GROWTH.

Interim Report 2018

HEARTLAND BANK

Contents

As a registered bank, Heartland Bank Limited (**Heartland**) is required to prepare quarterly Disclosure Statements. Heartland's interim financial statements for the six months ended 31 December 2017 (reporting period) are contained in this Disclosure Statement.

CONTINUED GROWTH

FOR HEARTLAND FOR THE SIX MONTHS TO 31 DECEMBER 2017

Profitability improved, driven by asset growth across key divisions.

Our strategic focus on key growth areas and digital channels, including business and personal lending as well as our Australian operation, has resulted in growth in these sectors.

Our clear strategic direction is rewarding shareholders with profitability and shareholder returns, and we are confident that these will continue into the second half of the 2018 financial year.

Te tupuranga tonutanga o Heartland mō ngā marama e ono, atu ki te 31 o Hakihea 2017.

Kua piki ake te painga o te tupu o ngā nama, ā, he mea hāpai tēnei e te whanaketanga tonutanga o ā mātou rawa, puta noa i ngā wehenga e kīia ana e mātou, he wehenga matua.

Ko ngā wāhanga matua i āta arotahitia ake e mātou i roto i tā mātou rautaki ko te āhuatanga ki ngā huarahi mamati, pēnei i te wāhi ki ngā tukunga pūtea ā-pakihi, ā-whaiaro anō hoki, ngā whakahaerenga i Ahitereiria, katoa ēnei e noho nei hei take i whanake ake ai ēnei wāhanga o te uepū.

Ko te huarahi mahea o tā mātou rautaki, kei te huarahi o te whakawhiwhi i te hunga whai pānga ki ētahi anō painga ā-pūtea me ētahi anō whakawhiwhinga e tika ana mā te hunga whai pānga, ā, e māia ana mātou ki te kī, ka pēnei tonu mātou ā ahu atu ki tērā haurua tau rā o te tau pūtea 2018.

We are very pleased to report another strong result for the first six months of the 2018 financial year. Profitability once again increased with Heartland achieving a net profit after tax of $31.1 million, an increase of seven percent from the previous corresponding reporting period[1].

Geoffrey Ricketts
Chair of the Board

Jeff Greenslade
Chief Executive Officer

The drivers of this growth came from our Personal, Reverse Mortgage, Motor and Business divisions. A focus for the half year was the on-going development of our online offering for small-to-medium enterprise (SME) business loans, *Open for Business*, which grew by 45 percent from the previous corresponding reporting period.

Performance

Household (Consumer, Reverse Mortgages and Residential Mortgages)
Net operating income for our Household division was $50.3 million, an increase of $4.8 million (10 percent) from the previous corresponding reporting period.

Strong receivables growth was achieved in motor vehicle loans and personal lending through the Harmoney platform both in New Zealand and Australia.

Particularly strong growth of $58.2 million excluding foreign exchange (11 percent or 22 percent annualised) was achieved in our Australian reverse mortgage business, Heartland Seniors Finance. This was driven by continued broadening of our broker distribution network – now with 330 accredited brokers across Australia – and favourable market conditions. Australia has a longer history and larger market with the reverse mortgage product, which we have successfully leveraged resulting in a 16.8 percent market share (as at 30 September 2017). Heartland Seniors Finance also accounted for 66.8 percent of total Australia reverse mortgage market growth in the 12 months to 30 September 2017.

Net receivables in the New Zealand reverse mortgage book grew by $24.3 million (6 percent or 12 percent annualised) during the current reporting period.

Business
Net operating income for the Business division was $26.3 million, an increase of $3.2 million (14 percent) from the previous corresponding reporting period. This growth was achieved through our continued focus on the SME business market. In particular, extending our reach through intermediaries and the *Open for Business* online origination platform, which is dedicated to supporting the working capital needs of SME owners and which grew by 45 percent from the previous corresponding reporting period.

Rural
Net operating income was $16.3 million, an increase of $2.4 million (17 percent) from the previous corresponding reporting period.

While receivables growth in the Rural division was flat, this is not unusual as growth in Rural receivables is dependent on external environmental factors.

Our Rural team is focused on growth and generating opportunities via intermediation. Our attractive livestock lending proposition and the speed of our online finance offering, coupled with the fact we lend on stock alone, provides good opportunities for growth.

Strategy

Our strategy remains unchanged:
- Focus on the areas where we can offer 'best or only' products;
- Take a leading position in niche markets and avoid competition with the mainstream banks;
- Use digital channels and intermediaries to help us reach more customers; and
- Create opportunities to originate customer relationships online and introduce automation behind the scenes.

We continue to set ourselves ambitious targets. Our focus for the remaining six months of the 2018 financial year is to:
- continue to grow *Open for Business* in New Zealand while introducing it to the Australian market;
- increase lending through peer-to-peer lender Harmoney (both in New Zealand and across the Tasman); and
- launch a mobile app for depositors, which is the first stage of our planned end-to-end, fully automated online deposit platform.

Our focus on identifying niche markets where we can achieve attractive margins has continued to serve us well resulting in a net interest margin of 4.44 percent. This is a significant positive point of difference between Heartland and other banks.

This is important as the markets where we are experiencing growth (motor, personal lending and *Open for Business*), tend to generate higher levels of non-performing-loans than the residential mortgage books of major banks and indeed our own reverse mortgage business. The higher net interest margin we achieve more than compensates for this risk and results in a better balance.

[1] Previous corresponding reporting period refers to the six months ended 31 December 2016.

Interim Dividend

3.5c

per share

Payment date: 3 April 2018

A feature of these core markets, particularly motor vehicle loans and reverse mortgages, is that they are well-seasoned with history going back before the Global Financial Crisis. This data allows us to analyse performance through downturns and to be able to gauge expected losses with greater certainty.

Australia

As already mentioned, our reverse mortgage business in Australia continues to grow strongly. Off the back of this success, we are exploring opportunities to expand our product offering across the Tasman, including participating in the SME lending market through our relationship with Spotcap and launching our successful *Open for Business* platform into the Australian SME business market. We are also accessing the Australian personal lending market through Harmoney's peer-to-peer platform.

Heartland's people

We are a small bank unencumbered by legacy infrastructure and our people are the basis of our success.

We are committed to making Heartland a more diverse and inclusive place of work and have begun a number of initiatives with an initial focus on gender and ethnic diversity.

In November 2017, CEO Jeff Greenslade joined Champions for Change, a group of New Zealand Chairs and CEOs who are committed to aising the value of diversity and inclusion within their organisations, peers and the wider business community.

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

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

In December and January we ran a successful internship programme with a group of Māori students from the InZone Education Foundation, and we have plans to offer additional internships at the end of 2018.

Looking forward

Underlying asset growth is expected to continue, with strong Household, Business and Rural volumes projected through the expansion of customer reach through digital and intermediary channels, and expansion in Australia.

We expect the net profit after tax for the year ending 30 June 2018 to be at the upper end of the previously advised range of $65.0 million to $68.0 million.

We would like to take this opportunity to thank Heartland's staff for their efforts and our shareholders for their continued support.

Geoffrey Ricketts
Chair of the Board

Jeff Greenslade
Chief Executive Officer

E koa mārika ana mātou i te āheinga ō mātou ki te pūrongo i ngā hua pārekareka mō ngā marama e ono o te tau pūtea, 2018. I whanake ake anō ngā painga ā-rawa i tā Heartland eke ki tētahi tahua āpitihanga, i muri mai i te tāke, o te $31.1 miriona, he pikinga tērā mā te whitu paihēneti, tēnā i ngā wāhanga māwhitiwhiti ā-tau i mua tata atu[1].

Geoffrey Ricketts
Tiamana

Jeff Greenslade
Pou Whakahaere

Ko ngā kaitautoko o ēnei whakawhanaketanga, ko ngā wehenga o Mōkete Whaiaro, Mōkete Tauaro, Ā-Waka, Ā-Pakihi anō hoki. Ko tētahi atu arotahitanga o te haurua tau ko te whanaketanga tonutanga o ngā tuaritanga huarahi mamati mō ngā Moni Taurewa Ā-Pakihi Iti, *Open for Business*, ko ia tērā i whanake mā te 45 paihēneti, tēnā i ngā wāhanga māwhitiwhiti ā-tau i mua tata atu.

Ngā Mahinga

Whare (Kiritaki, Mōkete Tauaro, me ngā Mōkete Whare)

Ko ngā pūtea, i muri o te utu tāke, mō te wāhi ki ō mātou whare, ko te $50.3 miriona, he pikinga tērā o te $4.8 million (10 paihēneti) nō ngā tau māwhitiwhiti kua pūrongotia i mua.

Inā noa atu ngā whanaketanga o te moni kikokore, i kitea i roto i ngā Moni Taurewa Waka, Whaiaro, me ngā pūtea tuku i te pae o Harmoney, i Aotearoa, i Ahitereiria anō hoki.

Inā hoki, i rangona nuitia te whanaketanga $58.2 miriona (11 paihēneti, 22 paihēneti rānei ā-tau) i ā mātou Mōkete Tauaro Pakihi i Ahitereiria, i Heartland Seniors Finance. He hua tēnei nō te kaha hōrapa o te whatunga kaihoko takawaenga – ā, ināianei tērā ētahi 330 kaihoko takawaenga ōkawa nei, puta noa i Ahitereiria – he āhuatanga ā-mākete papai tēnei. He roa kē atu te hītori, he nui kē noa atu hoki te ātea mākete o Ahitereira ki ngā hanganga mōkete tauaro, tērā rā kua whakamahia e mātou, i eke rā ana hea ā-mākete nei mā te 16.8 paihēneti (mai i te 30 Mahuru, 2017). I pā hoki ki a Heartland Seniors Finance he 16.8 paihēneti, e ai ki te tapeke whanaketanga ā-mākete i ana marama 12, mai i te 30 o Mahuru, 2017.

I whanake ngā rawa te moni kikokore, i muri o te utu tāke, i roto i ngā pukapuka mōkete tauaro a Aotearoa mā te $24.3 million (e 6 paihēneti, 12 paihēneti rānei ā-tau) i te wā o tēnei wāhanga whakapūrongo.

Pakihi

Ko ngā utu, i muri o te utu tāke, i whakawhiwhia mō ngā whakahaerenga ki ngā wehenga Pakihi, ko te $26.3 miriona, he pikinga tērā mā te $3.2 miriona (14 paihēneti) nō ngā tau māwhitiwhiti kua pūrongotia i mua. He mea tautoko ēnei whakatutukitanga e tā mātou arotahi tonu ki ngā uepū, mākete pakihi iti-ki-te-pakihi-wawaenga. Inā hoki, i taea ai ērā, i ā mātou takawaenga me ō mātou pae mamati, Open for Business, a ia e tapatahi nei ki te tautoko i ngā pūtea mahi a te hunga SME, i whanake ērā mā te 45 paihēneti, nō ngā tau māwhitiwhiti kua pūrongotia i mua.

Taiwhenua

Ko ngā utu i whakawhiwhia mō ngā whakahaerenga, i muri o te utu tāke, he $16.3 miriona, he pikinga tērā mā te $2.4 miriona (17 paihēneti) nō ngā tau māwhitiwhiti kua pūrongotia i mua.

Ahakoa i papatahi ngā whanaketanga a te moni kikokore i te wehenga taiwhenua, ehara tērā i te mea hou, inarā ko ngā whanaketanga i te ao utu taiwhenua, i muri o te utu tāke, kei te āhua tonu o ngā ākinga taiao.

E arotahi ana tō mātou kāhui Taiwhenua ki te whakapakari i ā mātou pukapuka me te kimi huarahi mā roto mai i a mātou takawaenga. Ko ngā tono hirahira e tukuna ai he tahua hoko kararehe ki te tangata, me te hohoro o ngā tukanga tuku pūtea mamati, me te āpitihanga atu hoki ki ngā pūtea tuku mō te kararehe kau noa, katoa ēnei he huarahi pai mō te whakawhanaketanga.

Rautaki

Ko tā mātou rautaki, kāore tonu i rerekē ake:

- Kia arotahi tonu ki ngā wāhi e taea e mātou te hoatu i ngā hanga 'pai, māmore anake rānei'.
- Kia tū ai mātou ki ngā tūranga rangatira o ō mātou mākete motuhake, kei uru ki te whakataetae ki ngā pēke auraki.
- Ki te whakamahi i ngā hangarau ā-tuihono, me ngā takawaenga hoki e toro ai mātou ki ētahi atu anō kiritaki.
- Ki te waihanga huarahi hou e taea ai toro atu, ā-mamati nei, ki ētahi atu kiritaki, te kōkiri hoki i ētahi huarahi ā-rorohiko e māmā ake ai ngā mahinga tāngata.

He rite tonu tā mātou waihanga whāinga whakakipakipa. Ko te arotahinga mō ngā marama e ono o FY18, e toe mai nei, ko te:

- Whakawhanaketia tonutia te *Open for Business* ki Aotearoa i a mātou ka whakatūtaki tonu i te mea nei ki ngā mākete o Ahitereiria;
- Whakapiki i te tukunga pūtea, mā tētati tikanga hoa mahi-ki-te-hoa mahi, mā te kaupapa tuku pūtea a Harmoney (i Aotearoa, i tērā atu taha hoki o Te Moana-tāpokopoko)
- Whakarewa i tētahi pūmanawa tautono mō ngā kaitāpae, te wāhanga tuatahi tonu o tā mātou rautaki e rorohiko katoa ai ngā tukanga tāpae pūtea.

[1] Ko taua wāhanga māwhitiwhiti ā-tau, ko ngā marama e ono ki 31 Hakihea 2016.

Tau e wehea ana o te wā nei

3.5c

ia tohatoha

Rā utu: 3 Paengawhāwhā 2018

E arotahi ana mātou ki te tautuhi mākete motuhake e taea ai e mātou te minamina i ētahi hua ā-pūtea, tēnei waiaro hoki, he waiaro i eke ai te paenga haumoni more ki te 4.44 paihēneti. He nui tēnei, he rerekētanga pai hoki tēnei i waenga i a mātou me ētahi atu pēke.

He nui tēnei, nā te mea kei ngā mākete e kitea nei e mātou kei te whanaketanga (ā-waka, moni tuku whaiaro, me tērā o Open for Business), i te nuinga o te wā he nui kē atu te oreoretanga i reira o ngā moni taurewa okioki tēnā i wā ngā pukapuka mōkete ā-whare o ngā pēke matua, me wā mātou tonu o ngā mōkete tauaro, i mahi ai. He nui kē atu te wikitōria, e ai ki te paenga haumoni more, tēnā i tā mātou kē i hoatu ai mō tēnei mōreareatanga, ahakoa tērā, he painga pūtea tonu te otinga atu. E kī ana ā mātou raraunga, he māmā ake te matakite i te mākete nei e ai ki ana hinganga.

Ahitereiria

Tērā, kua kōrerotia kētia, ko ā mātou pakihi mōkete tauaro, i Ahitereiria, kei te whanake kaha tonu. Nā ērā angitutanga i taea ai e mātou te tirotiro ki ētahi atu huarahi e hōrapa ai te tuaritia o ā mātou hanga ki Te Moana-tāpokopoko, pēnei i te whai wāhitanga atu ki ngā mākete tuku SME mā roto mai i ā mātou hononga ki a Spotcap, me te whakarewanga ake o tā mātou kaupapa, o Open for Business ki te mākete pakihi iti o Ahitereiria. Kei te whai wāhi hoki mātou ki te mākete tuku whaiaro mā roto mai i te tūāpapa hoa mahi-ki-te-hoa mahi a Harmoney's.

Ngā Tāngata o Heartland

He pēke iti mātou e noho herekore nei i te mārō o ō mātou whakapapa, ko te tangata te tūāpapa o ō mātou angitutanga.

E tapatahi ana mātou kia iwi rau ake a Heartland, kia wairua marae hoki ia, ā, kua rewa kē ētahi kaupapa, ko tōna oroko arotahitanga ko te iratanga, me te iwi rautanga.

I te Whiringa-ā-rangi o te tau 2017, i whai wāhi ai a Pou Whakahaere Jeff Greenslade ki Champions for Change, he kāhui Tiamana, Pou Whakahaere hoki tēnei o Aotearoa e ū ana ki te whakapiki i te uarā o te iwi rautanga, me te whai wāhitanga atu a tēnā, a tēnā ki ō rātou pakihi, ki ō rātou hoa mahi, me te hapori whānau hoki o te pakihi.

I te wāhanga ā-ira tangata, kua nui ā mātou whanaketanga i roto i ngā tau. Ko te Kāhui Whakahaere Rautaki a te Pou Whakahaere kua hauruatia, he 50/50 ira tāne/ ira wahine, ā, he 40 paihēneti o te Kāhui Rangatira, he wahine. Ko te arotahitanga mō ngā marama e ono kei mua i te aroaro, ko te kimi huarahi ki te tō mai i te wahine rangatira ki te pupuri hoki i a ia, he whakapakari hoki i te tauritenga ā-ira tangata i roto i te pakihi katoa.

He whāinga hoki tō mātou ki te whakapiki ake i te whakatairangatanga o te Māoritanga, me te tūmanako hoki, ā tōna wā, ka noho mai ko mātou te kōwhiringa matua mā ngā māhuri tōtara Māori o āpōpō.

I te Hakihea, me te Kohitātea, i whakahaerehia e mātou he hōtaka tūranga tāepa mā ētahi tauira Māori nō te InZone Education Foundation, ā, kua whakamaheretia ētahi āpitihanga tūranga tāepa e mātou mō te pito whakamutunga o te tau 2018.

Te Titiro Whakamua

Ka tupu huna tonu te rawa i te tautokona kahatia o te ao Ā-Whare, Ā-Pakihi, Ā-Taiwhenua hoki e te horonga kiritaki i ngā āheinga ā-tuihono nei, me ngā toronga hoki a ā mātou takawaenga, me te hōrapatanga hoki ki Ahitereiria.

Ko te whakapae ka eke ngā whakawhiwhinga kikokiko, i muri mai o tāke mō te tau, tērā ka mutu hei te 30 o Pipiri, 2018, ka eke ki te takiwā whakarunga o tērā i āta whakahautia mai, o te $65.0 miriona, ki te $68.0 miriona.

Hei konei, i tēnei āheinga tonu, e pīrangi ana māua ki te mihi ki ngā kaimahi o Heartland i ana whatinga kō, me te hunga whai pānga mai anō hoki mō te auau tonu o te tautoko mai.

Geoffrey Ricketts
Tiamana

Jeff Greenslade
Pou Whakahaere

2018 Half Year Highlights

Net Finance Receivables ($m)

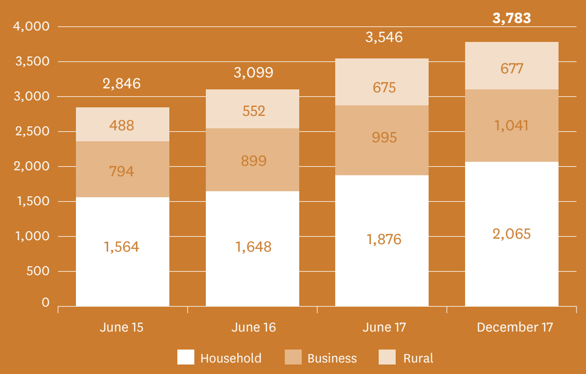
Strong growth in Personal, Motor, Reverse Mortgages and Business lending.

Australia reverse mortgages up 22% (annualised excluding foreign currency translation gains).

13%

Net Finance Receivables (annualised)

Net Finance Receivables ($m)



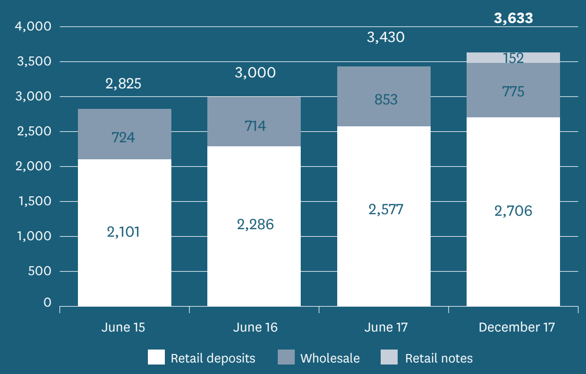
Growing and diversified funding base

Inaugural issue of fixed notes in New Zealand debt capital markets for $150 million in September 2017.

10%

Retail deposits growth (annualised)

Growing and diversified funding base

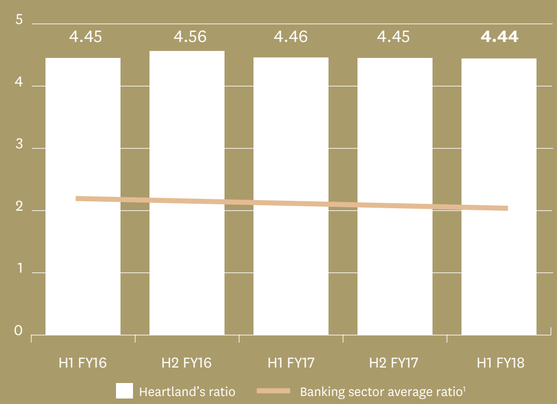


Net Interest Margin

4.44%

Net Interest Margin more than double the banking sector average at 4.44%.

Net Interest Margin (%)



Delivering shareholder value

47%

Total shareholder return (TSR)[2] of 47% for the 12 months ending 31 December 2017.

120%

TSR of 120% for the three years to 31 December 2017.

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

[2] Total shareholder return means share price appreciation plus dividends received. TSR has been calculated including the benefit of imputation credits.

Disrupting business lending, one SME at a time

Ministry of Business Innovation and Employment (MBIE) research indicates there are some 500,000 small-to-medium enterprises (SMEs) in New Zealand, 70 percent of which are sole traders.

These owners are typically working 'in' the business during the day generating revenue and working 'on' the business in the evenings.

While the SMEs operate in different sectors, they face similar challenges – they are time poor; they have capital growth needs; and the big banks generally want to lend them money secured against a residential property. Heartland's *Open for Business* online lending platform responds to these factors:

- Business owners can apply for working capital online without having to make an appointment and take time 'off the tools' or away from their desk to attend a meeting at the bank.
- They can apply online for an unsecured business loan up to $75,000 (or a partially secured business loan up to $250,000).
- The loans are not tied to a customer's residential property.

This last part is important. The traditional route for SMEs to secure business lending is to approach the bank they hold their residential mortgage with and seek to borrow money against the equity in their residential property, usually the family home. However, our observations suggest there is a market of SME owners who value speed and certainty over lower cost lending solutions which tethers the family home to the success of the business.

At Heartland, we're open for business. Let's talk.

O4B OPEN FOR BUSINESS

Open for Business – did you know?

- With the *Open for Business* platform, business owners can apply for working capital online and receive a decision in seconds.
- Customers can apply for an unsecured business loan up to $75,000 or a partially secured business loan up to $250,000.
- Heartland is a specialist lender which means customers don't need to change their transactional bank to work with us.
- We don't tether the business loan to the customer's residential property.
- We don't sting customers with early repayment fees and penalties.
- We offer flexible payment schedules to suit each customers' business e.g. to fit around seasonal peaks.
- From capital growth to working capital to cashflow to business debt consolidation, Heartland can help with all kinds of business finance.

Financial Commentary

Increase in profitability was driven by growth in net finance receivables, particularly in Household and Business lending. Overall net finance receivables grew by $237.2 million (7 percent or 13 percent annualised) to $3.8 billion during the period.

Net operating income

Net Operating Income (NOI) was $93.9 million, up $10.9 million or 13 percent, compared to the previous corresponding reporting period. The increase in NOI was primarily attributable to the growth of net finance receivables.

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

Costs

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

Impairments

Impaired asset expense increased by $3.5 million to $10.4 million for the six months ended 31 December 2017.

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

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

Impairment expense in the Business division increased $0.8 million compared to the previous corresponding reporting period. The increase was largely attributable to a $1.2 million insurance recovery in the previous corresponding reporting period.

Impairment expense in the Rural division increased $1.0 million compared to a very low impairment in the previous corresponding reporting period.

Net impaired and past due loans over 90 days as a percentage of net receivables was 1.2 percent for the six months to 31 December 2017, which is comparable to the 1.1 percent in the previous corresponding reporting period.

Business performance

Household (Consumer, Reverse Mortgages and Residential Mortgages)

Household net operating income was $50.3 million, an increase of $4.8 million or 10 percent from the previous corresponding reporting period. During the six months, net finance receivables for the Household division increased by $190.0 million to $2.1 billion as at 31 December 2017.

Net operating income from the Consumer division (which includes motor vehicle loans, personal loans and lending through the Harmoney platform) was $31.5 million, an increase of $1.1 million or 4 percent from the previous corresponding reporting period. Consumer net finance receivables grew $86.8 million (9 percent or 19 percent annualised) to $1.0 billion as at 31 December 2017. The strong growth in net finance receivables was not fully reflected in net operating income due to a large proportion of the new business coming from lower risk, lower margin loans.

Motor vehicle net finance receivables continued to grow strongly, increasing by $62.0 million (8 percent or 15 percent annualised) to $886.3 million as at 31 December 2017.

Personal lending also grew strongly with net finance receivables for personal loans and Harmoney increasing by $24.8 million (26 percent or 52 percent annualised) to $119.6 million as at 31 December 2017.

Net operating income from Reverse Mortgages was $18.0 million, an increase of $3.7 million or 26 percent from the previous corresponding reporting period. Particularly strong growth was experienced in Australia with net finance receivables growing by $82.5 million (including foreign currency translation gains of $24.3 million) to $598.0 million as at 31 December 2017.

Growth was 11 percent or 22 percent annualised, excluding foreign currency translation gains. This was driven by continued broadening of the broker distribution network and favourable market conditions.

Net finance receivables in New Zealand Reverse Mortgages grew by $24.3 million (6 percent or 12 percent annualised) to $429.6 millionas at 31 December 2017.

Business

Business net operating income was $26.3 million, an increase of $3.2 million or 14 percent from the previous corresponding reporting period. The increase in net operating income was driven by growth in net finance receivables, which increased by $46.0 million (5 percent or 9 percent annualised) to $1.0 billion as at 31 December 2017. This growth was achieved through continued focus on the SME business market, extending our reach through intermediaries and Heartland's *Open for Business* online origination platform which is dedicated to supporting the working capital needs of SME owners and which grew by 45 percent.

Rural

Rural net operating income was $16.3 million, an increase of $2.4 million or 17 percent from the previous corresponding reporting period. Net finance receivables for the Rural division increased by $1.2 million (0.2 percent or 0.4 percent annualised) to $676.6 million as at 31 December 2017, following a strong period of growth in the preceding six months.

Funding and liquidity

The six months ending 31 December 2017 saw the Heartland balance sheet grow and diversify through increased retail deposits and a successful fixed rate notes offer.

Retail deposits grew $129.3 million (5 percent or 10 percent annualised) during the six month period, to $2.7 billion as at 31 December 2017. The market continues to respond well to Heartland's term deposit and call account offerings which give customers competitive interest rates and unlimited on call access to their money.

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

Rights issue

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

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

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

Net assets

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

Capital management

The regulatory capital ratio as at 31 December 2017 was 14.76% up from 13.56% as at 30 June 2017. During the reporting period, Heartland completed a $59 million rights issue to support continued growth in its loan portfolio and maintain a strong balance sheet.

As a result of the elevated capital ratio, Return on Equity (ROE) reduced from 11.6% for the year ended 30 June 2017 to 10.8% for the six months ended 31 December 2017.

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

A 2018 interim dividend of 3.5 cents per share was declared at the release of the 2018 interim results. The interim dividend will be paid on 3 April 2018 to shareholders on the company's register as at 5.00pm on 16 March 2018 and will be fully imputed.

The Dividend Reinvestment Plan (DRP) will apply to the interim dividend with a 2.5% discount[3]. Shareholders who wished to participate in the DRP needed to elect to do so by 16 March 2018.

Change in Profitability

Six months ended 31 December 2016 net profit after tax	**$29.1m**	
Increased net operating income	$10.9m	Net finance receivables increased 7 percent (or 13 percent annualised) resulting in resulting in a 13% increase in net operating income.
Increased operating costs	($4.3)m	Increase in operating expenses due to increase in net receivables combined with depreciation of new core banking system.
Increased impairment expense	($3.5)m	Increase in impairment expenses due to growth of net receivables, some operational issues following the introduction of Heartland's new banking system, combined with an insurance recovery in the previous corresponding reporting period.
Increased income tax expense	($1.1)m	Increase tax expense due to improved profitability.
Six months ended 31 December 2017 net profit after tax	**$31.1m**	

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

DISCLOSURE STATEMENT

FOR THE SIX MONTHS TO 31 DECEMBER 2017

As a registered bank, Heartland is required to prepare quarterly Disclosure Statements. Heartland's interim financial statements for the six months ended 31 December 2017 (reporting period) are contained in this Disclosure Statement.

Contents

Disclosure Statement

GENERAL INFORMATION

This Disclosure Statement has been issued by Heartland Bank Limited (the bank) and its subsidiaries (the banking group) for the six months ended 31 December 2017 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the Order). The financial statements of the bank for the six months ended 31 December 2017 form part of, and should be read in conjunction with, this Disclosure Statement.

Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

The bank's address for service is Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland.

GUARANTEE ARRANGEMENTS

As at the date this Disclosure Statement was signed, no material obligations of the bank were guaranteed.

DIRECTORS

There have been no changes to the Board of Directors since the signing of the 30 June 2017 Disclosure Statement.

As at the date this Disclosure Statement was signed, the Directors of the bank are:

Ellen F Comerford
Jeffrey K Greenslade
Edward J Harvey
Bruce R Irvine
Graham R Kennedy
Christopher R Mace
Geoffrey T Ricketts
Vanessa C M Stoddart
Gregory R Tomlinson

CONDITIONS OF REGISTRATION

These conditions apply on and after 1 October 2016.

The registration of Heartland Bank Limited (the bank) as a registered bank is subject to the following conditions:

1. That—

   (a) the Total capital ratio of the banking group is not less than 8%;

   (b) the Tier 1 capital ratio of the banking group is not less than 6%;

   (c) the Common Equity Tier 1 capital ratio of the banking group is not less than 4.5%;

   (d) the Total capital of the banking group is not less than $30 million;

   (e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and

   (f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "Application requirements for capital recognition or repayment and notification requirements in respect of capital" (BS16) dated November 2015 in respect of regulatory capital instruments.

   For the purposes of this condition of registration,—

   the Total capital ratio, the Tier 1 capital ratio, the Common Equity Tier 1 capital ratio and Total capital must be calculated in accordance with the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

   an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8(2)(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

   a Tier 2 capital instrument is an instrument that meets the requirements of subsection 9(2)(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

1A. That—

   (a) the bank has an internal capital adequacy assessment process (ICAAP) that accords with the requirements set out in the document "Guidelines on a bank's internal capital adequacy assessment process (ICAAP)" (BS12) dated December 2007;

   (b) under its ICAAP the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015; and

   (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

1B. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

   (a) according to the following table, limit the aggregate distributions of the bank's earnings to the percentage limit to distributions that corresponds to the banking groups' buffer ratio:

Banking groups' buffer ratio	Percentage limit to distributions of the bank's earnings
0% – 0.625%	0%
>0.625% – 1.25%	20%
>1.25% – 1.875%	40%
>1.875% – 2.5%	60%

   (b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

   (c) have the capital plan approved by the Reserve Bank.

   For the purposes of this condition of registration,—

   "buffer ratio", "distributions", and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

CONDITIONS OF REGISTRATION (CONTINUED)

2. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

   In this condition of registration, the meaning of “material” is based on generally accepted accounting practice.

3. That the banking group’s insurance business is not greater than 1% of its total consolidated assets.

   For the purposes of this condition of registration, the banking group’s insurance business is the sum of the following amounts for entities in the banking group:

   (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and

   (b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

   In determining the total amount of the banking group’s insurance business—

   (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

   (b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

   For the purposes of this condition of registration,—

   “insurance business” means the undertaking or assumption of liability as an insurer under a contract of insurance:

   “insurer” and “contract of insurance” have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

4. That aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

Credit rating of the bank[1]	Connected exposure limit (% of the banking group’s Tier 1 capital)
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

   Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15% of the banking group’s Tier 1 capital.

   For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled “Connected exposures policy” (BS8) dated November 2015.

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

[1] This table uses the rating scales of Standard & Poor’s, Fitch Ratings and Moody’s Investor Service (Fitch Ratings' scale is identical to Standard & Poor’s).

CONDITIONS OF REGISTRATION (CONTINUED)

6. That the bank complies with the following corporate governance requirements:

   (a) the board of the bank must have at least five directors;

   (b) the majority of the board members must be non-executive directors;

   (c) at least half of the board members must be independent directors;

   (d) an alternate director,—

      (i) for a non-executive director must be non-executive; and

      (ii) for an independent director must be independent;

   (e) at least half of the independent directors of the bank must be ordinarily resident in New Zealand;

   (f) the chairperson of the board of the bank must be independent; and

   (g) the bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the bank).

   For the purposes of this condition of registration,—

   "independent,"—

   (a) in relation to a person other than a person to whom paragraph (b) applies, has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014; and

   (b) in relation to a person who is the chairperson of the board of the bank, means a person who—

      (i) meets the criteria for independence set out in section 10 except for those in paragraph 10(1)(a) in BS14; and

      (ii) does not raise any grounds of concern in relation to the person's independence that are communicated in writing to the bank by the Reserve Bank of New Zealand:

   "non-executive" has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014.

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:

   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

   (b) the Reserve Bank has advised that it has no objection to that appointment.

8. That a person must not be appointed as chairperson of the board of the bank unless:

   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

   (b) the Reserve Bank has advised that it has no objection to that appointment.

9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

   (a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;

   (b) the committee must have at least three members;

   (c) every member of the committee must be a non-executive director of the bank;

   (d) the majority of the members of the committee must be independent; and

   (e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

   For the purposes of this condition of registration, "independent" and "non-executive" have the same meanings as in condition of registration 6.

CONDITIONS OF REGISTRATION (CONTINUED)

10. That a substantial proportion of the bank's business is conducted in and from New Zealand.

11. That the banking group complies with the following quantitative requirements for liquidity-risk management:

    (a) the one-week mismatch ratio of the banking group is not less than zero percent at the end of each business day;

    (b) the one-month mismatch ratio of the banking group is not less than zero percent at the end of each business day; and

    (c) the one-year core funding ratio of the banking group is not less than 75 percent at the end of each business day.

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated July 2014 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated December 2011.

12. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:

    (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;

    (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;

    (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and

    (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

13. That no more than 10% of total assets may be beneficially owned by a SPV.

    For the purposes of this condition,—

    "total assets" means all assets of the banking group plus any assets held by any SPV that are not included in the banking group's assets:

    "SPV" means a person—

    (a) to whom any member of the banking group has sold, assigned, or otherwise transferred any asset;

    (b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and

    (c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the banking group under a covered bond:

    "covered bond" means a debt security issued by any member of the banking group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

14. That—

    (a) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:

        (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and

        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and

    (b) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:

        (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination;

        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and

        (iii) the Reserve Bank has given the bank a notice of non-objection to the significant acquisition or business combination.

    For the purposes of this condition of registration, "qualifying acquisition or business combination", "notification threshold" and "non-objection threshold" have the same meaning as in the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011.

CONDITIONS OF REGISTRATION (CONTINUED)

15. That the bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the bank can—

    (a) close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager—

        (i) all liabilities are frozen in full; and

        (ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;

    (b) apply a *de minimis* to relevant customer liability accounts;

    (c) apply a partial freeze to the customer liability account balances;

    (d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;

    (e) maintain a full freeze on liabilities not pre-positioned for Open Bank Resolution; and

    (f) reinstate customers' access to some or all of their residual frozen funds.

    For the purposes of this condition of registration, "de minimis", "partial freeze", "customer liability account", and "frozen and unfrozen funds" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

16. That the bank has an Implementation Plan that—

    (a) is up-to-date; and

    (b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS 17).

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

17. That the bank has a compendium of liabilities that—

    (a) at the product-class level lists all liabilities, indicating which are—

        (i) pre-positioned for Open Bank Resolution; and

        (ii) not pre-positioned for Open Bank Resolution;

    (b) is agreed to by the Reserve Bank; and

    (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

    For the purposes of this condition of registration, "compendium of liabilities", and "pre-positioned and non pre-positioned liabilities" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

18. That on an annual basis the bank tests all the component parts of its Open Bank Resolution solution that demonstrates the bank's prepositioning for Open Bank Resolution as specified in the bank's Implementation Plan.

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

19. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 60%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

20. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

21. That the bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

CONDITIONS OF REGISTRATION (CONTINUED)

In these conditions of registration,—

"banking group"—

means Heartland Bank Limited (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

"generally accepted accounting practice" has the same meaning as in section 8 of the Financial Reporting Act 2013.

In conditions of registration 19 to 21,—

"loan-to-valuation ratio", "non property-investment residential mortgage loan", "property-investment residential mortgage loan", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated October 2016:

"loan-to-valuation measurement period" means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of March 2017.

AUDITOR

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland

PENDING PROCEEDINGS OR ARBITRATION

There are no pending legal proceedings or arbitrations concerning any member of the banking group at the date of this Disclosure Statement that may have a material adverse effect on the bank or the banking group.

CREDIT RATINGS

As at the date of signing this Disclosure Statement, the bank's credit rating issued by Fitch Australia Pty Ltd (Fitch Ratings) was BBB stable. This BBB credit rating was issued on 14 October 2015 and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars. This BBB stable credit rating was affirmed by Fitch Ratings on 3 October 2017.

OTHER MATERIAL MATTERS

There are no material matters relating to the business or affairs of the bank or the banking group that are not contained elsewhere in this Disclosure Statement which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which the bank or any member of the banking group is the issuer.

DIRECTORS' STATEMENTS

Each Director of the bank states that he or she believes, after due enquiry, that:

1. As at the date on which this Disclosure Statement is signed:

   (a) the Disclosure Statement contains all the information that is required by the Order; and

   (b) the Disclosure Statement is not false or misleading.

2. During the six months ended 31 December 2017:

   (a) the bank complied with all Conditions of Registration;

   (b) credit exposures to connected persons were not contrary to the interests of the banking group; and

   (c) the bank had systems in place to monitor and control adequately material risks of the banking group, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

This Disclosure Statement is dated 20 February 2018 and has been signed by all of the Directors.

G. T. Ricketts (Chair – Board of Directors)

G. R. Kennedy

J. K. Greenslade

C. R. Mace

E. F. Comerford

V. C. M. Stoddart

E. J. Harvey

G. R. Tomlinson

B. R. Irvine

Interim Statement of Comprehensive Income

For the six months ended 31 December 2017

$000	Note	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Interest income	2	152,471	135,789	278,279
Interest expense	2	62,377	56,828	115,169
Net interest income		**90,094**	**78,961**	**163,110**
Operating lease income		3,082	3,688	6,989
Operating lease expenses		2,132	2,728	5,195
Net operating lease income		**950**	**960**	**1,794**
Lending and credit fee income		1,202	1,534	3,005
Other income		1,663	1,567	3,343
Net operating income		**93,909**	**83,022**	**171,252**
Selling and administration expenses	3	40,248	35,966	71,684
Profit before impaired asset expense and income tax		**53,661**	**47,056**	**99,568**
Impaired asset expense	4	10,416	6,892	15,015
Profit before income tax		**43,245**	**40,164**	**84,553**
Income tax expense		12,159	11,072	23,745
Profit for the period		**31,086**	**29,092**	**60,808**
Other comprehensive income				
Items that are or may be reclassified subsequently to profit or loss:				
Effective portion of changes in fair value of cash flow hedges, net of income tax		(492)	1,290	1,108
Movement in available for sale reserve, net of income tax		1,034	(1,736)	(353)
Movement in foreign currency translation reserve, net of income tax		2,510	(279)	761
Items that will not be reclassified to profit or loss:				
Movement in defined benefit reserve, net of income tax		231	(84)	(84)
Other comprehensive income / (loss) for the period, net of income tax		**3,283**	**(809)**	**1,432**
Total comprehensive income for the period		**34,369**	**28,283**	**62,240**
Earnings per share from continuing operations				
Basic earnings per share	5	6c	6c	12c
Diluted earnings per share	5	6c	6c	12c

Total comprehensive income for the period is attributable to owners of the bank.

The notes on pages 26 to 49 are an integral part of these interim financial statements.

Interim Statement of Changes in Equity

For the six months ended 31 December 2017

$000	Note	Share capital	Treasury shares reserve	Employee benefits reserve	Foreign currency translation reserve	Available for sale reserve	Defined benefit reserve	Hedging reserve	Retained earnings	Total equity
Unaudited – December 2017										
Balance at 1 July 2017		**473,128**	**(2,612)**	**3,118**	**(1,055)**	**609**	**(83)**	**(1,152)**	**97,642**	**569,595**
Total comprehensive income for the period										
Profit for the period		–	–	–	–	–	–	–	31,086	31,086
Other comprehensive income / (loss), net of income tax		–	–	–	2,510	1,034	231	(492)	–	3,283
Total comprehensive income for the period		**–**	**–**	**–**	**2,510**	**1,034**	**231**	**(492)**	**31,086**	**34,369**
Contributions by and distributions to owners										
Dividends paid	8	–	–	–	–	–	–	–	(28,393)	(28,393)
Dividend reinvestment plan	8	7,495	–	–	–	–	–	–	–	7,495
Issue of share capital	8	59,225	–	–	–	–	–	–	–	59,225
Transaction costs associated with capital raising		(681)	–	–	–	–	–	–	–	(681)
Share based payments		–	–	216	–	–	–	–	–	216
Shares vested		709	–	(1,196)	–	–	–	–	–	(487)
Total transactions with owners		**66,748**	**–**	**(980)**	**–**	**–**	**–**	**–**	**(28,393)**	**37,375**
Balance at 31 December 2017		**539,876**	**(2,612)**	**2,138**	**1,455**	**1,643**	**148**	**(1,644)**	**100,335**	**641,339**
Unaudited – December 2016										
Balance at 1 July 2016		**421,377**	**(2,612)**	**3,878**	**(1,816)**	**962**	**1**	**(2,260)**	**78,811**	**498,341**
Total comprehensive income for the period										
Profit for the period		–	–	–	–	–	–	–	29,092	29,092
Other comprehensive (loss) / income, net of income tax		–	–	–	(279)	(1,736)	(84)	1,290	–	(809)
Total comprehensive income for the period		**–**	**–**	**–**	**(279)**	**(1,736)**	**(84)**	**1,290**	**29,092**	**28,283**
Contributions by and distributions to owners										
Dividends paid	8	–	–	–	–	–	–	–	(24,041)	(24,041)
Dividend reinvestment plan	8	5,277	–	–	–	–	–	–	–	5,277
Issue of share capital	8	20,000	–	–	–	–	–	–	–	20,000
Transaction costs associated with capital raising		(411)	–	–	–	–	–	–	–	(411)
Share based payments		–	–	553	–	–	–	–	–	553
Shares vested		1,801	–	(1,801)	–	–	–	–	–	–
Total transactions with owners		**26,667**	**–**	**(1,248)**	**–**	**–**	**–**	**–**	**(24,041)**	**1,378**
Balance at 31 December 2016		**448,044**	**(2,612)**	**2,630**	**(2,095)**	**(774)**	**(83)**	**(970)**	**83,862**	**528,002**

The notes on pages 26 to 49 are an integral part of these interim financial statements.

Interim Statement of Changes in Equity (continued)

For the six months ended 31 December 2017

$000	Note	Share capital	Treasury shares reserve	Employee benefits reserve	Foreign currency translation reserve	Available for sale reserve	Defined benefit reserve	Hedging reserve	Retained earnings	Total equity
Audited – June 2017										
Balance at 1 July 2016		**421,377**	**(2,612)**	**3,878**	**(1,816)**	**962**	**1**	**(2,260)**	**78,811**	**498,341**
Total comprehensive income for the year										
Profit for the year		–	–	–	–	–	–	–	60,808	60,808
Other comprehensive income / (loss), net of income tax		–	–	–	761	(353)	(84)	1,108	–	1,432
Total comprehensive income for the year		**–**	**–**	**–**	**761**	**(353)**	**(84)**	**1,108**	**60,808**	**62,240**
Contributions by and distributions to owners										
Dividends paid	8	–	–	–	–	–	–	–	(41,977)	(41,977)
Dividend reinvestment plan	8	10,590	–	–	–	–	–	–	–	10,590
Issue of share capital	8	40,003	–	–	–	–	–	–	–	40,003
Transaction costs associated with capital raising		(655)	–	–	–	–	–	–	–	(655)
Share based payments		–	–	1,053	–	–	–	–	–	1,053
Shares vested		1,813	–	(1,813)	–	–	–	–	–	–
Total transactions with owners		**51,751**	**–**	**(760)**	**–**	**–**	**–**	**–**	**(41,977)**	**9,014**
Balance at 30 June 2017		**473,128**	**(2,612)**	**3,118**	**(1,055)**	**609**	**(83)**	**(1,152)**	**97,642**	**569,595**

The notes on pages 26 to 49 are an integral part of these interim financial statements.

Interim Statement of Financial Position

As at 31 December 2017

$000	Note	Unaudited December 2017	Unaudited December 2016	Audited June 2017
Assets				
Cash and cash equivalents		117,316	69,655	57,040
Investments		294,197	298,519	318,698
Investment properties		1,724	6,827	4,909
Finance receivables	6	3,783,091	3,321,209	3,545,897
Operating lease vehicles		17,551	21,232	19,038
Other assets		15,522	16,196	10,000
Intangible assets		71,365	65,584	71,237
Deferred tax asset		6,718	7,334	7,852
Total assets		**4,307,484**	**3,806,556**	**4,034,671**
Liabilities				
Borrowings	7	3,633,423	3,247,021	3,429,741
Current tax liabilities		6,722	5,986	9,856
Trade and other payables		26,000	25,547	25,479
Total liabilities		**3,666,145**	**3,278,554**	**3,465,076**
Equity				
Share capital		539,876	448,044	473,128
Treasury shares		(2,612)	(2,612)	(2,612)
Retained earnings and reserves		104,075	82,570	99,079
Total equity		**641,339**	**528,002**	**569,595**
Total equity and liabilities		**4,307,484**	**3,806,556**	**4,034,671**
Total interest earning and discount bearing assets		4,179,777	3,678,038	3,909,711
Total interest and discount bearing liabilities		3,626,752	3,241,811	3,425,685

The notes on pages 26 to 49 are an integral part of these interim financial statements.

Interim Statement of Cash Flows

For the six months ended 31 December 2017

$000	Note	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Cash flows from operating activities				
Interest received		139,100	128,484	261,339
Operating lease income received		2,618	4,394	6,974
Lending, credit fees and other income received		3,335	3,887	6,325
Operating inflows		**145,053**	**136,765**	**274,638**
Payments to suppliers and employees		33,543	37,432	68,017
Interest paid		63,266	64,305	125,022
Taxation paid		14,559	11,884	21,695
Operating outflows		**111,368**	**113,621**	**214,734**
Net cash flows from operating activities before changes in operating assets and liabilities		**33,685**	**23,144**	**59,904**
Proceeds from sale of operating lease vehicles		2,804	4,622	7,678
Purchase of operating lease vehicles		(2,887)	(3,421)	(6,236)
Net movement in finance receivables		(237,056)	(219,505)	(441,400)
Net movement in deposits		131,864	229,878	285,551
Net cash flows (applied to) / from operating activities		**(71,590)**	**34,718**	**(94,503)**
Cash flows from investing activities				
Net proceeds from sale of investment properties		3,185	1,580	3,498
Proceeds from sale of office fit-out, equipment and intangible assets		16	–	–
Net decrease in investments		23,159	–	–
Total cash provided from investing activities		**26,360**	**1,580**	**3,498**
Purchase of office fit-out, equipment and intangible assets		2,437	8,922	15,180
Net increase in investments		–	59,349	82,616
Purchase of equity investments		–	4,000	–
Total cash applied to investing activities		**2,437**	**72,271**	**97,796**
Net cash flows from / (applied to) investing activities		**23,923**	**(70,691)**	**(94,298)**
Cash flows from financing activities				
Net decrease in wholesale funding		(79,703)	20,649	153,726
Proceeds from issue of Unsubordinated Notes	7	150,000	–	–
Increase in share capital	8	59,225	20,000	39,348
Total cash provided from financing activities		**129,522**	**40,649**	**193,074**
Dividends paid	8	20,898	18,764	31,387
Transaction costs associated with capital raising		681	411	–
Total cash applied to financing activities		**21,579**	**19,175**	**31,387**
Net cash flows from financing activities		**107,943**	**21,474**	**161,687**
Net increase / (decrease) in cash held		**60,276**	**(14,499)**	**(27,114)**
Opening cash and cash equivalents		57,040	84,154	84,154
Closing cash and cash equivalents		**117,316**	**69,655**	**57,040**

The notes on pages 26 to 49 are an integral part of these interim financial statements.

Interim Statement of Cash Flows (continued)

For the six months ended 31 December 2017

RECONCILIATION OF PROFIT AFTER TAX TO NET CASH FLOWS FROM OPERATING ACTIVITIES

$000	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Profit for the period	**31,086**	**29,092**	**60,808**
Add / (less) non-cash items:			
Depreciation and amortisation expense	2,311	1,001	2,376
Depreciation on lease vehicles	1,975	2,435	4,701
Capitalised net interest income	(10,884)	(10,758)	(32,221)
Impaired asset expense	10,416	6,892	15,015
Total non-cash items	**3,818**	**(430)**	**(10,129)**
Add / (less) movements in operating assets and liabilities:			
Finance receivables	(237,056)	(219,505)	(441,400)
Operating lease vehicles	(488)	890	818
Other assets	1,814	(2,994)	5,938
Current tax	(3,134)	(768)	3,102
Derivative financial instruments revaluation	(1,273)	(1,746)	(1,261)
Deferred tax	1,134	(266)	(784)
Deposits	131,864	229,878	285,551
Other liabilities	645	567	2,854
Total movements in operating assets and liabilities	**(106,494)**	**6,056**	**(145,182)**
Net cash flows (applied to) / from operating activities	**(71,590)**	**34,718**	**(94,503)**

The notes on pages 26 to 49 are an integral part of these interim financial statements.

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

BASIS OF REPORTING

Reporting entity

The interim financial statements presented are the consolidated financial statements comprising Heartland Bank Limited (the bank) and its subsidiaries (the banking group).

As at 31 December 2017, the bank is a listed public company incorporated in New Zealand under the Companies Act 1993, a registered bank under the Reserve Bank of New Zealand Act 1989 and a FMC reporting entity for the purposes of the Financial Markets Conduct Act 2013.

Basis of preparation

The interim financial statements presented here are for the following periods:

- 6 month period ended 31 December 2017 – Unaudited
- 6 month period ended 31 December 2016 – Unaudited
- 12 month period ended 30 June 2017 – Audited

The interim financial statements of the banking group incorporated in this Disclosure Statement have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP), NZ IAS 34 Interim Financial Reporting, IAS 34 Interim Financial Reporting and the NZX Main Board Listing Rules. They do not include all of the information required for full annual financial statements and should be read in conjunction with the bank's Annual Report for the year ended 30 June 2017.

The interim financial statements have been prepared on a going concern basis in accordance with historical cost, unless stated otherwise. The accounting policies applied by the banking group in these consolidated interim financial statements are the same as those applied by the banking group in its consolidated financial statements as at and for the year ended 30 June 2017.

Certain comparative information has been restated to comply with the current period presentation.

PERFORMANCE

1. Segmental analysis

Segment information is presented in respect of the banking group's operating segments which are those used for the banking group's management and internal reporting structure.

All income received is from external sources, except those transactions with related parties. Certain selling and administration expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Administration and Support (Admin & Support).

Operating segments

The banking group operates predominantly within New Zealand and Australia and comprises the following main operating segments:

Households Providing both a comprehensive range of financial services to New Zealand families – including term, transactional and savings based deposit accounts together with residential mortgage lending (including reverse mortgages), motor vehicle finance and consumer finance – as well as reverse mortgage lending and other financial services to Australian families.

Business Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized businesses.

Rural Providing specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.

The banking group's operating segments are different from the industry categories detailed in Note 13 – Asset quality. The operating segments are primarily categorised by sales channel, whereas Note 13 – Asset quality is based on credit risk concentrations.

1. Segmental analysis (continued)

Operating segments (continued)

$000	Households	Business	Rural	Admin & Support	Total
Unaudited – 6 months ended 31 December 2017					
Net interest income	47,503	26,115	16,245	231	90,094
Net other income	2,750	176	22	867	3,815
Net operating income	**50,253**	**26,291**	**16,267**	**1,098**	**93,909**
Selling and administration expenses	7,357	3,778	2,146	26,967	40,248
Profit / (loss) before impaired asset expense and income tax	**42,896**	**22,513**	**14,121**	**(25,869)**	**53,661**
Impaired asset expense	6,695	2,359	1,362	–	10,416
Profit / (loss) before income tax	**36,201**	**20,154**	**12,759**	**(25,869)**	**43,245**
Income tax expense	–	–	–	12,159	12,159
Profit / (loss) for the period	**36,201**	**20,154**	**12,759**	**(38,028)**	**31,086**
Total assets	**2,083,029**	**1,042,707**	**676,630**	**505,118**	**4,307,484**
Total liabilities	**–**	**–**	**–**	**3,666,145**	**3,666,145**
Unaudited – 6 months ended 31 December 2016					
Net interest income	42,631	22,394	13,763	173	78,961
Net other income	2,857	664	96	444	4,061
Net operating income	**45,488**	**23,058**	**13,859**	**617**	**83,022**
Selling and administration expenses	8,824	4,119	2,120	20,903	35,966
Profit / (loss) before impaired asset expense and income tax	**36,664**	**18,939**	**11,739**	**(20,286)**	**47,056**
Impaired asset expense	4,960	1,557	375	-	6,892
Profit / (loss) before income tax	**31,704**	**17,382**	**11,364**	**(20,286)**	**40,164**
Income tax expense	–	–	–	11,072	11,072
Profit / (loss) for the period	**31,704**	**17,382**	**11,364**	**(31,358)**	**29,092**
Total assets	**1,782,053**	**949,604**	**617,611**	**457,288**	**3,806,556**
Total liabilities	**–**	**–**	**–**	**3,278,554**	**3,278,554**

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

1. Segmental analysis (continued)

Operating segments (continued)

$000	Households	Business	Rural	Admin & Support	Total
Audited – 12 months ended 30 June 2017					
Net interest income	88,346	45,431	29,087	246	163,110
Net other income	4,514	1,629	139	1,860	8,142
Net operating income	**92,860**	**47,060**	**29,226**	**2,106**	**171,252**
Selling and administration expenses	13,980	8,195	4,356	45,153	71,684
Profit / (loss) before impaired asset expense and income tax	**78,880**	**38,865**	**24,870**	**(43,047)**	**99,568**
Impaired asset expense	10,321	4,377	317	–	15,015
Profit / (loss) before income tax	**68,559**	**34,488**	**24,553**	**(43,047)**	**84,553**
Income tax expense	–	–	–	23,745	23,745
Profit / (loss) for the period	**68,559**	**34,488**	**24,553**	**(66,792)**	**60,808**
Total assets	**1,894,514**	**999,891**	**675,439**	**464,827**	**4,034,671**
Total liabilities	**–**	**–**	**–**	**3,465,076**	**3,465,076**

2. Net interest income

$000	Note	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Interest income				
Cash and cash equivalents		435	333	825
Investments		4,766	4,242	8,966
Finance receivables		147,270	131,214	268,488
Total interest income		**152,471**	**135,789**	**278,279**
Interest expense				
Retail deposits		44,904	42,442	86,692
Bank and securitised borrowings		13,518	13,310	25,714
Subordinated and Unsubordinated Notes	7	2,568	–	326
Net interest expense on derivative financial instruments		1,387	1,076	2,437
Total interest expense		**62,377**	**56,828**	**115,169**
Net interest income		**90,094**	**78,961**	**163,110**

3. Selling and administration expenses

$000	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Personnel expenses	22,528	20,167	40,766
Directors' fees	514	313	769
Superannuation	466	310	781
Audit and review of financial statements[1]	223	218	454
Other assurance services paid to auditor[2]	26	28	44
Other fees paid to auditor[3]	121	102	143
Depreciation – property, plant and equipment	701	697	1,361
Amortisation – intangible assets	1,610	304	1,015
Operating lease expense as a lessee	1,039	1,049	2,102
Legal and professional fees	999	1,065	1,698
Other operating expenses	12,021	11,713	22,551
Total selling and administration expenses	**40,248**	**35,966**	**71,684**

1 Audit and review of financial statements includes fees paid for both the audit of annual financial statements and the review of interim financial statements.

2 Other assurance services paid to the auditor comprise review of regulatory returns, trust deed reporting, registry audits and other agreed upon procedure engagements.

3 Other fees paid to the auditor include professional fees in connection with regulatory advisory services, accounting advice and a Health and Safety framework review.

4. Impaired asset expense

$000	Note	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Non-securitised				
Individually impaired expense		1,876	1,197	4,505
Collectively impaired expense		8,383	4,818	9,199
Total non-securitised impaired asset expense		**10,259**	**6,015**	**13,704**
Securitised				
Collectively impaired expense		157	877	1,311
Total securitised impaired asset expense		**157**	**877**	**1,311**
Total				
Individually impaired expense	13(d)	1,876	1,197	4,505
Collectively impaired expense	13(d)	8,540	5,695	10,510
Total impaired asset expense		**10,416**	**6,892**	**15,015**

5. Earnings per share

	December 2017			December 2016			June 2016		
	Earnings per share cents	Net profit after tax $000	Weighted average no. of shares 000	Earnings per share cents	Net profit after tax $000	Weighted average no. of shares 000	Earnings per share cents	Net profit after tax $000	Weighted average no. of shares 000
Basic earnings	6	31,086	520,741	6	29,092	482,334	12	60,808	493,177
Diluted earnings	6	31,086	520,795	6	29,092	485,368	12	60,808	496,725

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the weighted average number of fully paid shares less treasury shares.

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

FINANCIAL POSITION

6. Finance receivables

$000	Note	Unaudited December 2017	Unaudited December 2016	Audited June 2017
Non-securitised				
Neither at least 90 days past due nor impaired		3,617,858	2,979,768	3,285,911
At least 90 days past due		36,634	32,405	33,047
Individually impaired		35,944	15,921	28,578
Gross finance receivables		**3,690,436**	**3,028,094**	**3,347,536**
Less provision for impairment		28,256	21,535	24,762
Less fair value adjustment for present value of future losses[1]		3,325	4,404	3,851
Total non-securitised finance receivables		**3,658,855**	**3,002,155**	**3,318,923**
Securitised				
Neither at least 90 days past due nor impaired		124,103	316,449	225,495
At least 90 days past due		440	3,786	2,582
Individually impaired		–	14	–
Gross finance receivables		**124,543**	**320,249**	**228,077**
Less provision for impairment		307	1,195	1,103
Total securitised finance receivables		**124,236**	**319,054**	**226,974**
Total				
Neither at least 90 days past due nor impaired		3,741,961	3,296,217	3,511,406
At least 90 days past due		37,074	36,191	35,629
Individually impaired		35,944	15,935	28,578
Gross finance receivables		**3,814,979**	**3,348,343**	**3,575,613**
Less provision for impairment	13(d)	28,563	22,730	25,865
Less fair value adjustment for present value of future losses[1]		3,325	4,404	3,851
Total finance receivables		**3,783,091**	**3,321,209**	**3,545,897**

[1] A fair value adjustment of $8m for the present value of future losses was recognised on acquisition of New Sentinel Limited and Australian Seniors Finance Pty Limited. This fair value adjustment is being amortised over the estimated lifetime of the finance receivables acquired.

Refer to Note 13 - Asset quality for further analysis of finance receivables by credit risk concentration.

7. Borrowings

$000	Note	Unaudited 6 months to December 2017	Unaudited 6 months to December 2016	Audited 12 months to June 2017
Deposits		2,703,234	2,512,629	2,573,980
Subordinated Bonds		3,379	3,379	3,378
Subordinated Notes		22,277	–	21,180
Unsubordinated Notes		151,902	–	–
Bank borrowings		637,572	454,317	616,838
Borrowings – securitised	17(b)	115,059	276,696	214,365
Total borrowings		**3,633,423**	**3,247,021**	**3,429,741**

On 21 September 2017, the bank issued unsubordinated fixed rate notes (Unsubordinated Notes). These notes are paid a fixed rate of interest every 6 months and will mature on 21 September 2022.

Deposits and Unsubordinated notes rank equally and are unsecured. The Subordinated bonds and Subordinated Notes rank below all other general liabilities of the banking group.

Securitised borrowings held by investors in Heartland ABCP Trust 1 (ABCP Trust) rank equally with each other and are secured over the securitised assets of that trust. Securitised borrowings comprise notes issued by ABCP Trust and drawings under the ABCP Trust's bank facilities. The ABCP Trust has bank facilities of $175 million (December 2016: $350 million; June 2017: $300 million) which mature on 28 February 2018.

The banking group has an Australian bank facility provided by Commonwealth Bank of Australia (CBA bank facility) totalling AUD $600 million, with AUD $495 million drawn (December 2016: AUD $363 million; June 2017: AUD $440 million). The CBA bank facility is secured over the shares in Australian Seniors Finance Pty Limited (ASF) and the assets of the ASF group (comprising ASF, the ASF Settlement Trust and the Seniors Warehouse Trust). The CBA bank facility has a maturity date of 30 September 2019.

The banking agreements include covenants for the provision of information, attainment of minimum financial ratios and equity, compliance with specified procedures and certification of due performance by ASF Group.

8. Share capital and dividends

000s	Unaudited December 2017 Number of shares	Unaudited December 2016 Number of shares	Audited June 2017 Number of shares
Issued shares			
Opening balance	516,236	476,469	476,469
Shares issued during the period	37,161	19,123	32,860
Dividend reinvestment plan	4,163	3,573	6,907
Closing balance	**557,560**	**499,165**	**516,236**
Less treasury shares	(2,299)	(2,299)	(2,299)
Net closing balance	**555,261**	**496,866**	**513,937**

On 14 December 2017, the bank issued 34,838,414 new shares at $1.70 per share under a Pro Rata Rights Offer. Other shares issued during the period relate to staff share schemes.

Under dividend reinvestment plans, the banking group issued 4,163,008 new shares at $1.8004 per share on 21 September 2017 (December 2016: 3,573,104 new shares at $1.4766 per share on 7 October 2016; June 2017: 3,573,104 new shares at $1.4766 per share on 7 October 2016 and 3,334,049 new shares at $1.5939 per share on 7 April 2017).

The shares have equal voting rights, rights to dividends and distributions and do not have a par value.

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

8. Share capital and dividends (continued)

(a) Dividends paid

	December 2017			December 2016			June 2017		
	Date declared	Cents per share	$000	Date declared	Cents per share	$000	Date declared	Cents per share	$000
Final dividend	14/08/17	5.5	28,393	16/08/16	5.0	24,041	16/08/16	5.0	24,041
Interim dividend							21/02/17	3.5	17,936
Total dividends paid		**5.5**	**28,393**		**5.0**	**24,041**		**8.5**	**41,977**

9. Related party transactions and balances

Transactions with key management personnel

Key management personnel, being directors of the bank, the Chief Executive Officer (CEO) and those executive staff reporting directly to the CEO and their immediate relatives, have transacted with the banking group during the period as follows:

$000	Unaudited December 2017	Unaudited December 2016	Audited June 2017
Transactions with key management personnel			
Interest income	3	3	8
Interest expense	(69)	(382)	(691)
Total transactions with key management personnel	**(66)**	**(379)**	**(683)**
Due from / (to) key management personnel			
Finance receivables	63	79	71
Borrowings – deposits	(8,464)	(22,928)	(9,153)
Total due (to) key management personnel	**(8,401)**	**(22,849)**	**(9,082)**

10. Fair value

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the banking group determines fair value using valuation techniques.

The banking group measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (derived from prices).
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The banking group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

10. Fair value (continued)

(a) Financial instruments measured at fair value

The following methods and assumptions were used to estimate the fair value of each class of financial asset and liability measured at fair value on a recurring basis in the Interim Statement of Financial Position.

Investments

Investments in public sector securities and corporate bonds are classified as being available for sale and are stated at fair value, with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using observable market inputs (Level 2 under the fair value hierarchy).

Investments valued under Level 2 of the fair value hierarchy are valued either based on quoted market prices or dealer quotes for similar instruments, or discounted cash flows analysis.

Investments in unlisted equity securities are classified as being fair valued through profit or loss and are valued under Level 3 of the fair value hierarchy, with the fair value being based on unobservable inputs.

Finance receivables

Fixed rate reverse mortgage loans classified as finance receivables are stated at fair value with the fair value being based on present value of future cash flows discounted using observable market interest rates (Level 2 under the fair value hierarchy).

Derivative items

Interest rate swaps are classified as held for trading and are recognised in the interim financial statements at fair value. Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are determined on the basis of discounted cash flow analysis using observable market prices and adjustments for counterparty credit spreads (Level 2 under the fair value hierarchy).

The following table analyses financial instruments measured at fair value at the reporting date by the level in the fair value hierarchy into which each fair value measurement is categorised. The amounts are based on the values recognised in the Interim Statement of Financial Position.

$000	Level 1	Level 2	Level 3	Total
Unaudited – December 2017				
Assets				
Investments	284,856	–	9,341	294,197
Finance receivables	–	3,717	–	3,717
Total assets measured at fair value	**284,856**	**3,717**	**9,341**	**297,914**
Liabilities				
Derivative liabilities held for risk management	–	2,568	–	2,568
Total liabilities measured at fair value	**–**	**2,568**	**–**	**2,568**
Unaudited – December 2016				
Assets				
Investments	287,228	–	11,291	298,519
Finance receivables	–	17,733	–	17,733
Derivative assets held for risk management	–	178	–	178
Total assets measured at fair value	**287,228**	**17,911**	**11,291**	**316,430**
Liabilities				
Derivative liabilities held for risk management	–	2,860	–	2,860
Total liabilities measured at fair value	**–**	**2,860**	**–**	**2,860**

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FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

10. Fair value (continued)

(a) Financial instruments measured at fair value (continued)

$000	Level 1	Level 2	Level 3	Total
Audited – June 2017				
Assets				
Investments	306,907	–	11,791	318,698
Finance receivables	–	11,211	–	11,211
Total assets measured at fair value	**306,907**	**11,211**	**11,791**	**329,909**
Liabilities				
Derivative liabilities held for risk management	–	3,349	–	3,349
Total liabilities measured at fair value	**–**	**3,349**	**–**	**3,349**

(b) Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments not measured at fair value and analyses these by the level in the fair value hierarchy into which each fair value measurement is categorised.

$000		Unaudited Total Fair Value December 2017	Unaudited Total Carrying Value December 2017	Unaudited Total Fair Value December 2016	Unaudited Total Carrying Value December 2016	Audited Total Fair Value June 2017	Audited Total Carrying Value June 2017
Assets							
Cash and cash equivalents	Level 1	117,316	117,316	69,655	69,655	57,040	57,040
Finance receivables	Level 3	3,645,531	3,655,138	2,975,084	2,984,422	3,300,325	3,307,712
Finance receivables – securitised	Level 3	124,344	124,236	319,474	319,054	227,166	226,974
Other financial assets	Level 3	5,189	5,189	5,030	5,030	101	101
Total financial assets		**3,892,380**	**3,901,879**	**3,369,243**	**3,378,161**	**3,584,632**	**3,591,827**
Liabilities							
Borrowings	Level 2	3,521,873	3,518,364	2,974,043	2,970,325	3,220,344	3,215,376
Borrowings – securitised	Level 2	115,059	115,059	276,696	276,696	214,365	214,365
Other financial liabilities	Level 3	23,352	23,352	22,604	22,604	22,130	22,130
Total financial liabilities		**3,660,284**	**3,656,775**	**3,273,343**	**3,269,625**	**3,456,839**	**3,451,871**

Further information on valuation techniques and assumptions used for determining fair value is included in Note 16 of the bank's Annual Report for the year ended 30 June 2017.

RISK MANAGEMENT

11. Risk management policies

There have been no material changes in the banking group's policies for managing risk, or material exposures to any new types of risk since the reporting date of the previous disclosure statement, refer to the bank's Annual Report for the year ended 30 June 2017.

12. Credit risk exposure

Credit risk is the risk that a borrower will default on any type of debt by failing to make payments when it is obligated to do so. The risk is primarily that of the lender and includes loss of principal and interest, disruption to cash flows and increased collection costs.

Credit risk is managed to achieve sustainable and superior risk-reward performance whilst maintaining exposures within acceptable risk "appetite" parameters. This is achieved through the combination of governance, policies, systems and controls, underpinned by sound commercial judgement as described below.

To manage this risk the Board Risk Committee (BRC) has been delegated the task of overseeing a formal credit risk management strategy. The BRC reviews the banking group's credit risk exposures to ensure consistency with the banking group's credit policies to manage all aspects of credit risk.

The credit risk management strategies ensure that:

- Credit origination meets agreed levels of credit quality at point of approval.
- Sector and geographical risks are actively managed.
- Industry concentrations are actively monitored.
- Maximum total exposure to any one debtor is actively managed.
- Changes to credit risk are actively monitored with regular credit reviews.

(a) Maximum exposure to credit risk

The following table represents the maximum credit risk exposure, without taking account of any collateral held. The exposures set out below are based on net carrying amounts as reported in the Interim Statement of Financial Position.

$000	Unaudited December 2017
Cash and cash equivalents	117,316
Investments	284,856
Finance receivables	3,783,091
Other financial assets	5,189
Total on balance sheet credit exposures	**4,190,452**

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12. Credit risk exposure (continued)

(b) Concentration of credit risk by geographic region

$000	Unaudited December 2017
New Zealand:	
Auckland	1,074,776
Wellington	232,265
Rest of North Island	1,065,767
Canterbury	496,277
Rest of South Island	594,543
Australia:	
Queensland	150,127
New South Wales	270,347
Victoria	132,597
Western Australia	29,830
South Australia	22,731
Rest of Australia	12,359
Rest of the world[1]	131,978
	4,213,597
Collective provision	(19,820)
Less acquisition fair value adjustment for present value of future losses	(3,325)
Total on balance sheet credit exposures	**4,190,452**

[1] These overseas assets are primarily NZD-denominated investments in AA+ and higher rated securities issued by offshore supranational agencies ("Kauri Bonds").

(c) Concentration of credit risk by industry sector

$000	Unaudited December 2017
Agriculture	754,754
Forestry and Fishing	81,412
Mining	17,030
Manufacturing	77,895
Finance & Insurance	384,639
Wholesale trade	37,185
Retail trade	188,770
Households	1,923,556
Property and Business services	396,171
Transport and storage	202,831
Other	149,354
	4,213,597
Collective provision	(19,820)
Less acquisition fair value adjustment for present value of future losses	(3,325)
Total on balance sheet credit exposures	**4,190,452**

12. Credit risk exposure (continued)

(d) Credit exposure to individual counterparties

At 31 December 2017 the banking group did not have any period end or peak end-of-day credit exposures over 10% of equity to individual counterparties (not being members of groups of closely related counterparties) or groups of closely related counterparties (excluding central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent, or any bank with a long-term credit rating of A- or A3 or above, or its equivalent, and connected persons) (December 2016: nil; June 2017: nil).

The peak aggregate end-of-day credit exposure is determined by taking the maximum end-of-day aggregate amount of credit exposure over the period divided by the banking group's equity as at the end of the period. Credit exposures disclosed are based on actual exposures. The credit rating is applicable to an entity's long term senior unsecured obligations payable in New Zealand, in New Zealand dollars.

13. Asset quality

The disclosures below are categorised by the following credit risk concentrations:

Rural Lending to the farming sector primarily livestock, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers. Includes lending to individuals and small to medium enterprises.

Other Corporate Business lending other than rural lending.

Residential Lending secured by a first ranking mortgage over a residential property used primarily for residential purposes either by the mortgagor or a tenant of the mortgagor.

All Other This relates primarily to consumer lending to individuals.

(a) Finance receivables by credit risk concentration

$000	Note	Rural	Other corporate	Residential	All other	Total
Unaudited – December 2017						
Neither at least 90 days past due nor impaired		813,339	996,793	1,096,605	835,224	3,741,961
At least 90 days past due		10,692	9,461	802	16,119	37,074
Individually impaired		6,179	26,963	2,489	313	35,944
Fair value adjustment for present value of future losses		–	–	(3,325)	–	(3,325)
Provision for impairment	13(d)	(5,172)	(13,191)	(2,959)	(7,241)	(28,563)
Total net finance receivables		**825,038**	**1,020,026**	**1,093,612**	**844,415**	**3,783,091**

(b) Past due but not impaired

$000	Rural	Other corporate	Residential	All other	Total
Unaudited – December 2017					
Less than 30 days past due	19,384	22,046	2,757	33,662	77,849
At least 30 days but less than 60 days past due	5,648	11,611	2,085	10,026	29,370
At least 60 days but less than 90 days past due	1,860	5,755	713	5,801	14,129
At least 90 days past due	10,692	9,461	802	16,119	37,074
Total past due but not impaired	**37,584**	**48,873**	**6,357**	**65,608**	**158,422**

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13. Asset quality (continued)

(c) Individually impaired assets

$000	Note	Rural	Other corporate	Residential	All other	Total
Unaudited – December 2017						
Opening		2,313	25,550	714	–	28,577
Additions		9,381	10,268	1,988	313	21,950
Deletions		(4,567)	(8,253)	(206)	–	(13,026)
Write offs		(948)	(602)	(7)	–	(1,557)
Closing gross individually impaired assets		**6,179**	**26,963**	**2,489**	**313**	**35,944**
Less: provision for individually impaired assets	13(d)	685	7,701	232	125	8,743
Total net impaired assets		**5,494**	**19,262**	**2,257**	**188**	**27,201**

(d) Provision for impairment

$000	Rural	Other corporate	Residential	All other	Total
Unaudited – December 2017					
Provision for individually impaired assets					
Opening provision for individually impaired assets	1,005	7,288	129	–	8,422
Impairment loss for the period					
Charge for the period	628	1,015	110	123	1,876
Recoveries	–	–	–	2	2
Write offs	(948)	(602)	(7)	–	(1,557)
Closing provision for individually impaired assets	**685**	**7,701**	**232**	**125**	**8,743**
Provision for collectively impaired assets					
Opening provision for collectively impaired assets	3,144	5,699	2,340	6,260	17,443
Impairment loss for the period					
Charge for the period	1,398	629	345	6,168	8,540
Effect of changes in foreign exchange rates	–	–	86	–	86
Recoveries	–	4	–	272	276
Write offs	(55)	(842)	(44)	(5,584)	(6,525)
Closing provision for collectively impaired assets	**4,487**	**5,490**	**2,727**	**7,116**	**19,820**
Total provision for impairment	**5,172**	**13,191**	**2,959**	**7,241**	**28,563**

(e) Undrawn balances for individually impaired assets

As at 31 December 2017 there $0.20 million undrawn lending commitments to counterparties for whom drawn balances are classified as individually impaired (December 2016: nil; June 2017: $0.22 million).

(f) Other assets under administration

Other assets under administration are any loans, not being individually impaired or 90 days or more past due, where the customer is in any form of voluntary or involuntary administration, including receivership, liquidation, bankruptcy or statutory management. As at 31 December 2017, the banking group had $1.60 million assets under administration (December 2016: $1.31 million; June 2017: $1.20 million).

14. Liquidity risk

The banking group holds the following financial assets for the purpose of managing liquidity risk:

$000	Unaudited December 2017
Cash and cash equivalents	117,316
Investments	284,856
Undrawn committed bank facilities	60,000
Total liquidity	**462,172**

Contractual liquidity profile of financial assets and liabilities

The following tables present the banking group's financial assets and liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the table represents undiscounted future principal and interest cash flows. As a result, the amounts in the table below may differ to the amounts reported in the Interim Statement of Financial Position.

The contractual cash flows presented below may differ significantly from actual cash flows. This occurs as a result of future actions by the banking group and its counterparties, such as early repayments or refinancing of term loans and borrowings. Deposits and other public borrowings include customer savings deposits and transactional accounts, which are at call. History demonstrates that such accounts provide a stable source of long term funding for the banking group.

The banking group does not manage its liquidity risk on a contractual liquidity basis.

$000	On demand	0-6 months	6-12 months	1-2 years	2-5 years	5+ years	Total
Unaudited – December 2017							
Financial assets							
Cash and cash equivalents	117,316	–	–	–	–	–	117,316
Investments	–	21,956	42,468	101,044	135,489	9,341	310,298
Finance receivables	–	785,632	422,022	695,951	1,163,327	4,482,122	7,549,054
Finance receivables – securitised	–	44,018	32,806	39,925	20,377	–	137,126
Other financial assets	–	5,189	–	–	–	–	5,189
Total financial assets	**117,316**	**856,795**	**497,296**	**836,920**	**1,319,193**	**4,491,463**	**8,118,983**
Financial liabilities							
Borrowings	852,165	1,131,703	614,591	675,191	364,747	785	3,639,182
Borrowings – securitised	–	115,266	–	–	–	–	115,266
Derivative financial liabilities	–	2,568	–	–	–	–	2,568
Other financial liabilities	–	23,352	–	–	–	–	23,352
Total financial liabilities	**852,165**	**1,272,889**	**614,591**	**675,191**	**364,747**	**785**	**3,780,368**
Net financial (liabilities) / assets	**(734,849)**	**(416,094)**	**(117,295)**	**161,729**	**954,446**	**4,490,678**	**4,338,615**
Unrecognised loan commitments	164,153	–	–	–	–	–	164,153
Undrawn committed bank facilities	60,000	–	–	–	–	–	60,000

Undrawn committed bank facilities of $60.0 million are available to be drawn down on demand. To the extent drawn, $60.0 million is contractually repayable in 0-6 months' time upon facility expiry.

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15. Interest rate risk

Contractual repricing analysis

The interest rate risk profile of financial assets and liabilities that follows has been prepared on the basis of maturity or next repricing date, whichever is earlier.

$000	0-3 months	3-6 months	6-12 months	1-2 years	2+ years	Non-interest bearing	Total
Unaudited – December 2017							
Financial assets							
Cash and cash equivalents	117,308	–	–	–	–	8	117,316
Investments	34,655	1,530	37,282	91,796	119,593	9,341	294,197
Finance receivables	2,561,007	143,753	241,529	355,580	351,508	5,478	3,658,855
Finance receivables – securitised	20,341	18,333	29,434	36,701	19,427	–	124,236
Other financial assets	–	–	–	–	–	5,189	5,189
Total financial assets	**2,733,311**	**163,616**	**308,245**	**484,077**	**490,528**	**20,016**	**4,199,793**
Financial liabilities							
Borrowings	2,075,396	504,536	588,801	108,875	231,517	9,239	3,518,364
Borrowings – securitised	115,059	–	–	–	–	–	115,059
Derivative financial liabilities	2,568	–	–	–	–	–	2,568
Other financial liabilities	–	–	–	–	–	23,352	23,352
Total financial liabilities	**2,193,023**	**504,536**	**588,801**	**108,875**	**231,517**	**32,591**	**3,659,343**
Effect of derivatives held for risk management	253,570	(40,955)	(86,630)	(172,165)	46,180	–	–
Net financial assets / (liabilities)	**793,858**	**(381,875)**	**(367,186)**	**203,037**	**305,191**	**(12,575)**	**540,450**

16. Concentrations of funding

(a) Concentration of funding by industry

$000	Unaudited December 2017
Agriculture	52,550
Forestry and Fishing	22,783
Mining	490
Manufacturing	11,094
Finance and Insurance	932,965
Wholesale trade	10,502
Retail trade	15,839
Households	2,174,775
Property and Business services	104,890
Transport and Storage	7,917
Other	125,439
	3,459,244
Subordinated Notes	22,277
Unsubordinated Notes	151,902
Total borrowings	**3,633,423**

16. Concentrations of funding (continued)

(b) Concentration of funding by geographical area

$000	Unaudited December 2017
Auckland	986,476
Wellington	233,195
Rest of North Island	628,842
Canterbury	864,846
Rest of South Island	233,995
Overseas	686,069
Total borrowings	**3,633,423**

OTHER DISCLOSURES

17. Structured entities

(a) Heartland Cash and Term PIE Fund (Heartland PIE Fund)

The banking group controls the operations of Heartland PIE Fund which is a portfolio investment entity that invests in the bank's deposits. Investments of Heartland PIE Fund are represented as follows:

$000	Unaudited December 2017	Unaudited December 2016	Audited June 2017
Deposits	97,546	90,078	93,998

(b) Heartland ABCP Trust 1 (ABCP Trust)

The banking group has securitised a pool of receivables comprising commercial and motor vehicle loans to the ABCP Trust.

The banking group continues to recognise the securitised assets and associated borrowings in the Interim Statement of Financial Position through the holding of subordinated debt of the ABCP Trust and the receipt of deferred purchase consideration from that trust. Whilst the bank has those interests in the ABCP Trust, the loans sold to the trust are set aside for the benefit of investors in the ABCP Trust and bank depositors have no recourse to these assets. The ABCP Trust's material assets and liabilities are represented as follows:

$000	Note	Unaudited December 2017	Unaudited December 2016	Audited June 2017
Cash and cash equivalents – securitised		11,360	9,699	9,272
Finance receivables – securitised	6	124,236	319,054	226,974
Borrowings – securitised	7	(115,059)	(276,696)	(214,365)
Derivative financial liabilities – securitised		(822)	(1,043)	(1,042)

(c) Seniors Warehouse Trust (SW Trust) and ASF Settlement Trust (ASF Trust)

SW Trust and ASF Trust form part of ASF's reverse mortgage business and were set up by ASF as asset holding entities. The Trustee for both Trusts is ASF Custodians Pty Limited and the Trust Manager is ASF. The balances of SW Trust and ASF Trust are represented as follows:

$000	Unaudited December 2017	Unaudited December 2016	Audited June 2017
Cash and cash equivalents	8,940	3,315	9,126
Finance receivables	616,485	472,161	520,572
Borrowings	(537,969)	(414,527)	(462,298)
Derivative financial liabilities	(195)	(1,309)	(547)

18. Capital adequacy

The banking group is subject to regulation by the Reserve Bank of New Zealand (RBNZ). The RBNZ has set minimum regulatory capital requirements for banks that are consistent with the internationally agreed framework developed by the Basel Committee on Banking Supervision. The resulting Basel II and III requirements define what is acceptable as capital and provide for methods of measuring the risks incurred by the banking group.

The bank's Conditions of Registration prescribe minimum capital adequacy ratios calculated in accordance with the Capital Adequacy Framework (Standardised Approach) BS2A.

The banking group has adopted the Basel II standardised approach per the RBNZ BS2A to calculate its regulatory requirements. Basel II is made up of the following three Pillars:

- Pillar 1 sets out the minimum capital requirements for credit, market and operational and compliance risks.
- Pillar 2 is designed to ensure that banks have adequate capital to support all risks (not just those set out under Pillar 1 above) and is enforced through the requirement for supervisory review.
- Pillar 3 outlines the requirements for adequate and transparent disclosure.

Basel III was developed in order to strengthen the regulation, supervision and risk management of the banking sector. The measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress; improve risk management and governance; and strengthen banks' transparency and disclosures. The requirements that impact capital are as follows:

- The level of capital required to be held by banks increased through the introduction of new minimum capital requirements for Common Equity Tier 1 (CET1) capital, Additional Tier 1 (AT1) capital and Total capital as a percentage of risk-weighted-assets (RWAs).
- A capital conservation buffer held over and above the minimum capital ratio requirements used to absorb losses during periods of financial and economic stress.
- A counter-cyclical capital buffer be held and to be used at the RBNZ's discretion, to assist in attaining the macro-prudential goal of protecting the banking sector from periods of extraordinary excess aggregate credit growth.
- Strengthen the calculation of RWAs, particularly in respect of counterparty credit risk.

The capital adequacy tables set out on the following pages summarise the composition of regulatory capital and the capital adequacy ratios for the banking group as at 31 December 2017.

Internal Capital Adequacy Assessment Process (ICAAP)

The banking group has an ICAAP which complies with the requirements set out in the "Guidelines on a Bank's Internal Capital Adequacy Assessment Process (ICAAP)" BS12 and is in accordance with its Conditions of Registration.

The Board has overall responsibility for ensuring the banking group has adequate capital in relation to its risk profile and establishes minimum internal capital levels and limits above the regulatory minimum. The banking group has established a Capital Management Policy (CMP) to determine minimum capital levels for Tier 1 and Total capital under Basel III and in accordance with its Conditions of Registration. The documented process ensures that the banking group has sufficient available capital to meet minimum capital requirements, even in stressed events. It describes the risk profile of the banking group and the risk appetite and tolerances under which it operates, and assesses the level of capital held against the material risks of the banking group (both Pillar 1 and Pillar 2).

The ICAAP identifies the additional capital required to be held against other material risks, being concentration risk, strategic / business risk, reputational risk, regulatory risk and model risk. See Note 18(l) for further details.

Compliance with minimum capital levels is monitored by the Asset and Liability Committee and reported to the Board monthly. The ICAAP and CMP is reviewed annually by the Board.

18. Capital adequacy (continued)

(a) Capital ratios

$000	Unaudited December 2017
Tier 1 Capital	
CET1 capital	
Paid-up ordinary shares issued by the bank	539,876
Retained earnings (net of appropriations)	100,335
Accumulated other comprehensive income and other disclosed reserves	(327)
Less deductions from CET1 capital:	
Intangible assets	(71,365)
Deferred tax assets	(6,718)
Hedging reserve	1,644
Defined benefit superannuation fund assets	(659)
Total CET1 capital	**562,786**
AT1 Capital	
Nil	–
Total Tier 1 Capital	**562,786**
Tier 2 Capital	
Subordinated Bonds	485
Subordinated Notes	15,829
Foreign currency translation reserve	1,455
Total Tier 2 Capital	**17,769**
Total Capital	**580,555**

18. Capital adequacy (continued)

(b) Capital structure

The following details summarise each instrument included within Total Capital. None of these instruments are subject to phase-out from eligibility as capital under the RBNZ's Basel III transitional arrangements.

Ordinary shares

In accordance with BS2A, ordinary share capital is classified as CET1 capital. The ordinary shares have no par value. Each ordinary share of the bank carries the right to vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the bank in the event of liquidation.

Retained earnings

Retained earnings is the accumulated profit or loss that has been retained in the banking group. Retained earnings is classified as CET1 capital.

Reserves classified as CET1 capital

Treasury shares reserve	The treasury shares reserve comprises shares in Heartland Bank Limited held by the bank.
Employee benefits reserve	The employee benefits reserve comprises employee share options which have been recognised as an expense but not yet been exercised and converted into ordinary shares.
Available for sale reserve	The available for sale reserve comprises the changes in the fair value of available for sale securities, net of tax. These changes are recognised in profit or loss as other income when the asset is either derecognised or impaired.
Defined benefit reserve	The defined benefit plan reserve represents the excess of the fair value of the assets of the defined benefit superannuation plan over the net present value of the defined benefit obligations.
Hedging reserve	The hedging reserve comprises the fair value gains and losses associated with the effective portion of designated cash flow hedging instruments.

Foreign currency translation reserve

The foreign currency translation reserve represents the differences in translation which arise when converting the financial statements of the Australian controlled entities from their functional currency into the presentational currency. It constitutes Tier 2 capital of the banking group.

Subordinated Bonds and Notes

Heartland's 2018 Subordinated Bonds (the Subordinated Bonds) constitute Tier 2 Capital of the banking group. The Subordinated Bonds had an issue period from 12 July 2013 to 15 December 2013 and have a maturity date of 15 December 2018. The Subordinated Bonds pay quarterly interest in arrears at a rate of 6.5% per annum, provided the bank will be solvent immediately after the payment is made. The bank may elect to repay the Subordinated Bonds prior to 15 December 2018 if a regulatory event or tax event occurs and provided it will be solvent immediately after the repayment and the Reserve Bank has consented to the repayment. The Subordinated Bonds are subordinated to all other general liabilities of the banking group and are denominated in New Zealand dollars.

Heartland's 2027 Subordinated Unsecured Convertible Notes (the Subordinated Notes) constitute Tier 2 Capital of the banking group. The Subordinated Notes had an issue date of 7 April 2017 and have a maturity date of 7 April 2027. The Subordinated Notes pay quarterly interest in arrears at a rate of BBSW+4.15% per annum, provided the bank will be solvent immediately after the payment is made. The bank may elect to repay some or all of the Subordinated Notes on the First Optional Redemption Date (7 April 2022) or on any scheduled Interest Payment Date thereafter, as well as if a regulatory event or tax event occurs. Early repayment may only be made provided the bank will be solvent immediately after the repayment and the Reserve Bank has consented to the repayment. The Subordinated Notes are subordinated to all other general liabilities of the banking group and are denominated in Australian dollars.

If the Reserve Bank or a Statutory Manager requires the bank to convert all or part of the Subordinated Bonds, or to convert or write off (if conversion is not able to be effected) all or part of the Subordinated Notes, the Subordinated Bonds or Subordinated Notes will be converted or written off (as applicable) and could in each case be reduced to zero to comply with the Reserve Bank's loss absorbency requirements. The bank has not had any defaults of principal, interest or other breaches with respect to the Subordinated Bonds or Subordinated Notes.

18. Capital adequacy (continued)

(c) Credit risk

(i) On balance sheet exposures

	Total exposure after credit risk mitigation $000	Average risk weighting %	Risk weighted exposure $000	Minimum Pillar 1 capital requirement $000
Unaudited – December 2017				
Cash	9	0%	–	–
Multilateral development banks	68,235	0%	–	–
Multilateral development banks	51,603	20%	10,321	826
Banks – Tier 1	194,487	20%	38,897	3,112
Banks – Tier 2	868	50%	434	35
Banks – Tier 3	19,957	100%	19,957	1,597
Public sector entity (AA- and above)	49,666	20%	9,933	795
Public sector entity (A- and above)	6,991	50%	3,496	280
Corporates (AA- and above)	1,855	20%	371	30
Corporates (A- and above)	3,026	50%	1,513	121
Corporates (BBB- and above)	5,475	100%	5,475	438
Welcome Home Loans – loan to value ratio (LVR) <= 90%[1]	3,714	35%	1,300	104
Welcome Home Loans – LVR 90% >=100%[1]	1,118	50%	559	45
Reverse Residential mortgages <= 60% LVR	998,563	50%	499,282	39,943
Reverse Residential mortgages 60 <= 80% LVR	26,527	80%	21,222	1,698
Reverse Residential mortgages > 80% LVR	2,499	100%	2,499	200
Non property investment mortgage loan <=80% LVR	28,219	35%	9,877	790
Non property investment mortgage loan 80 <= 90% LVR	4,355	50%	2,178	174
Non property investment mortgage loan 90 <=100% LVR	462	75%	347	28
Non property investment mortgage loan > 100% LVR	2,562	100%	2,562	205
Property Investment Mortgage Loan <= 80% LVR	16,099	40%	6,440	515
Property Investment Mortgage Loan 80 <=90% LVR	1,582	70%	1,107	89
Property Investment Mortgage Loan < 100% LVR	5,262	100%	5,262	421
Past due residential mortgages	2,650	100%	2,650	212
Other past due assets – provision >=20%	14,025	100%	14,025	1,122
Other past due assets – provision < 20%	55,177	150%	82,766	6,621
All other equity holdings	9,341	400%	37,364	2,989
Other assets	2,654,415	100%	2,654,415	212,353
Not risk weighted assets	78,742	0%	–	–
Total on balance sheet exposures	**4,307,484**		**3,434,252**	**274,743**

[1] The LVR classification above is calculated in line with the banking group's Pillar 1 Capital requirement which includes capital relief for Welcome Home loans that are guaranteed by the Crown.

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

18. Capital adequacy (continued)

(c) Credit risk (continued)

(ii) Off balance sheet exposures

	Total exposure $000	Average credit conversion factor $000	Credit equivalent amount $000	Average risk weight %	Risk weighted exposure $000	Minimum Pillar 1 capital requirement $000
Unaudited – December 2017						
Off balance sheet exposures						
Direct credit substitute	1,913	100%	1,913	100%	1,913	153
Performance-related contingency	4,977	50%	2,489	100%	2,489	199
Other commitments where original maturity is more than one year	69,603	50%	34,802	100%	34,802	2,784
Other commitments where original maturity is less than or equal to one year	171,960	20%	34,392	100%	34,392	2,751
Market related contracts[1]						
Interest rate contracts	337,633	n/a	–	20%	–	–
Interest rate contracts	275,985	0.5%	1,380	20%	276	22
Total off balance sheet exposures	**862,071**		**74,976**		**73,872**	**5,909**

[1] The credit equivalent amount for market related contracts was calculated using the current exposure method.

(d) Additional mortgage information – LVR range

$000	On balance sheet exposures	Off balance sheet exposures[2]	Total exposures
Unaudited – December 2017			
Does not exceed 80%	1,069,408	10,044	1,079,452
Exceeds 80% but not 90%	12,150	–	12,150
Exceeds 90%	12,054	–	12,054
Total exposures	**1,093,612**	**10,044**	**1,103,656**

[2] Off balance sheet exposures represent unutilised limits.

At 31 December 2017 $1.12 million relating to Welcome Home loans, whose credit risk is mitigated by the Crown is included in "Exceeds 90% residential mortgages". Other loans in the exceeds 90% LVR range are primarily business and rural lending where residential mortgage security is only a part of the total security. For capital adequacy calculations only the value of first mortgages over residential property is included in the LVR calculation, in accordance with BS2A. All new residential mortgage loans are in respect of non property investments lending and have a loan-to-valuation ratio of less than or equal to 80%.

(e) Reconciliation of mortgage related amounts

$000	Unaudited December 2017
Loans and advances – loans with residential mortgages	1,093,612
On balance sheet residential mortgage exposures subject to the standardised approach	**1,093,612**
Off balance sheet mortgage exposures subject to the standardised approach	10,044
Total residential exposures subject to the standardised approach	**1,103,656**

(f) Credit risk mitigation

As at 31 December 2017 the banking group has $4.83 million of Welcome Home Loans, whose credit risk is mitigated by the Crown. Other than this the banking group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

18. Capital adequacy (continued)

(g) Operational Risk

$000	Implied risk weighted exposure	Total operational risk capital requirement
Unaudited – December 2017		
Operational risk	224,626	17,970

Operational risk is calculated based on the previous 12 quarters of the banking group.

(h) Market risk

$000		Implied risk weighted exposure	Aggregate capital charge
Unaudited – December 2017			
Market risk end-of-period capital charge	Interest rate risk only	117,377	9,390
Market risk peak end-of-day capital charge	Interest rate risk only	131,464	10,517
Market risk end-of-period capital charge	Foreign currency risk only	83,354	6,668
Market risk peak end-of-day capital charge	Foreign currency risk only	83,354	6,668

Peak end of day aggregate capital charge at the end of the period is derived by following the risk methodology for measuring capital requirements within Part 10 of the standardised approach. Peak end of day aggregate capital charge is derived by determining the maximum end of month capital charge over the reporting period. Based on the portfolio of the banking group's risk exposures, it is considered by management that the difference between end of month aggregate capital charge and end of day aggregate capital charge is insignificant.

(i) Total capital requirements

$000	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
Unaudited – December 2017			
Total credit risk			
On balance sheet	4,307,484	3,434,252	274,743
Off balance sheet	862,071	73,872	5,909
Operational risk	n/a	224,626	17,970
Market risk	n/a	200,731	16,058
Total	**n/a**	**3,933,481**	**314,680**

Notes to the Interim Financial Statements

FOR THE SIX MONTHS ENDED 31 DECEMBER 2017

18. Capital adequacy (continued)

(j) Capital ratios

%	Unaudited December 2017	Unaudited December 2016
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	14.31%	12.99%
Minimum Common Equity Tier 1 Capital as per Conditions of Registration	4.50%	4.50%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	14.31%	12.99%
Minimum Tier 1 Capital as per Conditions of Registration	6.00%	6.00%
Total Capital expressed as a percentage of total risk weighted exposures	14.76%	12.96%
Minimum Total Capital as per Conditions of Registration	8.00%	8.00%
Buffer ratio	6.76%	4.96%
Buffer ratio requirement	2.50%	2.50%

(k) Solo capital adequacy

%	Unaudited December 2017	Unaudited December 2016
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	15.70%	14.34%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	15.70%	14.34%
Total Capital expressed as a percentage of total risk weighted exposures	16.19%	14.34%

For the purposes of calculating capital adequacy on a solo basis, subsidiaries which are both wholly owned and wholly funded by the bank are to be consolidated with the bank. Therefore, capital adequacy on a solo basis is calculated based on the bank and its subsidiaries excluding ABCP Trust, SW Trust and ASF Trust.

(l) Capital for other material risks

In addition to the material risks included in the calculation of the capital ratios, the banking group has identified other material risks to be included in the capital allocation (being concentration risk, strategic/ business risk, reputational risk, regulatory and model risk). As at 31 December 2017, the banking group has made an internal capital allocation of $104.89 million (December 2016: $55.2 million) to cover these risks.

19. Insurance business, securitisation, funds management, other fiduciary activities

Insurance business

The banking group conducts insurance business through its subsidiary MARAC Insurance Limited (MIL).

The banking group's aggregate amount of insurance business comprises the total consolidated assets of MIL of $13.3 million, which is 0.31% of the total consolidated assets of the banking group.

The banking group's objective is to minimise the insurance risk to within acceptable levels through the policies and procedures implemented by management. Should adverse conditions arise, these policies and procedures are expected to mitigate the impact of the conditions on the banking group.

Marketing and distribution of insurance products

The banking group markets and distributes term life insurance and general insurance covering risks such as redundancy, bankruptcy or suspension of employment. The insurance products are either underwritten by MIL, a subsidiary of the bank, or sold by MIL on behalf of other parties who underwrite those products themselves. There have been no material changes in the banking group's marketing and distribution of insurance products since the reporting date of the previous disclosure statement.

19. Insurance business, securitisation, funds management, other fiduciary activities (continued)

Securitisation, funds management and other fiduciary activities

There have been no material changes to the bank's involvement in securitisation activities, and no material changes to the bank's involvement in funds management and other fiduciary activities, in either case since the reporting date of the previous disclosure statement.

20. Contingent liabilities and commitments

$000	Unaudited December 2017	Unaudited December 2017	Audited June 2017
Letters of credit, guarantee commitments and performance bonds	6,890	10,567	10,903
Total contingent liabilities	**6,890**	**10,567**	**10,903**
Undrawn facilities available to customers	164,153	99,061	120,948
Conditional commitments to fund at future dates	77,410	120,820	153,166
Total commitments	**241,563**	**219,881**	**274,114**

21. Events after reporting date

There have been no material events after the reporting date that would affect the interpretation of the interim financial statements or the performance of the banking group.

KPMG

Independent auditor's review report

To the shareholders of Heartland Bank Limited

Report on the half year disclosure statement of Heartland Bank Limited (the "bank") and its controlled entities (the "banking group")

Review conclusion

Based on our review of the consolidated interim financial statements and supplementary information of the bank and the banking group on pages 9 to 32, nothing has come to our attention that causes us to believe that:

i. the consolidated interim financial statements do not present fairly in all material respects the banking group's financial position as at 31 December 2017 and its financial performance and cash flows for the six month period ended on that date;

ii. the interim financial statements (excluding the supplementary information disclosed in accordance with schedules 5, 7, 9, 13, 16 and 18 of the Registered bank Disclosure Statements (New Zealand Incorporated Registered banks) order 2014 (as amended) (the "order")), have not been prepared, in all material respects, with NZ IAS 34 *Interim Financial Reporting* ("NZ IAS 34");

iii. the supplementary information, does not fairly state, in all material respects, the matters to which it relates in accordance with schedules 5, 7, 9, 13, 16 and 18 of the order; and

iv. the supplementary information relating to capital adequacy, has not been prepared, in all material respects, in accordance with the Registered banks conditions of registration, Capital Adequacy Framework (Standardised Approach) (BS2A) and disclosed in accordance with schedule 9 of the order.

We have completed a review of the accompanying consolidated half year disclosure statement which comprises:

- the interim financial statements formed of:
  - the interim statement of financial position as at 31 December 2017;
  - the interim statements of comprehensive income, changes in equity and cash flows for the 6 month period then ended; and
  - notes to the interim financial statements, including a summary of significant accounting policies and other explanatory information;
- the supplementary information prescribed in schedules 5, 7, 9, 13, 16 and 18 of the order.

Basis for conclusion

A review of the half year disclosure statement in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* ("NZ SRE 2410") is a limited assurance engagement. The auditor performs procedures, consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

As the auditor of the bank, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

Our firm has also provided other services to the banking group in relation to regulatory and accounting advisory services, and a health and safety framework review. Subject to certain restrictions, partners and employees of our firm may also deal with the banking group on normal terms within the ordinary course of trading activities of the business of the banking group. These matters have not impaired our independence as reviewer of the banking group. The firm has no other relationship with, or interest in, the banking group.

Use of this independent review report

This independent review report is made solely to the shareholders as a body. Our review work has been undertaken so that we might state to the shareholders those matters we are required to state to them in the independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the shareholders as a body for our review work, this independent review report, or any of the opinions we have formed.

Responsibilities of the directors for the consolidated half year disclosure statement

The directors, on behalf of the group, are responsible for:

- the preparation and fair presentation of the consolidated half year disclosure statement in accordance with NZ IAS 34 and schedules 3, 5, 7, 13, 16 and 18 of the order;
- the preparation and fair presentation of the supplementary information in regards to capital adequacy in accordance with the registered banks conditions of registration, Capital Adequacy Framework (Standardised Approach) (BS2A) and schedule 9 of the order;
- implementing necessary internal control to enable the preparation of a consolidated half year disclosure statement that is fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

Auditor’s responsibilities for the review of the bank and banking group half year disclosure statement

Our responsibility is to express a conclusion on the consolidated half year disclosure statement based on our review. We conducted our review in accordance with NZ SRE 2410. NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the:

- the consolidated interim financial statements do not present fairly in all material respects the banking group’s financial position as at 31 December 2017 and its financial performance and cash flows for the 6 month period ended on that date;
- the consolidated interim financial statements do not, in all material respects, comply with NZ IAS 34;
- the supplementary information does not, fairly state, in all material respects, the matters to which it relates in accordance with schedules 5, 7, 13, 16 and 18 of the order; and
- the supplementary information relating to capital adequacy is not, prepared in all material respects, in accordance with the registered banks conditions of registration, Capital Adequacy Framework (Standardised Approach) (BS2A) and disclosed in accordance with schedule 9 of the order.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly, we do not express an audit opinion on the consolidated half year disclosure statement.

This description forms part of our independent review report.

KPMG

KPMG
Auckland
20 February 2018

Corporate Directory

Directors

Geoffrey Ricketts	Chair and Independent Non-Executive Director
Bruce Irvine	Deputy Chair and Independent Non-Executive Director
Jeff Greenslade	Executive Director and Chief Executive Officer
Ellie Comerford	Independent Non-Executive Director
John Harvey	Independent Non-Executive Director
Graham Kennedy	Independent Non-Executive Director
Chris Mace	Independent Non-Executive Director
Vanessa Stoddart	Independent Non-Executive Director
Greg Tomlinson	Non-Executive Director

Strategic Management Group

Jeff Greenslade	Chief Executive Officer
Chris Flood	Deputy Chief Executive Officer
Laura Byrne	Head of People and Culture
Richard Lorraway	Chief Risk Officer
David Mackrell	Chief Financial Officer
Sarah Smith	Head of Business Enablement
Lydia Zulkifli	Head of Digital Strategy

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