62.3 million (2.7%)[13] increase in gross finance receivables (**Receivables**) and a $57.5 million (10.6%) increase in liquid assets which includes cash, cash equivalents and investments, reflecting a deliberate strategy to maintain significant excess liquidity through the period of uncertainty associated with COVID-19.

Receivables growth was experienced primarily in Motor, Australian Reverse Mortgages, Business Intermediated, New Zealand Reverse Mortgages and digital Home Loans, partly offset by decreases in Harmoney and other personal lending, Livestock, Business Relationship, Open for Business (**O4B**) and Rural Relationship.

Borrowings[14] increased by $110.4 million (2.4%). Deposits increased $4.4 million and other funding increased $106.0 million, primarily due to growth in Australian Reverse Mortgages.

Net assets increased by $37.1 million to $737.1 million. Net tangible assets (**NTA**) increased by $40.6 million to $650.7 million, resulting in an NTA per share of $1.12 (30 June 2020: $1.05).

Business performance

New Zealand Reverse Mortgages

New Zealand Reverse Mortgages NOI was $11.2 million, a decrease of $1.8 million (13.8%) compared with 1H2020. Excluding the impact of one-offs (described above) from 1H2020, underlying NOI was largely flat half-on-half on account of timing differences between changes to lending rates and cost of funds.

New Zealand Reverse Mortgages Receivables increased $16.7 million (5.9%) to $576.6 million, driven by continued enhancements in digital platforms and investment in marketing to increase brand awareness. Receivables growth has been impacted by elevated repayments in 1H2021 due to:

- comparatively lower repayments in Q4 of FY2020 with property sales restricted by COVID-19 related lockdowns
- a buoyant property market in 1H2021.

Motor

Motor NOI was $33.0 million, an increase of $2.9 million (9.6%) compared with 1H2020.

[13] Annualised 1H2021 growth excluding the impact of changes in FX rates.
[14] Includes retail deposits and other borrowings.

Following a strong result in FY2020, Motor Receivables continued to increase during 1H2021, posting a $78.3 million (13.8%) increase to $1,203.9 million. The growth was mainly from the Motor dealer book via car dealerships, brokers and partnerships such as Kia Finance and Jaguar/Land Rover Financial Services.

Heartland intends to grow its distribution channels and innovate to offer new products and world-class customer experiences. Investment in digital enhancements, such as the aforementioned self-serve online application, underpins strong performance of the Motor book which resulted in a 22% increase in new business origination compared with 1H2020.

Harmoney and other personal lending

Harmoney NOI was $6.8 million, a decrease of $1.6 million (19.0%) compared with 1H2020.

Harmoney Receivables decreased by $56.0 million (55.6%), with the New Zealand Harmoney portfolio contracting $34.7 million (47.2%) to $111.2 million, while the Australian Harmoney portfolio decreased by $21.3 million (78.2%) to $32.7 million. Both New Zealand and Australian portfolios continued to contract in 1H2021 as a result of high repayments, as described above.

Harmoney is currently undergoing a transition of its funding model from a peer-to-peer off-balance sheet model to wholesale securitised on-balance sheet funding via warehouse structures. Heartland supports this transition and has entered into a non-binding Heads of Agreement with Harmoney such that it expects its facilities to move to this model in the near term, therefore allowing for the resumption of portfolio growth.

Home Loans

Following a successful pilot, Heartland's digital Home Loans product was launched in October 2020 with conservative lending criteria targeting high quality applicants. Loans were slow to drawdown over the summer holiday period, however strong application rates have continued in the second half of FY2021 (**2H2021**) with $303.6 million approved online and $16.6 million drawn down year-to-date.

The challenges in converting applications to drawdowns are being driven by the time taken to process refinances from other banks and the struggle faced by approved purchasers to find and secure their desired property in a buoyant market.

Business Intermediated

Business Intermediated lending NOI was $13.4 million, an increase of $2.7 million (25.2%) compared with 1H2020.

Business Intermediated Receivables increased $33.1 million (13.2%) to $532.1 million, reflecting Heartland Bank's growth focus on this portfolio, and continued deepening and expansion of the intermediary network underpinned by a strong focus on distributor/vendor and point of sale support. The growth was further supported by strong demand from partners in the transport and logistics sector which continues to experience increasing demand and a solid performance following the COVID-19 outbreak.

Heartland Bank has been proactively approaching its business customers to understand their requirements in response to the pandemic, and provide the support where needed. In addition, Heartland Bank launched Heartland Extend for Business, providing business owners with the flexibility to manage and adjust their loan repayments in line with the cash and growth requirements of their businesses. The product has been well received and the uptake has been pleasing.

Business Relationship

Business Relationship lending NOI was $12.2 million, an increase of $1.0 million (8.9%) compared with 1H2020.

Business Relationship Receivables decreased $16.6 million (6.6%) to $479.8 million as a result of a continued focus on reducing concentration risk in low margin exposures.

O4B

O4B NOI was $7.5 million, an increase of $0.9 million (13.6%) compared with 1H2020.

O4B growth slowed down in 2H2020 as a result of COVID-19 disruptions and the availability of Government-backed funding for small businesses. This trend continued in 1H2021, resulting in O4B Receivables decreasing a further $14.4 million (18.4%) to $140.7 million. Ongoing investments in operational capacity, automation and marketing to increase product awareness, and improving economic sentiment are expected to fuel growth to pre-COVID-19 levels in future periods.

Rural

Rural lending NOI was $15.6 million, a decrease of $0.1 million (0.5%) compared with 1H2020.

Rural Receivables decreased by $35.2 million (11.5%) to $570.5 million. Rural Relationship Receivables reduced by $12.1 million (4.9%) to $478.3 million, while Livestock Receivables decreased by $23.1 million (39.7%) to $92.2 million. The continued downward trend reflects Heartland's strategy to continue to optimise non-core Rural Relationship lending to reduce low margin concentration.

Whilst in its infancy, the Sheep & Beef Direct platform has seen a pleasing volume of high-quality applications since its launch in late 2020. At 16 February 2021, eligible applications totalled $52.3 million, with $26.8 million approved online and $3.0 million drawn down. Refinements will continue to be made to reach target customers and improve user experience.

Australia

Australian operations NOI was $18.2 million, an increase of $1.6 million (9.6%) compared with 1H2020.

Australian Reverse Mortgages Receivables increased by $52.1 million (10.6%)[15] to $1,030.8 million.

New applications for reverse mortgages remained steady throughout the period, notwithstanding the disruption arising from COVID-19 and associated lockdowns in Australia, and are expected to increase as those disruptions ease. There has been recent interest in Heartland's reverse mortgage product from significant mortgage aggregators in Australia, which Heartland expects to come to fruition in 2H2021.

Funding and liquidity

New Zealand

Heartland Bank increased borrowings by $32.7 million (0.9%), primarily as a result of an increase in other borrowings of $30.9 million (8.6%) and an increase in deposits of $1.9 million (0.1%).

[15] Excluding the impact of changes in FX rates.

Within other borrowings, money market borrowings for liquidity management purposes increased by $31.9 million and secured funding increased by $2.3 million.

Deposits grew $1.9 million (0.1%). Heartland Bank continues its focus on reducing risk concentrations in its deposit book while shifting its deposit mix in favour of lower rate call deposits where Heartland is relatively underweight. This resulted in the call to total deposit ratio increasing to 31% as at 31 December 2020 (31 December 2019: 27%; 30 June 2020: 25%).

Heartland's savings products have also received market recognition, being awarded Canstar's Bank of the Year – Savings award in 2020 (third consecutive year), and Canstar's 5-Star Rating for Outstanding Value Savings Account for its Direct Call (fifth consecutive year) and YouChoose accounts.

Heartland Bank increased total liquidity by $18.8 million (2.6%) primarily due to growth in investments of $21.8 million (5.6%).

Heartland Bank increased its committed auto warehouse facility from $150 million to $300 million in May 2020, and its target holding of cash and cash equivalents in response to the uncertain economic and liquidity impacts of COVID-19 in 2H2020, which it continued to maintain in 1H2021. As such, Heartland Bank holds liquidity well in excess of regulatory minimums.

Heartland Bank's capital position has progressively increased during 1H2021, reflecting its continued strong profitability and the RBNZ restrictions on distributions imposed in 2H2020. As a result, Heartland Bank's regulatory capital ratio was 13.95% as at 31 December 2020 (31 December 2019: 12.56%; 30 June 2020: 12.67%) considerably in excess of regulatory minimum.

Australia

Heartland Australia increased borrowings by A$72.7 million (8.6%), largely as a result of an A$142 million new long-term mortgage-backed syndicated loan for the Australian Reverse Mortgage business funded by established offshore institutional investors. The first-of-its-kind transaction achieves another milestone in executing Heartland's strategy to diversify type, source and tenor of its Australian funding and importantly, evidences market liquidity to existing warehouse funders. The financing structure provides Heartland access to deep pools of efficient long-dated funding that is typically unavailable to most Australian non-bank financial institutions. Heartland's high-quality reverse mortgage asset portfolio has enabled the structure to achieve leverage of 98%[16].

During 1H2021, Heartland Australia successfully continued to execute on its strategic funding programme to cater for the strong growth that continues to be generated.

Heartland now has access to committed Australian Reverse Mortgage loan funding of A$1 billion in aggregate. Further expansion of existing warehouse funding through increased senior limits and the introduction of mezzanine funding is planned, together with continued optimisation of long-term duration matched funding.

Digitalisation

As a financial technology business (**FinTech**), digitalisation is at the core of everything Heartland does. The COVID-19 pandemic has accelerated customer demand for digital services and products. Heartland's digital strategy has positioned it well to respond to this, with multiple digital platforms enabling contactless online applications and decisioning.

[16] Being total senior debt divided by total reverse mortgages funded.

Heartland continues its journey to digitalise each customer touchpoint, including its processes and customer care services, enhancing the customer experience and reducing operational costs. Over the last six-month period, various new digital platforms were developed, including an online quoting tool for business intermediaries, online calculator for Kia Finance, integrated biometrics for Motor dealers, and a broker portal for Australian Reverse Mortgage broker partners.

In October 2020, Heartland Bank relaunched its digital Home Loans, expanding lending criteria and improving the self-serve online application following customer feedback received in the March 2020 trial. Heartland Bank continues to maintain the lowest floating, 1-, 2-, and 3-year fixed interest rates by banks in New Zealand.

The self-serve online application for Heartland Bank's Motor product allows New Zealanders to apply for a vehicle loan online at any time and receive a decision in minutes. Development of a similar solution for dealers is currently underway.

Sheep & Beef Direct is Heartland Bank's new Rural Loans product, designed to enable farmers who are looking to buy or refinance a sheep or beef farm to do so online – anytime, anywhere, with online approval available upon completion.

The relaunch of O4B in Australia followed a trial in November 2019. The platform allows small business owners to apply online for unsecured business finance up to $150,000, with longer terms and lower interest rates available compared with similar competitor products.

Regulatory update

As a result of COVID-19, some delays to regulatory change timeframes were announced in 2020. However, a significant volume of regulatory change continues to be upcoming. Key changes include Phase 2 of the review of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**), the proposed Financial Markets (Conduct of Institutions) Amendment Bill (**Conduct Bill**), and the changes to the Consumer Credit law.

The Government has made a number of in-principle decisions in relation to its review of the RBNZ Act which will affect the New Zealand financial system, including proposing a depositor protection scheme and significant strengthening of accountability requirements for directors and executives. Submissions were due in October 2020 on the latest round of consultation and Heartland will continue to monitor progress in respect of the review.

If enacted, the Conduct Bill would introduce a new conduct regime for registered banks (including Heartland Bank), licensed insurers and non-bank deposit takers in New Zealand.
In October 2021, changes to New Zealand Consumer Credit law will come into force. These changes will result in lenders being required to obtain more information for the purposes of their suitability and affordability determinations, and the liability regime for directors and senior managers will be substantially strengthened. Heartland is considering the changes currently and the potential impact of them on its business.

The RBNZ, in late 2020, also announced a further delay to the start of increases in bank capital until 1 July 2022 to allow banks continued headroom to respond to the impacts of COVID-19 and to support economic recovery. The RBNZ has launched a consultation on the details for implementing the final capital review decisions, which closes on 31 March 2021. Decisions are due to be implemented from 1 July 2021 onwards.

Sustainability update

Heartland's sustainability framework comprises three pillars, being Social Equity, Environmental Conservation and Economic Prosperity. For more detail, go to page 60 of Heartland's FY2020 Annual Report, found at shareholders.heartland.co.nz.

Heartland is currently undergoing a phase of assessing and measuring the impact of the risks arising from these pillars, including climate change risk. However, progress towards Heartland's sustainability goals is underway with key achievements noted below.

Social Equity

- The 2020/2021 Manawa Ako internship programme ended on 29 January. This year's intake increased significantly on the previous intake – up 32% (11 interns) to 45 interns.
- There are currently 12 interns who have remained in full-time or part-time employment.

Environmental Conservation

- Heartland's baseline measurement of greenhouse gas (**GHG**) emissions has now been audited. The work of the auditor (which is still subject to peer review) validated the methodology taken to measure Heartland's emissions and has amended the FY2019 emissions profile slightly to 1,157 tCO2e (within 1% of that reported in Heartland's FY2020 Annual Report).
- Heartland's GHG emissions reduction target will be published on Heartland's website by 31 March 2021.
- A 'Green Team' has been established internally to champion environmental initiatives.

Economic Prosperity

- Delivered total shareholder return (**TSR**) of 124% over the last five years (17 February 2016 – 17 February 2021), compared with the NZX50 Index TSR of 108% in the same period, and continued growth in EPS (from 10.0 cps in FY2015 to 12.5 cps in FY2020).
- Initial development was completed for Rocket, a financial literacy programme targeted at school leavers. The programme, designed to be used on a smartphone, was soft-launched at Heartland's Annual Shareholder Meeting in November 2020.

Strategic priorities

Heartland has three core strategic objectives: acquiring scale in New Zealand, expanding in Australia and digitalising everything it does.

Currently, the Group comprises four distinct businesses: New Zealand banking, motor finance, financial technology, and Australia (primarily comprising Reverse Mortgages). As a result of management's review of how these underlying businesses are presented in the market, more emphasis is being put on discrete reporting of these business activities.

New Zealand

Heartland continues to explore opportunities to consolidate banking services to achieve scale and enhance customer offerings. Heartland also continues to look for ways to enhance its existing customer offerings – it is currently expanding the YouChoose product features to make it more accessible for customers and enable it to appeal to a wider customer segment.

Heartland is also seeking to achieve the optimal holding structure for the motor vehicle finance business to provide access to flexible and efficient capital. No conclusions have yet been reached,

however work is underway to set the foundations which would allow Heartland to separate the business to be a Group subsidiary, should it choose to do so.

Australia

Heartland has recently rebranded its Australian Seniors Finance product to Heartland Reverse Mortgages to ensure a stronger brand alignment and consistency with Heartland and its products.

Looking forward, Heartland aims to more broadly service the needs of the aged sector in Australia through a diversified product offering to a wider demographic. Opportunities exist to provide products which support customers transitioning from late stage employment to retirement, and subsequent entry into various stages of aged care. Other forms of equity release, in addition to reverse mortgages, are being explored.

This represents a significant growth opportunity for Heartland, with the Federal Government recently releasing the independent Retirement Income Review Final Report which observes that "individuals can significantly boost their retirement incomes without having to increase their superannuation contributions [by] …accessing equity in their home"[17].

In addition to this, research about financing ageing in place, released by Melbourne's RMIT University and supported by Heartland, found that almost 90% of senior Australians want to remain in their home for as long as they can, but have limited funds to do so. RMIT University supported the Federal Government's notion that reverse mortgages could be the solution for many.

Heartland remains the leading provider of reverse mortgages in Australia with 12-month market share increasing from 26%[18] to 28%[19]. With the equity release market set to triple in the next 10 years[20], a similar trend is expected in the future.

Heartland began the 2021 calendar year with the completion of a senior unsecured bond placement of A$75 million. This is the third issuance under Heartland Australia's Medium-Term Note programme and takes aggregate outstanding issuance to A$220 million. The funding will enable scale and expansion in Australia, including through the development of new products intended to appeal to various segments of the aged sector, thereby ensuring Australian retirees can choose how best to fund their retirement lifestyle.

Digital

Recognising Heartland as a FinTech, Heartland's strategy is to digitalise everything it does. Progress towards this goal is described in the 'Digitalisation' section on page 10.

Interim dividend

Heartland is pleased to declare a 1H2021 interim dividend of 4.0 cps (0.5 cps down on 1H2020). The dividend yield of 4.8%[21] compares with 8.3%[22] in 1H2020. As was the case for the 2H2020 final dividend, the dividend decrease reflects restrictions imposed by the RBNZ on distributions by banks in New Zealand. However, the continued growth in Heartland's Australian operations enable it to

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[17] Source: Retirement Income Review Final Report, The Treasury, Australian Government.
[18] Based on APRA ADI Property Exposure and Heartland Seniors Finance data as at 31 March 2020.
[19] Based on APRA ADI Property Exposure and Heartland Seniors Finance data as at 30 September 2020.
[20] Source: Global Equity Release Roundtable 2020 survey report, EPPARG and EY.
[21] Total fully imputed dividends for 1H2021 (interim) and 2H2020 (final) divided by the closing share price as at 9 February 2021 of $1.88.
[22] Total fully imputed dividends for 1H2020 (interim) and 2H2019 (final) divided by the closing share price as at 14 February 2020 of $1.84.

distribute earnings derived from assets held outside of Heartland Bank. Heartland expects to return to a pay-out ratio aligning to historical levels once the RBNZ restrictions are removed.

The interim dividend will be paid on Tuesday 16 March 2021 (**Payment Date**) to shareholders on the company's register as at 5.00pm on Tuesday 2 March 2021 (**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 final dividend with a 2.0% discount[23].

The DRP offer document and participation form is available on Heartland's shareholder website at: https://shareholders.heartland.co.nz/shareholder-resources/dividends.

Looking forward

Heartland's 1H2021 NPAT has exceeded expectations, particularly due to a much lower than forecast impaired asset expense and pleasing origination levels in core portfolios. However, aggregate balance sheet growth has been modest (primarily due to elevated repayments) and this may moderate the uplift in net operating income ordinarily experienced in the second half of the financial year.

Heartland believes customer repayment activity will normalise, and impaired asset expense levels will be in line with budget for the remainder of the financial year. Provided this occurs and the economic conditions continue to improve, Heartland expects NPAT for FY2021 to be at the upper end of the guidance range of $83 million to $85 million.

– Ends –

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[23] 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 Heartland Group Holdings Limited DRP offer document dated 10 December 2018.