NZX/ASX release
29 August 2023

Heartland's FY2023 result demonstrates resilience

Heartland Group Holdings Limited (**Heartland**) (**NZX/ASX: HGH**) is pleased to announce a net profit after tax (**NPAT**) of $95.9 million for the financial year ended 30 June 2023 (**FY2023**). On an underlying[1] basis, FY2023 NPAT was $110.2 million. NPAT increased $0.7 million (0.8%), and on an underlying basis, $14.1 million (14.6%), compared with the financial year ended 30 June 2022 (**FY2022**).[2]

Highlights for FY2023

Financial highlights

- NPAT of $95.9 million, up 0.8% ($0.7 million) on FY2022 NPAT. Underlying NPAT of $110.2 million, up 14.6% ($14.1 million) on FY2022 underlying NPAT.
- One-off or non-cash technical items had a $14.3 million net[3] impact on NPAT.
- Gross finance receivables (**Receivables**)[4] of $6.8 billion, up 10.1% ($625.5 million).[5]
- Underlying return on equity (**ROE**) of 11.9%, down 68 basis points (**bps**).[6]
- Net interest margin (**NIM**)[7] of 3.97%, down 8 bps. Underlying NIM of 4.00%, down 16 bps.
- Net interest income (**NII**) of $282.0 million, up 12.7%. Underlying NII of $283.9 million, up 14.3%.
- Underlying cost to income (**CTI**) ratio of 42.0%, down 53 bps on FY2022.[8]
- Underlying impairment expense ratio of 0.36%, up 7 bps.[9]
- FY2023 final dividend of 6.0 cents per share (**cps**), resulting in a FY2023 total dividend of 11.5 cps, up 0.5 cps on the FY2022 total dividend.
- Earnings per share (**EPS**) of 14.0 cps, down 2.1 cps. Underlying EPS of 16.0 cps, down 0.3 cps.

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[1] Financial results are presented on a reported and underlying basis. Reported results are prepared in accordance with NZ GAAP and include the impacts of positive and negative one-offs, which can make it difficult to compare performance. Underlying results (which are non-GAAP financial information) exclude any impacts of 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 6 for a summary of reported and underlying results. A detailed reconciliation between reported and underlying financial information, including details about FY2023 one-offs, is set out on page 42 of the FY2023 investor presentation (**IP**). General information about the use of non-GAAP financial measures is set out on page 4 and 38 of the FY2023 IP.
[2] All comparative results are based on the audited full year consolidated financial statements of Heartland and its subsidiaries (the **Group**) for FY2022.
[3] Includes tax impact on one-offs (as and where applicable).
[4] Receivables includes Reverse Mortgages.
[5] Excludes 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 10.4%, down 169 bps compared with FY2022. For more information, see page 4 of the FY2023 IP.
[7] NIM is calculated as net interest income over average gross interest earning assets.
[8] Underlying CTI ratio refers to the CTI ratio calculated using underlying results. When calculated using reported results, the CTI ratio was 44.9%, up 126 bps compared with FY2022. For more information, see page 4 of the FY2023 IP.
[9] Underlying impairment expense ratio refers to the impairment expense ratio calculated using underlying results. When calculated using reported results, the impairment expense ratio was 0.36%, up 11 bps compared with FY2022. For more information, see page 4 of the FY2023 IP.

Strategic highlights

- $199 million raised through 2022 equity raise to fund growth ambitions for existing businesses and repay acquisition-related bridge debt of $174 million (A$158 million).
- Completed the integration of StockCo Australia into Heartland.
- Signed a conditional share purchase agreement for the purchase of Challenger Bank Limited (**Challenger Bank**) on 20 October 2022, subject to obtaining the requisite regulatory approvals.
- Australian Reverse Mortgages business increased market share to 38.4%.[10]
- Heartland Bank Limited (**Heartland Bank**) awarded Canstar New Zealand's Bank of the Year – Savings award for the sixth consecutive year.[11]
- Nearing completion of the upgrade of Heartland Bank's core banking system.

Strategic vision

Heartland is focused on creating sustainable growth and differentiation by providing products which are the 'best or only' of their kind, through scalable digital platforms. This is underpinned by the following strategic pillars:

1. Frictionless Service at the Lowest Cost – reflected in a superior CTI ratio
2. Expansion in Australia
3. Business as Usual Growth (reported on in *Business performance* from page 9).

Frictionless Service at the Lowest Cost – CTI ratio

Through technology, Heartland has been able to replicate the scale of big banks. This is evidenced by Heartland's CTI ratio, which improved by 53 bps on FY2022 to 42.0% on an underlying basis[8] in FY2023 – much lower than the average CTI ratio of New Zealand's main domestic non-major banks (The Co-operative Bank, Kiwibank, SBS and TSB) and more comparable to the average CTI ratio of Australia's major banks (ANZ, CBA, NAB and Westpac).[12]

Heartland's ambition is to achieve an underlying CTI ratio of less than 35% by FY2028 through revenue growth and ongoing automation and digitalisation initiatives. Key to achieving this ambition is increasing customer self-service functionality and improving efficiency through streamlining and digitising internal processes. This activity is intended to contribute to providing customers with frictionless service and enabling scalable growth possibilities for Heartland.

Ongoing digitalisation enhancements in FY2023 included expanding the secure automatic approval capabilities of the Asset Finance and New Zealand Livestock Finance application processes, reducing friction for customers and the need for manual assessment. This resulted in an uplift in approval rates of 20% and 12% respectively.

The percentage of New Zealand Reverse Mortgage website visitors who used mobile devices increased from 51% as at 30 June 2022 to 54% as at 30 June 2023. This reflects the inroads mobile phone technology is making with older demographics and supports Heartland's digital distribution strategy and lower cost servicing.

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[10] Based on Australian Prudential Regulation Authority (**APRA**) authorised deposit-taking institution (**ADI**) Property Exposure and Heartland Finance data as at 31 March 2023.

[11] Awarded in July 2023.

[12] The average CTI ratio of New Zealand's main domestic non-major banks excluding Heartland (The Co-operative Bank, Kiwibank, SBS and TSB) was 68.9% for the 12 months to 31 March 2023 (data from the RBNZ Financial Strength Dashboard, valid as at 31 July 2023). The average CTI ratio of Australia's major banks (ANZ, CBA, NAB and Westpac) was 45.2% for their most recent respective annual reporting periods.

After initially launching to a small set of customers, the Heartland Finance Mobile App was rolled out to all Australian Reverse Mortgage customers in June 2023, providing the ability to view balances, transactions and request a cash reserve or redraw from a mobile device. Within one month, more than 10% of Australian Reverse Mortgage customers had digital access (via the Heartland Finance Mobile App or online platform). In New Zealand, Heartland Bank has onboarded more than 10,000 new Heartland Mobile App users through recently developed self-service functionality, with Mobile App users up 65% from 1 July 2022.

The upgrade of Heartland Bank's core banking system is nearing completion and is due to go live within this calendar year. The upgraded system provides a platform on which to deliver increased levels of automation and digitalisation, positioning Heartland for increased scalability in the future.

A number of initiatives are being delivered through a systemised programme of work to further enhance digital, self-service and automation capabilities. This programme of work includes the following four key initiatives.

Zero inbound calls

This initiative is focused on digitising basic banking requests to enable customers to self-serve via the Heartland Mobile App, create a seamless user experience for customers, and reduce inbound customer call volumes. In doing so, Heartland's employees will be able to focus on more complex customer requests.

Heartland Bank's ambition is to reduce inbound customer call volumes by approximately 73% by 30 June 2025. To achieve this, mobile app self-service features will be developed to address the top reasons for inbound customer calls.

One-Click Deferral

Customers will be offered increased flexibility to self-manage their Motor Finance loan repayments digitally via the Mobile App, including customers in arrears. Seven new Heartland Mobile App functions and features will be developed to enable customers to self-manage their repayments, reducing the need for them to contact Heartland Bank.

Process automation

Heartland will continue to upgrade its existing back-end technology, and introduce scalable digital technologies to optimise back-end processes and improve efficiency. Increasing automation will improve internal workflows and reduce manual effort, thereby reducing friction for customers and employees. Heartland Bank's ambition is to automate approximately 65% of operations and collections manual processes by 30 June 2025.

Motor digitisation

Continued enhancement of Motor Finance digital capabilities will enable faster and easier access to vehicle finance for customers through online application platforms. Heartland's intention is to rollout seven branded online origination platforms to Motor Finance dealer partners in the financial year ending 30 June 2024 (**FY2024**).

Expansion in Australia

Heartland's focus for expansion in Australia is on:

1. growing its existing Australian Reverse Mortgages business
2. growing its existing Livestock Finance business (StockCo Australia)
3. seeking other opportunities to expand Heartland's 'best or only' strategy in Australia.

Strong growth has continued for Australian Reverse Mortgages, with a compound annual growth rate for the five-year period from 1 July 2018 to 30 June 2023 of 22.8%. Heartland has also maintained its position as the largest active provider of reverse mortgages in Australia, with market share of 38.4% as at 31 March 2023 (up from 33.1% at 31 March 2022)[13]. Further positioning itself as a leader in the sector, Heartland Finance was a finalist for Best Banking Innovation at the Australian Finder Innovation Awards 2022 and received the Excellence Award for Non-Bank of the Year at the Australian Mortgage Awards 2022.

The proportion of the Australian population aged over 65 years is expected to reach 21% by 2041 (up from ~17% in 2021).[14] The addressable market for reverse mortgages is estimated to be A$10-15 billion.[15] Further, the Australian Government's Home Equity Access Scheme continues to contribute to a greater awareness of home equity release options, including reverse mortgages. Non-bank participation in the sector has increased and supports the acceptance of reverse mortgages.

StockCo Australia has been operating in Australia since 2014 and is a leading specialist livestock financier with established direct and distributor networks. The Australian Livestock Finance portfolio experienced direct client growth in FY2023 of 11% (see page 11 for more detail), but subdued dollar growth due to stock market price volatilities and adverse weather conditions. This resulted in a contribution to FY2023 NPAT below the expected A$10-12 million (before any ongoing cost of acquisition debt funding). Global consumption and production of beef and veal, and sheep meat are projected to increase annually by 0.62% and 1.22% respectively between 2022-2031 due to a combination of income and population growth.[16] This, together with good feedstock conditions, makes for a positive outlook. The addressable market for livestock finance is estimated to be A$7 billion.[17]

The Challenger Bank acquisition remains subject to Reserve Bank of New Zealand (**RBNZ**) and APRA approval. The benefits of acquiring Challenger Bank, an established ADI, include:

- access to a deep and efficient pool of funding to support ongoing growth in Australian Reverse Mortgages and Livestock Finance
- 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 has continued to consider the appropriate group structure to accommodate the Challenger Bank acquisition. The final group structure is now expected to include Heartland Bank acquiring Challenger Bank. If this occurs, Heartland Banking Group's business would be carried out in both New Zealand and Australia.

Subject to completion of the acquisition, Heartland intends to leverage its extensive operational experience in New Zealand to drive expansion into Australia, including in Motor Finance and Asset Finance. Inorganic growth opportunities, through further acquisition, will also be explored in targeted areas of the market consistent with Heartland's 'best or only' strategy, and where there is an opportunity to add value as a means of adding scale or technology.

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[13] Based on APRA ADI Property Exposure and Heartland Finance data as at 31 March 2022 and 31 March 2023.
[14] Sourced from ARC Centre of Excellence in Population Ageing Research as at August 2022.
[15] Heartland internal analysis based on information from the ABS December 2022, Census 2021 and Deloitte (2021 Three Pillars Forum). Market size based on reverse mortgage lending from banks and non-banks.
[16] Sourced from OECD FAO Agricultural Outlook 2022-2031.
[17] Based on 2020 ABS total rural debt and 2021 StockCo Australia data.

Operating environment

FY2023 was challenging for customers across Australia and New Zealand, driven by cost of living pressures and increasing interest rates. Low commodity prices and adverse weather events have compounded matters for certain sectors to which Heartland lends, including livestock. In this environment, Heartland's asset quality has performed within expectations. Heartland has worked hard to support its customers, particularly those facing temporary difficulties due to the current economic environment. During the year, Heartland also reduced its risk appetite for unsecured personal and unsecured business lending.

The Auckland flooding and Cyclone Gabrielle weather events had limited impact on Heartland's customers. A small number of customers were significantly affected and Heartland is working with the New Zealand Government under the North Island Weather Events Loan Guarantee Scheme to provide customer support.

Reverse Mortgages

The Reverse Mortgage portfolios in both countries have low average weighted loan-to-value ratios (**LVR**s) and continue to demonstrate resilience. Conservative loan origination standards (such as low LVRs) have enabled Reverse Mortgage customers to weather the challenging combination of falling house prices and higher interest rates over the last year. As at 30 June 2023, after consecutive cash rate increases by the RBNZ and the Reserve Bank of Australia, and successive house price reductions, the average weighted LVR for New Zealand and Australian Reverse Mortgages respectively were 21.3% (up from 18.4% at 30 June 2022) and 21.5% (up from 20.5% at 30 June 2022). Both portfolios remain strong with good headroom to weather any further stress events.

Additionally, following consultation in which Heartland Bank participated, the RBNZ introduced a new lower risk weight bucket of 40% for reverse mortgage loans with LVRs of less than 30% to reflect the credit risk of low LVR loans, which is expected to be effective from 1 September 2023. Heartland Bank welcomes this change which better reflects the resilience of its low LVR reverse mortgage portfolio and is expected to provide additional benefit to Heartland Bank's capital ratio.

Motor Finance

The Motor Finance portfolio has performed as expected given the economic conditions. Arrears have trended upward across the year to 3.95% as at 30 June 2023, however the level of losses remains within cyclical norms. Historically, losses have been correlated to unemployment. While rates of unemployment remain low, current provisions factor in an allowance for the potential impact of rising unemployment.

Online Home Loans

Online Home Loans experienced subdued growth as property sales and new mortgage volumes declined in New Zealand. As at 30 June 2023, no loans were impaired (i.e. 30 days overdue on a payment). The average LVR across the portfolio is circa 59%, despite property value declines since the end of 2021. The portfolio therefore remains well secured. These factors are a result of the product's conservative criteria and strategy of targeting high-quality borrowers.

Livestock Finance

Stock market price volatility is not expected to have a material impact on the quality of the book. Historically, the impact of the variation in market price has, in most cases, been more than offset through livestock weight gains.

The book remains well secured, with producers retaining livestock for longer periods to ensure weight gain exceeds the impact of stock market pricing. StockCo Australia is one of the few livestock providers in Australia to have a dedicated breeder product. This allows producers to hold onto female stock for breeding, with the value of the progeny assisting in increasing their returns when prices are under pressure.

Business

As at 30 June 2023, the balance of Heartland's Economic Overlay of $8.0 million taken in FY2022 was $2.4 million. The Economic Overlay has been allocated to specifically provision for Business Relationship lending and Asset Finance loans that have been impacted by low economic growth, and remained in place at 30 June 2023.

The economic outlook for FY2024 is difficult to predict. Interest rates appear at or near the peak but are forecast to remain elevated until 2025. The rate of unemployment remains low despite forecasts of it rising. The upcoming New Zealand general election provides additional uncertainty. Despite this, and recognising the lag effect of these economic indicators, Heartland expects FY2024 will be a year with broadly similar credit outcomes to FY2023.

Financial results

Profitability

FY2023 reported results have been normalised to exclude one-off or non-cash technical items, including the following.[18]

1. Legacy hedge accounting impacts: a $9.1 million loss contributed by the derivatives that were de-designated from their prior hedge accounting relationships in FY2022. The de-designation resulted in a $16.7 million 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. The remaining $7.7 million will unwind across FY2024 and the financial year ending 30 June 2025 (**FY2025**).
2. Fair value loss on equity investment in Harmoney Corp Limited (**Harmoney**): a $4.5 million fair value loss was recognised on investment in Harmoney shares during FY2023. The fair value as at 30 June 2023 was determined based on the closing last traded price of Harmoney shares on the Australian Stock Exchange of A$0.32 per share.
3. Interest expense on the bridging loan for the acquisition of StockCo Australia: a $1.9 million interest expense was recognised in relation to a $174 million (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 2022 equity raise.
4. Australia Bank Programme costs: $2.2 million of transaction and other costs in relation to acquiring an ADI in Australia. In addition, $6.4 million of costs directly attributable to applying to become an ADI have been capitalised as an intangible asset.

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

[18] Refer to page 42 of the FY2023 IP for an exhaustive list of FY2023 one-offs and a detailed reconciliation between reported and underlying financial information.

	Reported			Underlying		
	FY2023	FY2022	Movement	FY2023	FY2022	Movement
NOI[19] ($m)	285.3	267.6	17.7	300.7	262.0	38.7
Operating expenses (**OPEX**) ($m)	128.1	116.8	11.3	126.2	111.4	14.9
NPAT ($m)	95.9	95.1	0.7	110.2	96.1	14.1
NIM	3.97%	4.05%	(8 bps)	4.00%	4.16%	(16 bps)
CTI ratio	44.9%	43.6%	126 bps	42.0%	42.5%	(53 bps)
Impairment expense ratio	0.36%	0.25%	11 bps	0.36%	0.29%	7 bps
ROE	10.4%	12.1%	(169 bps)	11.9%	12.6%	(68 bps)
EPS	14.0 cps	16.1 cps	(2.1 cps)	16.0 cps	16.3 cps	(0.3 cps)

NOI

Total NOI was $285.3 million, an increase of $17.7 million (6.6%) from FY2022.

Underlying NOI was $300.7 million, $38.7 million (14.8%) higher than in FY2022, $21.8 million of which was contributed by StockCo Australia. This was largely due to a $35.6 million (14.3%) increase in NII, driven by $1,127.5 million (18.9%) higher average interest earning assets in FY2023 than in FY2022, and a 16 bps decrease in underlying NIM compared with FY2022.

Underlying other operating income increased by $3.1 million (22.7%) from FY2022, mainly driven by increases in upfront Reverse Mortgage income and fee income.

NIM

After recording an 8 bps contraction in underlying NIM in the six months to 31 December 2022 (**1H2023**) compared with the six months to 30 June 2022 (**2H2022**), this trend stabilised in the six months to 30 June 2023 (**2H2023**) through proactive portfolio pricing and margin management. Underlying NIM for FY2023 decreased only 2 bps compared with 1H2023.

The cash rates in New Zealand and Australia have seen a rapid and sharp increase, rising from 2.00% and 0.85% as at June 2022, to 5.50% and 4.10% as at June 2023 respectively. This has created a difficult environment in which 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.

NIM compressions were also due to the continued shift in portfolio composition towards lower risk exposures. Personal lending and unsecured small-to-medium enterprise (**SME**) lending continued to reduce, while Business and Rural Relationship lending experienced larger repayments of higher risk loans. At the same time, there was growth in higher quality portfolios, such as Reverse Mortgages and Online Home Loans. Motor Finance experienced market share gains at the expense of margin, alongside general margin compression due to a shift in asset quality and competitive pressures. The impacts of this compression were partly offset following the acquisition of StockCo Australia, a higher NIM portfolio.

[19] Net operating income (**NOI**) includes fair value gains/losses on investments.

Through FY2024, NIM will be assisted by older Asset Finance and Motor Finance loans at lower rates continuing to be repaid.

OPEX

OPEX was $128.1 million, an increase of $11.3 million (9.7%) on FY2022. Underlying OPEX was $14.9 million (13.4%) higher compared with FY2022.

Higher underlying OPEX was primarily due to the acquisition of StockCo Australia which contributed $8.9 million to FY2023 OPEX. The remaining underlying OPEX increase is $6.0 million (5.4%), which was mainly driven by a 4.6% increase in staff expenses, an 18.6% increase in upfront Reverse Mortgage expenses (noting this is completely offset by an increase in upfront Reverse Mortgage income), and the balance from increased travel and administration costs.

CTI ratio

The underlying CTI ratio further improved by 53 bps on FY2022 to 42.0%.[20]

Heartland's commitment to efficiencies through technology and digitalisation are anticipated to provide ongoing benefits in the form of a reduced CTI ratio. The CTI ratio is expected to remain stable while investment in and delivery of digitalisation initiatives is underway, with CTI benefits to start materialising from late FY2024.

Impairment expense

Impairment expense was $23.2 million, $9.4 million (68.1%) up on FY2022. On an underlying basis, impairment expense was $7.5 million (47.9%) up on FY2022, including an allowance for the potential impact of rising unemployment on the Motor Finance portfolio. The residual increase in underlying impairment expense was mainly contributed to by the Harmoney book amortising at a slower rate in FY2023 compared with FY2022 and, to a lesser extent, by deterioration in the quality of unsecured Personal Lending which is no longer being actively originated in order to manage risk in the current environment. Underlying impairment expense ratio increased to 0.36% in FY2023, up 7 bps compared with FY2022.

As at 30 June 2023, the balance of Heartland's Economic Overlay of $8.0 million taken in FY2022 was $2.4 million. The Economic Overlay has been allocated to specifically provision for Business Relationship lending and Asset Finance loans that have been impacted by low economic growth, and remained in place at 30 June 2023.

ROE

Underlying ROE was 11.9%, down 68 bps compared with FY2022.[21] The result reflects a strengthened capital position following Heartland's equity raise in 1H2023, positioning it well for future growth opportunities.

Financial position

Total assets increased by $657.1 million (9.3%) during FY2023, driven by a $625.5 million (10.1%)[22] increase in Receivables and a $41.7 million (7.1%) increase in liquid assets from FY2022.

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[20] Underlying CTI ratio refers to the CTI ratio calculated using underlying results. When calculated using reported results, the CTI ratio was 44.9%, up 126 bps compared with FY2022. See page 4 of the FY2023 IP for more information about the use of the CTI ratio, a supplementary, non-GAAP measure.
[21] Underlying ROE refers to ROE calculated using underlying results. When calculated using reported results, ROE was 10.4%, down 169 bps compared with FY2022. For more information, see page 4 of the FY2023 IP.
[22] Excluding the impact of changes in FX rates.

Receivables growth was experienced across Heartland's core portfolios of Australian Reverse Mortgages, New Zealand Reverse Mortgages, Motor Finance, Asset Finance and Online Home Loans, partly offset by decreases in Business, Rural Relationship, Open for Business (**O4B**) and Personal Lending.

Borrowings[23] increased by $456.7 million (7.4%) compared with FY2022. Deposits increased by $538.5 million (15.0%) from FY2022, partially offset by a decrease in other borrowings of $81.8 million (3.2%) during FY2023. See further information under *Funding and liquidity* on page 12.

Net assets increased by $222.3 million to $1,031.0 million. Net tangible assets (**NTA**) increased by $207.4 million to $774.2 million, primarily as a result of a $199 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 Receivables increased $49.2 million (7.8%) from FY2022 to $682.8 million. Asset Finance NOI was $30.3 million, a decrease of $0.2 million (0.5%) compared with FY2022.

Heartland's focus remains on freight transport and yellow goods sectors. NIM has been affected by a change in the mix of new business weighted toward an improved credit profile. Lower margin loans are being repaid and replaced, and are expected to have a positive contribution to margin in late FY2024.

Business

Overall Business NOI was $31.7 million, an increase of $1.1 million (3.6%) compared with FY2022. Business Receivables decreased $56.6 million (9.0%) to $573.7 million. This was made up of Wholesale Lending and Business Relationship.

Wholesale Lending includes floorplan lending to vehicle retailers and wholesale facilities to other lenders, including for medium enterprises that on-lend to their own customers in the consumer motor and business sectors. Wholesale Lending Receivables decreased $27.1 million (9.9%) from FY2022 to $245.2 million, reflecting lower utilisation of limits as a result of unpredictable inventory conditions continuing into 2H2023.

Business Relationship Receivables decreased $29.5 million (8.2%) from FY2022 to $328.5 million, as this portfolio continues to transition away from legacy business to loans which present lower risk and are more cost efficient to transact.

Open for Business

O4B NOI was $12.9 million, a decrease of $0.8 million (5.7%) compared with FY2022. O4B Receivables decreased $24.1 million (17.1%)[22] to $117.1 million.

Heartland stopped actively originating O4B lending in the second quarter of FY2023 (**Q2**) to manage risk due to the macro-economic challenges for the SME sector. This has resulted in an amortising loan book pending improved conditions.

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[23] Includes retail deposits and other borrowings.

Motor Finance

Motor Finance NOI was $64.2 million, a decrease of $8.7 million (11.9%) compared with FY2022. Motor Finance Receivables increased $186.8 million (13.5%) to $1.57 billion.

Motor Finance has experienced market share gains at the expense of margin, alongside general margin compression due to a shift in asset quality and competitive pressures. While total new and used car sales in the New Zealand market were down by 6.2% in the period[24], Heartland's new business volumes increased by 11.6% from FY2022, with overall growth in FY2023 of 13.5% due to lower early repayments than expected.

Heartland's broad distribution network of dealers and partnerships with key distributors and large dealer franchise groups, along with its digital innovation, have been key contributing factors in achieving growth in a difficult market.

Heartland intends to expand its branded online origination platforms to other dealer partners in FY2024 so they can provide customers with swift digital options to apply for vehicle finance and receive a decision in minutes.

Personal Lending

Personal Lending includes loans originated directly through Heartland Bank, and legacy portfolios originated by Harmoney in New Zealand and Australia. To manage risk in the current environment, this portfolio is not actively originating. In addition, Heartland's Harmoney personal loans channel is closed to new business and running down.

Personal Lending NOI was $6.6 million, a decrease of $3.1 million (32.2%) compared with FY2022. Personal Lending Receivables decreased by $17.8 million (27.3%)[22] to $47.3 million. Harmoney Receivables decreased by $20.3 million (65.7%), made up of a decrease in the New Zealand Harmoney channel of $12.9 million (70.4%) to $5.5 million, and a decrease in the Australian Harmoney channel of $7.3 million (58.9%)[22] to $5.1 million. This is partially offset by Heartland originated personal lending which increased by $2.5 million (7.3%) to $36.7 million in FY2023.

Online Home Loans[25]

Online Home Loans NOI was $3.8 million, an increase of $1.7 million (80.2%) compared with FY2022. Online Home Loans Receivables increased $38.7 million (14.1%) to $313.4 million.

While subdued compared to FY2022, Online Home Loans experienced good growth in a challenging economic environment. This was moderated by a sharp decline in property sales and new mortgage volumes in New Zealand. The number of properties sold in the 12 months to February 2023 was the lowest observed since 1983.[26] Similarly, the monthly level of new mortgages issued has been at or near the lowest levels observed since at least 2014 (when the RBNZ began collating this data).[27]

Competitive pressures in the refinance market remain intense, with competitors generally offering large cash-backs and negotiating on rates. Heartland has remained disciplined in respect of its pricing strategy. Heartland's low-cost digital origination platform has enabled it to consistently offer competitive or market-leading rates. Customer retention remained strong, with retention exceeding 90% for customers whose fixed rates came up for renewal over the course of FY2023.

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[24] Based on data from the Motor Industry Association of New Zealand on new and used vehicle sales from motor vehicle dealers.
[25] Excludes legacy Retail Mortgages.
[26] Based on data from CoreLogic's February 2023 Housing Chart Pack.
[27] Based on RBNZ data on new residential mortgage lending by borrower type.

New Zealand Reverse Mortgages

New Zealand Reverse Mortgages NOI was $42.4 million, an increase of $9.9 million (30.3%) compared with FY2022. Receivables increased $167.3 million (23.2%) to $888.6 million.
The business continues to experience strong demand and growth due to:

- cost of living and cashflow pressures faced by older homeowners, with a reverse mortgage providing an option to fund desired lifestyle enhancements
- increased education, awareness and acceptance of reverse mortgages.

Over the last decade, Heartland has helped more than 22,000 New Zealanders to enjoy a more comfortable retirement by releasing equity from their homes. The outlook for New Zealand Reverse Mortgages remains positive, with additional demand from cost of living pressures driving growth. Website improvements will be released making it easier for mobile users, and streamlining the application process.

Rural

Overall Rural lending NOI was $34.2 million, an increase of $4.1 million (13.5%) compared with FY2022. Overall Rural portfolio Receivables increased by $11.4 million (1.7%) to $700.5 million. This was made up of Livestock Finance, Rural Relationship and Rural Direct.

Livestock Finance Receivables increased by $19.9 million (11.6%) from FY2022 to $191.2 million in a market impacted by falling commodity prices, difficult climatic conditions and Cyclone Gabrielle in the Hawke's Bay and Tairāwhiti regions. Of this growth, 6% originated from the addition of key intermediary partnerships, with the balance from existing customers.

Rural Relationship Receivables decreased by $17.1 million (3.9%) from FY2022 to $424.4 million, due to the continued transition of the book away from large, complex, low margin lending. Heartland's exposure to the dairy sector reduced to 32.8% of the total Rural book.

Rural Direct includes Heartland's Sheep & Beef Direct and Dairy Direct digital platforms which provide online finance to sheep, beef and dairy farmers. Rural Direct Receivables increased by $8.6 million (11.2%) from FY2022 to $84.9 million.

Australia

Australian Reverse Mortgages

Australian Reverse Mortgages NOI was $47.3 million, an increase of $8.2 million (20.9%) compared with FY2022.

Australian Reverse Mortgages Receivables increased by $263.5 million (20.7%)[22] to $1.54 billion, driven primarily by:

- increased debt consolidation and cost of living requests due to the current economic environment
- customers seeking funds for home improvements to ensure ageing well in place (for a person to remain in their home and make it more retirement-friendly as they age)
- customers looking to enjoy retirement with modest lifestyle spending (such as holidays or a new car)
- 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.

Heartland has now helped more than 26,000 Australians to live a more comfortable retirement since 2004. Growth is expected to remain strong in FY2024 as ongoing improvements and efficiencies are made to the loan application, approval and maintenance process.

Australian Livestock Finance

Australian Livestock Finance NOI was $31.9 million. Receivables increased $7.7 million (2.1%)[22] from FY2022 to $380.8 million. Subdued growth was due to macroeconomic events affecting livestock prices and demand, including adverse weather conditions, the rising interest rate environment, and low export demand with the USA drought and China's COVID-19 response contributing to freezers being full around the world. This resulted in lower dollars per head on the balance sheet.

Despite this, the volume of livestock financed by StockCo has increased. As at 30 June 2023, cattle transactions were up 25% compared with 30 June 2022. Sheep transactions were flat. This growth was supported by increasing distribution partner networks with consistent onboarding of new clients and increased facility limit usage.

Demand for Australian protein, mainly beef, is expected to increase and have a positive effect on livestock value in FY2024 as the USA drought breaks and their herd rebuild begins, coupled with the Chinese Government looking to stimulate the Chinese economy as people return to pre-COVID-19 activities.

Processor capacity has been strained due to a lack of skilled workers, the ongoing impacts of COVID-19 and adverse weather conditions. Slaughter production in 2022 was down approximately 27% from 2021 volumes. This is expected to improve in the first half of FY2024 and have a positive effect on livestock demand and value, and therefore demand for livestock financing, as processors work through their backlog.

Digitalisation of the direct channel application is underway to improve efficiency in the application process. A white label offering is also in development to strengthen and expand the existing distribution network, supporting ongoing growth through FY2024.

Funding and liquidity

Heartland increased borrowings by $456.7 million (7.4%) from FY2022 to $6,627.4 million.

New Zealand

Heartland Bank increased borrowings by $399.5 million (9.2%) from FY2022 to $4,746.2 million.

Deposits[28] grew $533.9 million (14.8%) during FY2023 to $4,131.0 million, which was driven by competitive pricing on targeted products, including Heartland's Notice Saver offerings which both received Canstar New Zealand recognition in FY2023. 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. In July 2023, Heartland Bank was awarded Canstar New Zealand's Bank of the Year – Savings for the sixth year in a row. In the first and second quarters of FY2023, Heartland Bank experienced the highest growth rate in retail deposits of all main and domestic banks in New Zealand.[29]

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[28] Includes intercompany deposits received by Heartland Bank (30 June 2023: nil; 30 June 2022: $4.6 million).
[29] Based on balance sheet data from the RBNZ.

Notice Saver increased by $206.1 million (40.1%) from FY2022. Term deposits increased by $439.6 million (20.1%), while call deposits decreased by $111.8 million (12.5%) during FY2023. The call to total deposit ratio decreased to 19% as at 30 June 2023 (30 June 2022: 25%).

Other borrowings decreased by $134.4 million (17.9%) from FY2022, 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 $40.7 million. This was partially offset by Heartland Bank's issuance of $100 million of unsecured subordinated notes to the retail market in 2H2023, which qualify as Tier 2 capital for regulatory purposes, further solidifying Heartland Bank's regulatory capital position.

Heartland Bank's total liquidity (including liquid assets and available committed lines) strengthened further in FY2023, increasing by $76.3 million (12.1%) to $704.2 million, well in excess of regulatory minimums.

Heartland Bank's regulatory capital ratio increased to 14.69% as at 30 June 2023 (30 June 2022: 13.49%). 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 common equity tier 1 ratio of 11.50% and a total capital ratio of 16.00% by 1 July 2028.

Australia

Heartland Australia (comprising Heartland Australia Holdings Pty Ltd and its subsidiaries) increased borrowings by A$282.0 million (23.5%) from FY2022 to A$1,482.2 million.

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. Heartland Australia's April 2023 A$120 million MTN maturity was refinanced. The aggregate outstanding issuance under Heartland Australia's MTN programme was A$240 million as at 30 June 2023 (30 June 2022: A$280 million).

The maturities of the two Reverse Mortgage securitisation warehouses were extended by two and three years respectively, and aggregate senior limits were expanded by A$100 million, providing Heartland Australia with access to A$1.54 billion of committed funding in aggregate. Conversations are underway with securitisation lenders to increase headroom in both facilities to support continued growth experienced in the portfolio.

StockCo Australia (comprising StockCo Australia Management Pty Ltd, StockCo Holdings 2 Pty Ltd and their subsidiaries) increased borrowings by A$17.2 million (5.2%) from FY2022 to A$346.4 million. StockCo Australia was transferred from Heartland to Heartland Australia Holdings Pty Ltd on 1 August 2023.

Regulatory update

Heartland continues to monitor and prepare for the significant volume of regulatory change in New Zealand.

In June 2023, it was announced that the Commerce Commission (**ComCom**) would conduct a market study into any factors that may affect competition for the supply or acquisition of personal banking services. A Preliminary Issues Paper for the market study was published on 10 August 2023 which sets out the context and proposed focus areas of the study. It is currently proposed that the study will focus on deposit accounts (transaction, savings, and term deposits, including overdraft facilities) and home loans. The ComCom will engage with stakeholders and conduct information gathering with a final report on its findings due 20 August 2024, which will include recommendations that identify ways to improve competition in the sector. Heartland Bank welcomes the opportunity to participate in the market study.

The Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 (**Conduct Act**) was passed in June 2022, and will come into force on 31 March 2025, following a transitional period. The Conduct Act applies to registered banks, licensed insurers and licensed non-bank deposit takers. 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 (including the prohibition of sales incentives based on volume or value targets). Incentives regulations will apply both to Heartland Bank and its intermediaries involved in the distribution of its products. Heartland Bank is preparing for licensing and compliance with the Conduct Act.

The Deposit Takers Act received royal assent (and became law) on 6 July 2023 (**DT Act**). The DT Act strengthens the regulatory framework for all institutions that take deposits (including Heartland Bank) and introduces a new depositor compensation scheme (**DCS**), overseen by the RBNZ.

Very little of the DT Act comes into force immediately, but Heartland Bank has begun considering the impact of the DT Act on its operations and is actively participating in submissions on the DCS and other regulations, guidance and prudential standards relating to the DT Act. The DT Act is expected to be fully in force by around 2028.

Initial changes to the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) came into force on 1 December 2021, with additional changes effective 7 July 2022. Heartland Bank implemented new processes and technologies to enable it to comply with these changes. Following the completion of the New Zealand Government's investigation into the impact of the December 2021 changes, more amendments to the CCCFA came into force in May 2023. Heartland Bank has further amended its processes to reflect these most recent amendments. On 9 August 2023, the Government announced further changes to the CCCFA, including a wider review of the CCCFA with terms of reference to be announced in due course. Heartland Bank will monitor for further developments in regards to these changes.

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. The Ministry of Business, Innovation and Employment recently consulted on an exposure draft of the Customer and Product Data Bill. 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.

Continued preparation 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 FY2024.

In Australia, Heartland continues to monitor changes to Australian regulatory requirements for its existing businesses, and is preparing for the acquisition of Challenger Bank (subject to the requisite regulatory approvals), which is an APRA regulated ADI.

Sustainability update

Heartland's sustainability strategy continues to evolve as it matures. The framework is built on three pillars: environment, people and financial wellbeing. Highlights for FY2023 are outlined below. For more detail, visit heartlandgroup.info/sustainability.

Environment

- Heartland's unaudited operational Greenhouse Gas (**GHG**) emissions for FY2023 saw a 17% reduction on the base year for the financial year ended 30 June 2019 (**FY2019**). This comprised strong reductions in Scope 1 and Scope 2 emissions, but an increase in travel-related emissions as a result of business travel requirements between New Zealand and Australia.
- Introduced an environment risk screening tool in the credit decisioning process to understand the sustainability of larger business and rural borrowers by reference to environmental, climate, reputational and regulatory factors (and mitigating actions being employed by borrowers).
- Undertook Australian and New Zealand Standard Industrial Classification (**ANZSIC**) code analysis to understand Heartland's exposure to high emitting industries or industries subject to a heightened degree of transitional risk as a result of climate factors. Heartland has a low exposure to customers in those industries.
- More than doubled lending to new generation vehicles through the Motor Finance portfolio, from 5% of all lending in FY2022 to 11% in FY2023. The increase was supported by the launch of a green vehicle rate in December 2022, and a guaranteed future value product across the Opel range, including two dedicated electric vehicles.

People

- Through its Manawa Ako internship programme, Heartland Bank welcomed 25 Māori and Pasifika interns to Heartland Bank in December 2022. More than 110 rangatahi (young people) have participated in the programme since inception in 2017.
- Heartland Bank maintained accreditation for the Rainbow Tick, as a Hearing Accredited Workplace, and Living Wage Employer.
- More than $710,000 provided to community groups and organisations by the Heartland Trust, in the areas of education, arts and culture, and wellbeing. The Heartland Trust is Heartland's registered charitable trust which is independent from, but closely supported by Heartland.
- Heartland Bank's products recognised as providing exceptional value for customers through Canstar New Zealand awards for Savings Bank of the Year and Outstanding Value Home Lender.

Financial wellbeing

- Supported more than 48,000 people in New Zealand and Australia to live a more comfortable retirement by releasing equity from their homes with a reverse mortgage.
- Heartland Bank continued to offer the Heartland Extend product to consumer customers, supporting customers in arrears to make their existing loan repayments more manageable.
- Development of new features and automation in Heartland Bank's mobile app and some online application forms to enable customers to control their own finances in their own time, without needing to speak with someone.

Final dividend

Heartland is pleased to declare a FY2023 final dividend of 6.0 cps, taking the FY2023 total dividend to 11.5 cps, up 0.5 cps on FY2022. Heartland's final dividend yield of 9.3%[30] compares with 7.1%[31] in FY2022.

The final dividend will be paid on Wednesday 20 September 2023 (**Payment Date**) to shareholders on the company's register as at 5.00pm NZST on Wednesday 6 September 2023 (**Record Date**) and will be fully imputed.

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[30] FY2023 total fully imputed dividends divided by the closing share price as at 25 August 2023 of $1.72.
[31] FY2022 total fully imputed dividends divided by the closing share price as at 19 August 2022 of $2.16.

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.[32] The DRP offer document and participation form is available on Heartland's website at heartlandgroup.info/investor-information/dividends.

Looking forward

Heartland's result in FY2023 is pleasing amidst a challenging economic background in New Zealand and Australia. Portfolio performance demonstrated the resilience of Heartland's products and 'best or only' strategy.

Heartland's strength is in its track record of strong growth in core lending portfolios. The business as usual growth focus in FY2024 will be on Reverse Mortgages (New Zealand and Australia), Motor Finance, Asset Finance and Livestock Finance (New Zealand and Australia). Growth will be supported by increased digitalisation and automation, and leveraging the demographic-driven demand being experienced in Reverse Mortgages.

Key to Heartland's expansion in Australia is obtaining an ADI licence. Heartland intends to do this through the acquisition of Challenger Bank, which remains subject to regulatory approvals. Heartland's desire is to complete the acquisition during the 2023 calendar year, after which its focus will be on integration and leveraging its common distribution channels in New Zealand to expand into Australia.

Heartland's NIM outlook is stable with repayment and replacement of lower margin Motor Finance and Asset Finance loans. The growth mix will continue to influence margin, causing acceptable contraction offset by corresponding growth.

Underpinning everything is Heartland's ambition to achieve an underlying CTI ratio of less than 35% by FY2028. This requires change and will take time. Initiatives are underway to increase customer self-service, reduce telephony and increase automation.

Through a continued focus on the execution of Heartland's strategic vision and achieving its underlying CTI ratio ambition, Heartland's ambition is to double underlying NPAT within five years – continuing Heartland's track record of income growth. Since 2012, Heartland's NPAT has more than tripled from $23.6 million at 30 June 2012.

Heartland expects NPAT for FY2024 to be within the guidance range of $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, which remains subject to RBNZ and APRA approval. As the acquisition nears completion, guidance will be updated to reflect the impact of Challenger Bank becoming part of Heartland.

– ENDS –

[32] 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 person(s) who authorised this announcement:

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About Heartland

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. In October 2022, Heartland announced its intention to purchase Challenger Bank, a digital bank based in Melbourne, Australia, subject to obtaining the requisite regulatory approvals.

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