Heart land

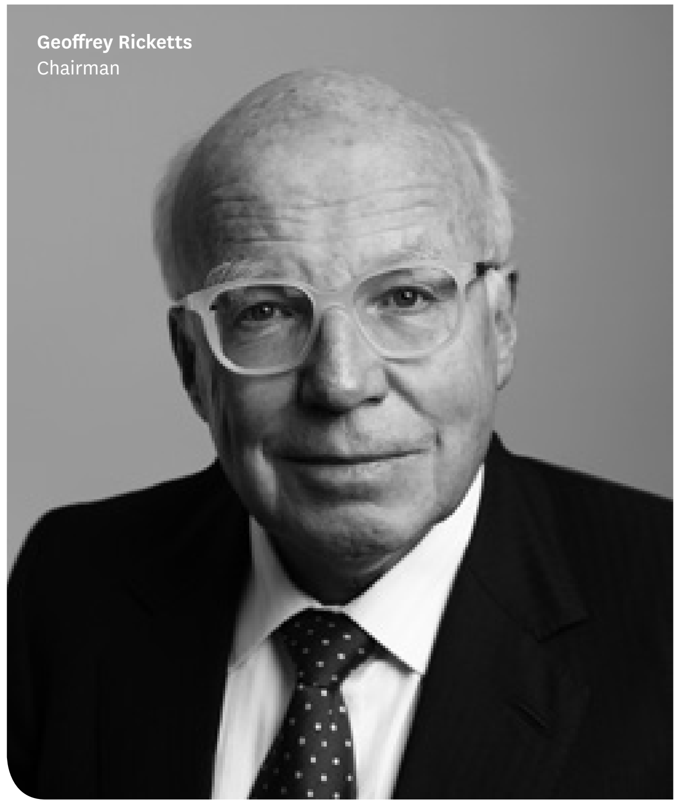
HEARTLAND
BANK

Interim Report
for the six months ended 31 December 2016

Contents

As a registered bank, Heartland Bank Limited is required to prepare quarterly Disclosure Statements. Heartland Bank Limited's interim financial statements for the six months ended 31 December 2016 (reporting period) are contained in its Disclosure Statement for the same reporting period.

Chairman and Chief Executive Officer's Report



Geoffrey Ricketts
Chairman

Jeffrey Greenslade
Chief Executive Officer

We are pleased to report another strong result for the first six months of the 2017 financial year. Profitability once again increased, with Heartland achieving a net profit after tax of $29.1m, an increase of 14% from the previous corresponding period. A key focus for the half year was execution of Heartland's digital distribution strategy which resulted in good initial growth, particularly in relation to Open for Business, a digital origination platform for small business loans.

Financial Commentary

Heartland's increased profitability for the half year was driven by strong receivables growth across all business divisions – Household, Business and Rural. Net finance receivables increased by $220.8m or 7% over the reporting period, driving an increase in net operating income of $5.3m or 7%. Earnings for the half year delivered an annualised return on equity of 11.6%, higher than the 11.1% achieved for the 2016 financial year. Based on the strong result for the half year, the Board has declared a fully imputed interim dividend of 3.5 cents per share.

Heartland's net assets increased from $498.3m to $528.0m during the reporting period. Net tangible assets (**NTA**) increased from $433.5m to $455.1m during the reporting period. On a per share basis, NTA was steady at $0.91 as at 31 December 2016 ($0.91 at 30 June 2016 and $0.90 at 31 December 2015).

Operating costs were down $1.1m to $36.0m. The cost to income ratio was 43% for the reporting period compared to 48% in the previous corresponding period, showing the benefit of scale economies achieved from growth. Impaired asset expense increased by $1.3m to $6.9m for the reporting period, primarily due to higher write-offs in the motor vehicle loan book and growth in personal loans and motor vehicle loans.

Funding and liquidity remained strong, despite a more competitive funding environment for banks generally, with retail deposits growing $229.8m to $2.5b over the reporting period. Heartland's cost of funds continued to decrease over the reporting period.

Heartland's net interest margin (**NIM**) for the reporting period was 4.44% compared to 4.52% for the six months ended 30 June 2016. This decrease was primarily driven by customer behaviour (with higher levels of early repayments experienced for motor vehicle loans) and changes to Heartland's asset mix. Heartland expects to maintain its NIM for the remainder of the 2017 financial year through a combination of changes to asset mix, re-pricing of selected existing loans, increasing new business rates and focusing distribution on lower loan size.

Business Performance

Business

Net operating income for the Business division increased 9% from the previous corresponding period, driven by growth in receivables. Net receivables for the Business division increased by 5% to $947.5m during the reporting period. Pleasing growth was achieved through the Open for Business digital origination platform for small business loans which grew by $16.0m or 142% to $27.3m. Extending the reach of the Open for Business platform will be a key priority for the Business division going forward, together with a progressive reduction in the average loan size for business customers in order to reduce concentrations and to enable a portfolio approach from a risk perspective.

Rural

Net operating income for the Rural division increased 6% from the previous corresponding period, again driven by strong receivables growth. Net receivables for the Rural division increased by 12% to $618.6m during the reporting period. This growth was primarily through term loans to both existing and new customers across all key rural sectors. Higher yielding assets in livestock finance and working capital declined in volume in the current reporting period, primarily due to seasonal factors. An increase in livestock facilities, including through the new Open for Livestock platform, is expected during the second half as stock trading volumes increase.

Trading conditions for Heartland's dairy customers improved over the course of the reporting period, with farmers enjoying increases in payments from dairy companies. Dairy customers have generally responded well to the difficult trading conditions over the past two years, with most customers managing to significantly lower their operating costs, and where necessary, to consolidate their financial position.

Household

The Household division – which is made up of motor vehicle loans, personal loans (including lending through the Harmoney platform), reverse mortgages and residential mortgages – performed strongly during the reporting period with net operating income increasing 7% from the previous corresponding period.

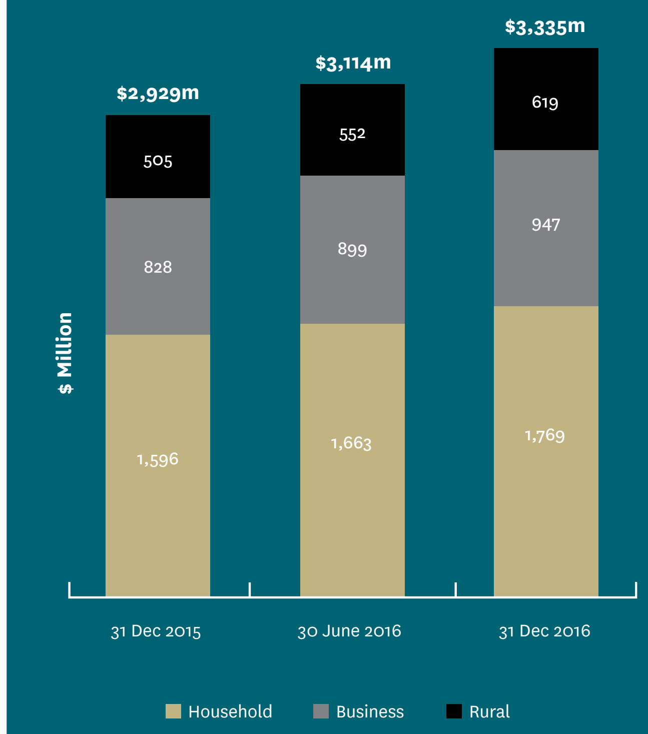
Net motor vehicle loan receivables continued to grow, increasing by 4% to $794.5m during the 6 months. Heartland remains optimistic about continued growth in the motor vehicle loan book, with its comparatively lower cost of funds continuing to provide an advantage over non-bank competitors in the motor vehicle finance market.

Strong growth in personal lending was also achieved in the reporting period with net receivables from personal loans increasing by 26% to $22.5m. Excellent growth was also achieved in lending through the Harmoney platform which increased by 69% to $62.1m.

Net operating income for reverse mortgages increased $3.1m from the previous corresponding period to $14.3m. Net receivables from reverse mortgages grew by 5% in New Zealand and 9% in Australia during the reporting period. Growth was particularly strong in Australia, driven by continued broadening of the broker distribution network.

Net receivables from residential mortgages reduced by $8.1m during the reporting period to $37.7m. Residential mortgages have been a non-core product for Heartland due to the highly competitive nature of the market. However, the recent launch of Heartland's Open for Home Loans platform enables Heartland to appeal to a part of this market through use of a scalable digital distribution platform for customers who value speed and ease when applying for a residential mortgage.

Net Finance Receivables



Net profit after tax

6 months to 31 December 2016

$29.1m

▲ 14% increase on 6 months to 31 December 2015

Net operating income

6 months to 31 December 2016

$83.0m

▲ 7% increase on 6 months to 31 December 2015

Strategy

Heartland's early strategic focus was product-centric, delivering innovative banking products in niches that were underserviced by the other banks. Heartland has entered the next phase of its strategy, focusing on the channels through which its products are delivered. Execution of this strategy is two-fold, with digital channels being utilised to provide a fast and simple customer experience and, for depositors and reverse mortgage customers, maintaining a high touch telephony service.

To date Heartland has successfully launched digital platforms for small business loans (Open for Business), livestock loans (Open for Livestock) and, most recently, residential mortgages (Open for Home Loans). The shift to a digital distribution model is a cost effective way for Heartland to broaden its reach in these markets. The development of new digital origination platforms and the improvement of Heartland's existing digital platforms will be a key priority for the remainder of the 2017 financial year.

Execution of Heartland's digital strategy is also being carried out through partnerships with businesses that are using innovative technology to provide unique lending products. In February 2017, Heartland announced a new partnership with Fuelled Limited, taking a 25% shareholding in the company. Fuelled offers business customers the ability to borrow money against outstanding invoices through a simple, fast and frictionless online service. Fuelled's competitive advantage stems from its simple online process that is fully and seamlessly integrated with accounting software provider Xero. This integration enables Fuelled's advanced credit assessment engine to make real time credit and financing decisions.

Another key strategic priority for the remainder of the financial year will be expansion of certain product offerings in Australia, including small business loans through a digital platform. Heartland also recently announced its new partnership with Spotcap Australia, an online lender providing business loans to small and medium sized businesses by utilising a unique, proprietary credit algorithm which provides an alternative basis for credit analysis. The partnership with Spotcap provides Heartland with the opportunity to gain exposure to digital business lending in Australia and support an innovative fintech solution that aligns with some of Heartland's key strategic priorities including expanding its digital distribution strategy and growing its presence in Australia.

Dividend and Capital Management

The Board has declared a fully imputed interim dividend of 3.5 cents per share. The Dividend Reinvestment Plan (**DRP**) was available in respect of the dividend and a discount of 2.5% was applied. Shareholders who wished to participate in the DRP needed to elect to do so by 24 March 2017.[1]

Moving forward Heartland intends to take a more dynamic approach to capital management, in the same way that the larger banks operate, holding a more efficient level of capital and approaching the market to access capital through multiple issuances that are timed and sized to meet its capital needs. Heartland reduced its total capital ratio to 13.0% as at 31 December 2016 down from 13.8% as at 30 June 2016.

Heartland's strong asset growth will require additional capital to support that growth and to invest in Heartland's digital distribution strategy. Heartland successfully completed a $20.0m institutional placement in December 2016 followed by a $20.0m share purchase plan for all shareholders under which shares were allotted on 15 March 2017. Heartland is also in the process of finalising an offer of approximately A$15.0m of Tier 2 regulatory capital to wholesale investors in Australia and New Zealand.

Return on Equity

Annualised for the six months to 31 December 2016

11.6%

▲ from **11.1%** for the 12 months to 30 June 2016

Interim dividend

To be paid on 7 April 2017

3.5c PER SHARE

New Board Appointments

Heartland welcomed two new directors to the Board in the first half of the 2017 financial year. Vanessa Stoddart, who joined the Board in October 2016, is an experienced director currently serving on a number of boards including The Warehouse Group Limited and the Financial Markets Authority. Vanessa brings outstanding professional leadership and governance experience to the role, having gained broad commercial experience in change management and performance improvement roles for some of New Zealand's largest companies.

Ellie Comerford joined the Heartland Board in January 2017 and was also appointed as Chair of Heartland's key Australian subsidiaries. Ellie is based in Australia and most recently served as CEO and Managing Director of Genworth Mortgage Insurance Australia, bringing outstanding strategic and management experience to the Heartland Board as well as a strong track record of working with Australian regulators.

Looking forward

Heartland's strong asset growth is expected to continue for the remainder of the 2017 financial year. In particular, focus will be on driving growth for products that are distributed through Heartland's digital platforms, given their modest size currently and the size of the market opportunity available.

Heartland expects net profit after tax for the year ending 30 June 2017 to be at the upper end of the previously advised range of $57.0m to $60.0m. This guidance range does not take into account the impact of any capital management initiatives.

Geoffrey Ricketts
Chairman

Jeffrey Greenslade
Chief Executive Officer

[1]For full information on the DRP, please see Heartland's DRP Offer Document dated 1 January 2016, which is available on our website.

Todd Somerville, Sarah Selwood and Richard Lorraway.

Lydia Zulkifli, Joshua Williams and Andrew Dixson.

Sarah Smith, Michael Drumm and Shannon Beech.

Disclosure Statement

For the six months ended 31 December 2016

As a registered bank, Heartland Bank Limited is required to prepare quarterly Disclosure Statements. Heartland Bank Limited's interim financial statements for the six months ended 31 December 2016 (reporting period) are contained in this Disclosure Statement.

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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 2016 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 2016 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

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

Nicola Greer retired from the Board effective 25 July 2016. Vanessa Stoddart was appointed to the Board effective 3 October 2016 and Ellen Comerford was appointed to the Board effective 1 January 2017.

Amendments to Conditions of Registration

With effect from 1 October 2016, conditions 19, 20 and 21 were amended to impose conditions relating to residential mortgage lending nationwide to property investors and non-property investors. In addition, the definition of terms used in these clauses was amended to refer to the updated version of the "Framework for Restrictions on High-LVR Residential Lending" (BS 19) dated October 2016.

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 group's buffer ratio	Percentage limit to distributions of the banks' 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.

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.

Conditions of Registration (continued)

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.

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).

[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)

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.

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.

Conditions of Registration (continued)

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.

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.

Conditions of Registration (continued)

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.

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 10 October 2016 and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars.

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 2016:
   (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 21 February 2017 and has been signed by all of the Directors.

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

G. R. Kennedy

B. R. Irvine

J. K. Greenslade

C. R. Mace

E. F. Comerford

V. C. M. Stoddart

E. J. Harvey

G. R. Tomlinson

Interim Statement of Comprehensive Income

For the six months ended 31 December 2016

	NOTE	Unaudited 6 mths to Dec 2016 $000	Unaudited 6 mths to Dec 2015 $000	Audited 12 mths to Jun 2016 $000
Interest income	2	135,789	134,340	265,475
Interest expense	2	56,828	62,869	118,815
Net interest income		**78,961**	**71,471**	**146,660**
Operating lease income		3,688	4,718	8,869
Operating lease expenses		2,728	3,271	6,230
Net operating lease income		**960**	**1,447**	**2,639**
Lending and credit fee income		1,534	1,767	3,339
Other income		1,567	3,076	4,923
Net operating income		**83,022**	**77,761**	**157,561**
Selling and administration expenses	3	35,966	37,039	69,872
Profit before impaired asset expense and income tax		**47,056**	**40,722**	**87,689**
Impaired asset expense	4	6,892	5,610	13,501
Profit before income tax		**40,164**	**35,112**	**74,188**
Income tax expense		11,072	9,514	20,024
Profit for the period		**29,092**	**25,598**	**54,164**
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		1,290	14	(708)
Movement in available for sale reserve, net of income tax		(1,736)	(1,035)	(208)
Movement in foreign currency translation reserve, net of income tax		(279)	(2,682)	(4,047)
Items that will not be reclassified to profit or loss:				
Movement in defined benefit reserve, net of income tax		(84)	(31)	(93)
Other comprehensive (loss) / income for the period, net of income tax		**(809)**	**(3,734)**	**(5,056)**
Total comprehensive income for the period		**28,283**	**21,864**	**49,108**
Earnings per share from continuing operations				
Basic earnings per share	5	6c	5c	11c
Diluted earnings per share	5	6c	5c	11c

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

The notes on pages 22 to 39 are an integral part of these interim financial statements.

Interim Statement of Changes in Equity

For the six months ended 31 December 2016

	NOTE	Share Capital $000	Treasury Shares Reserve $000	Employee Benefits Reserve $000	Foreign Currency Translation Reserve $000	Available for Sale Reserve $000	Defined Benefit Reserve $000	Hedging Reserve $000	Retained Earnings $000	Total Equity $000
Unaudited - Dec 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
Total other comprehensive (loss) / income		-	-	-	(279)	(1,736)	(84)	1,290	-	(809)
Total comprehensive (loss) / income for the perio		**-**	**-**	**-**	**(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**
Unaudited - Dec 2015										
Balance at 1 July 2015		**413,917**	**(272)**	**2,200**	**2,231**	**1,170**	**94**	**(1,552)**	**62,337**	**480,125**
Total comprehensive income for the period										
Profit for the period		-	-	-	-	-	-	-	25,598	25,598
Total other comprehensive (loss) / income		-	-	-	(2,682)	(1,035)	(31)	14	-	(3,734)
Total comprehensive (loss) / income for the perio		**-**	**-**	**-**	**(2,682)**	**(1,035)**	**(31)**	**14**	**25,598**	**21,864**
Contributions by and distributions to owners										
Dividends paid	8	-	-	-	-	-	-	-	(21,435)	(21,435)
Dividend reinvestment plan	8	4,119	-	-	-	-	-	-	-	4,119
Share based payments		-	-	1,015	-	-	-	-	-	1,015
Shares vested		105	50	(155)	-	-	-	-	-	-
Total transactions with owners		**4,224**	**50**	**860**	**-**	**-**	**-**	**-**	**(21,435)**	**(16,301)**
Balance at 31 December 2015		**418,141**	**(222)**	**3,060**	**(451)**	**135**	**63**	**(1,538)**	**66,500**	**485,688**
Audited - Jun 2016										
Balance at 1 July 2015		**413,917**	**(272)**	**2,200**	**2,231**	**1,170**	**94**	**(1,552)**	**62,337**	**480,125**
Total comprehensive income for the year										
Profit for the year		-	-	-	-	-	-	-	54,164	54,164
Total other comprehensive (loss)		-	-	-	(4,047)	(208)	(93)	(708)	-	(5,056)
Total comprehensive (loss) / income for the year		**-**	**-**	**-**	**(4,047)**	**(208)**	**(93)**	**(708)**	**54,164**	**49,108**
Contributions by and distributions to owners										
Dividends paid	8	-	-	-	-	-	-	-	(37,690)	(37,690)
Dividend reinvestment plan	8	7,300	-	-	-	-	-	-	-	7,300
Share based payments		-	-	1,888	-	-	-	-	-	1,888
Shares vested		160	50	(210)	-	-	-	-	-	-
Treasury shares acquired		-	(2,390)	-		-	-	-	-	(2,390)
Total transactions with owners		**7,460**	**(2,340)**	**1,678**	**-**	**-**	**-**	**-**	**(37,690)**	**(30,892)**
Balance at 30 June 2016		**421,377**	**(2,612)**	**3,878**	**(1,816)**	**962**	**1**	**(2,260)**	**78,811**	**498,341**

The notes on pages 22 to 39 are an integral part of these interim financial statements.

Interim Statement of Financial Position

As at 31 December 2016

	NOTE	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Assets				
Cash and cash equivalents		69,655	31,879	84,154
Investments		298,519	269,769	236,435
Investment properties		6,827	12,439	8,384
Finance receivables	6	3,334,800	2,928,601	3,113,957
Operating lease vehicles		21,232	26,645	24,557
Other assets		16,196	15,536	14,871
Intangible assets		65,584	54,314	57,755
Deferred tax asset		7,334	5,315	7,068
Total assets		**3,820,147**	**3,344,498**	**3,547,181**
Liabilities				
Borrowings	7	3,247,021	2,814,338	2,999,987
Current tax liabilities		5,986	1,095	6,754
Trade and other payables		39,138	43,377	42,099
Total liabilities		**3,292,145**	**2,858,810**	**3,048,840**
Equity				
Share capital		448,044	418,141	418,765
Retained earnings and reserves		79,958	67,547	79,576
Total equity		**528,002**	**485,688**	**498,341**
Total equity and liabilities		**3,820,147**	**3,344,498**	**3,547,181**

Total interest earning and discount bearing assets		3,691,629	3,229,307	3,427,117
Total interest and discount bearing liabilities		3,241,811	2,838,082	3,005,853

The notes on pages 22 to 39 are an integral part of these interim financial statements.

Interim Statement of Cash Flows

For the six months ended 31 December 2016

	NOTE	Unaudited 6 mths to Dec 2016 $000	Unaudited 6 mths to Dec 2015 $000	Audited 12 mths to Jun 2016 $000
Cash flows from operating activities				
Interest received		128,484	130,935	251,814
Operating lease income received		4,394	4,965	9,468
Lending, credit fees and other income received		3,887	3,393	7,940
Operating inflows		**136,765**	**139,293**	**269,222**
Payments to suppliers and employees		37,432	44,871	79,661
Interest paid		64,305	74,653	131,378
Taxation paid		11,884	13,449	20,297
Operating outflows		**113,621**	**132,973**	**231,336**
Net cash flows from operating activities before changes in operating assets and liabilities		**23,144**	**6,320**	**37,886**
Proceeds from sale of operating lease vehicles		4,622	4,764	7,933
Purchase of operating lease vehicles		(3,421)	(3,892)	(8,187)
Net movement in finance receivables		(219,505)	(67,676)	(251,734)
Net movement in deposits		229,878	77,521	186,120
Net cash flows from / (applied to) operating activities		**34,718**	**17,037**	**(27,982)**
Cash flows from investing activities				
Net proceeds from sale of investment properties		1,580	12,089	16,492
Proceeds from sale of office fit-out, equipment and intangible assets		-	762	784
Net decrease in investments		-	67,088	98,480
Total cash provided from investing activities		**1,580**	**79,939**	**115,756**
Purchase of office fit-out, equipment and intangible assets		8,922	6,053	12,700
Capital expenditure on investment properties		-	-	24
Net increase in investments		59,349	-	-
Purchase of equity investment		4,000	2,300	2,300
Total cash applied to investing activities		**72,271**	**8,353**	**15,024**
Net cash flows (applied to) / from investing activities		**(70,691)**	**71,586**	**100,732**
Cash flows from financing activities				
Net increase in wholesale funding		20,649	-	1,637
Increase in share capital	8	20,000	-	-
Total cash provided from financing activities		**40,649**	**-**	**1,637**
Dividends paid	8	18,764	17,316	30,390
Transaction costs associated with capital raising		411	-	-
Net decrease in wholesale funding		-	79,585	-
Total cash applied to financing activities		**19,175**	**96,901**	**30,390**
Net cash flows from / (applied to) financing activities		**21,474**	**(96,901)**	**(28,753)**
Net (decrease) / increase in cash held		**(14,499)**	**(8,278)**	**43,997**
Opening cash and cash equivalents		84,154	37,012	37,012
Cash impact of business acquisition (MARAC Insurance Limited)		-	3,145	3,145
Closing cash and cash equivalents		**69,655**	**31,879**	**84,154**

The notes on pages 22 to 39 are an integral part of these interim financial statements.

Interim Statement of Cash Flows (continued)

For the six months ended 31 December 2016

Reconciliation of profit after tax to net cash flows from operating activities

	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Profit for the period	**29,092**	**25,598**	**54,164**
Add non-cash items included in net profit before taxation:			
Depreciation and amortisation expense	1,001	1,029	2,153
Depreciation on lease vehicles	2,435	2,961	5,695
Capitalised net interest income	(10,758)	(12,581)	(25,548)
Impaired asset expense	6,892	5,610	13,501
Total non-cash items	**(430)**	**(2,981)**	**(4,199)**
Add / (less) movements in operating assets and liabilities:			
Finance receivables	(219,505)	(67,676)	(251,734)
Operating lease vehicles	890	392	(254)
Other assets	(2,994)	(5,531)	(2,446)
Disposal of property, plant and equipment and intangibles	-	-	(322)
Current tax	(768)	(6,784)	(1,125)
Derivative financial instruments revaluation	(1,746)	(1,422)	(1,338)
Deferred tax (benefit) / expense	(266)	2,439	686
Deposits	229,878	77,521	186,120
Other liabilities	567	(4,519)	(7,534)
Total movements in operating assets and liabilities	**6,056**	**(5,580)**	**(77,947)**
Net cash flows from operating activities	**34,718**	**17,037**	**(27,982)**

The notes on pages 22 to 39 are an integral part of these interim financial statements.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

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 2016, Heartland Bank Limited 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 2016 - Unaudited
• 6 month period ended 31 December 2015 - Unaudited
• 12 month period ended 30 June 2016 - 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 Heartland Bank Limited's Annual Report for the year ended 30 June 2016.

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 2016.

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 comprises the following main operating segments:

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

Comparative information has been restated to be consistent with the current reporting period.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

1 Segmental analysis (continued)

Operating segments (continued)

	Households $000	Business $000	Rural $000	Admin & Support $000	Total $000
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	1,789,958	954,290	618,611	457,288	**3,820,147**
Total liabilities	-	-	-	3,292,145	**3,292,145**
Unaudited - 6 months ended 31 December 2015					
Net interest income / (expense)	38,411	20,097	12,965	(2)	71,471
Net other income	4,236	1,072	64	918	6,290
Net operating income	**42,647**	**21,169**	**13,029**	**916**	**77,761**
Selling and administration expenses	10,811	5,000	2,235	18,993	37,039
Profit / (loss) before impaired asset expense and income tax	**31,836**	**16,169**	**10,794**	**(18,077)**	**40,722**
Impaired asset expense	2,792	2,444	374	-	5,610
Profit / (loss) before income tax	**29,044**	**13,725**	**10,420**	**(18,077)**	**35,112**
Income tax expense	-	-	-	9,514	9,514
Profit / (loss) for the period	**29,044**	**13,725**	**10,420**	**(27,591)**	**25,598**
Total assets	1,623,154	839,917	504,614	376,813	**3,344,498**
Total liabilities	-	-	-	2,858,810	**2,858,810**
Audited - 12 months ended 30 June 2016					
Net interest income	79,320	41,061	26,111	168	146,660
Net other income	6,752	1,921	152	2,076	10,901
Net operating income	**86,072**	**42,982**	**26,263**	**2,244**	**157,561**
Selling and administration expenses	17,995	9,015	4,351	38,511	69,872
Profit / (loss) before impaired asset expense and income tax	**68,077**	**33,967**	**21,912**	**(36,267)**	**87,689**
Impaired asset expense	7,161	3,381	2,959	-	13,501
Profit / (loss) before income tax	**60,916**	**30,586**	**18,953**	**(36,267)**	**74,188**
Income tax expense	-	-	-	20,024	20,024
Profit / (loss) for the period	**60,916**	**30,586**	**18,953**	**(56,291)**	**54,164**
Total assets	1,687,232	907,205	552,461	400,283	**3,547,181**
Total liabilities	-	-	-	3,048,840	**3,048,840**

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

2 Net interest income

	Unaudited 6 mths to Dec 2016 $000	Unaudited 6 mths to Dec 2015 $000	Audited 12 mths to Jun 2016 $000
Interest income			
Cash and cash equivalents	333	472	771
Investments	4,242	6,030	10,203
Finance receivables	131,214	127,838	254,501
Total interest income	**135,789**	**134,340**	**265,475**
Interest expense			
Retail deposits	42,442	45,298	85,955
Bank and securitised borrowings	13,310	16,904	31,232
Net interest expense on derivative financial instruments	1,076	667	1,628
Total interest expense	**56,828**	**62,869**	**118,815**
Net interest income	**78,961**	**71,471**	**146,660**

3 Selling and administration expenses

	Unaudited 6 mths to Dec 2016 $000	Unaudited 6 mths to Dec 2015 $000	Audited 12 mths to Jun 2016 $000
Personnel expenses	20,167	20,333	39,051
Directors' fees	313	459	743
Superannuation	310	354	748
Audit and review of financial statements [1]	218	218	436
Other assurance fees paid to auditor [2]	28	15	43
Other fees paid to auditor [3]	102	61	107
Depreciation - property, plant and equipment	697	429	1,081
Amortisation - intangible assets	304	600	1,072
Operating lease expense as a lessee	1,049	1,163	2,281
Legal and professional fees	1,065	1,517	2,352
Other operating expenses	11,713	11,890	21,958
Total selling and administration expenses	**35,966**	**37,039**	**69,872**

4 Impaired asset expense

	NOTE	Unaudited 6 mths to Dec 2016 $000	Unaudited 6 mths to Dec 2015 $000	Audited 12 mths to Jun 2016 $000
Non-securitised				
Individually impaired expense		1,197	740	1,072
Collectively impaired expense		4,818	4,345	11,186
Total non-securitised impaired asset expense		**6,015**	**5,085**	**12,258**
Securitised				
Individually impaired (benefit)		-	(9)	(9)
Collectively impaired expense		877	534	1,252
Total securitised impaired asset expense		**877**	**525**	**1,243**
Total				
Individually impaired expense	13(d)	1,197	731	1,063
Collectively impaired expense	13(d)	5,695	4,879	12,438
Total impaired asset expense		**6,892**	**5,610**	**13,501**

[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, and other agreed upon procedure engagements.

[3] Other fees paid to the auditor include professional fees in connection with regulatory advisory services, project quality assurance, accounting advice and an internal audit quality assurance review.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

5 Earnings per share

The calculation of basic earnings of 6c per share for the 6 months to 31 December 2016 (6 months to 31 December 2015: 5c per share; 12 months to 30 June 2016: 11c per share) is based on the profit for the period of $29,092,000 (31 December 2015: $25,598,000; 30 June 2016: $54,164,000), and a weighted average number of shares on issue of 482,334,081 (31 December 2015: 471,710,670; 30 June 2016: 473,359,905).

The calculation of diluted earnings of 6c per share for the 6 months to 31 December 2016 (6 months to 31 December 2015: 5c per share; 12 months to 30 June 2016: 11c per share) is based on the profit for the period of $29,092,000 (31 December 2015: $25,598,000; 30 June 2016: $54,164,000), and a weighted average number of shares on issue (including the shares allotted under the 2015 tranche of the LTI net share settled plan) of 485,367,780 (31 December 2015: 482,379,863; 30 June 2016: 481,160,055).

Financial Position

6 Finance receivables

	NOTE	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Non-securitised				
Neither at least 90 days past due nor impaired		2,987,781	2,625,684	2,785,927
At least 90 days past due		32,405	19,588	20,070
Individually impaired		15,921	27,167	33,751
Restructured assets		3,654	3,235	3,281
Gross finance receivables		**3,039,761**	**2,675,674**	**2,843,029**
Less provision for impairment		21,535	15,807	19,936
Less fair value adjustment for present value of future losses		4,404	5,599	4,987
Total non-securitised finance receivables		**3,013,822**	**2,654,268**	**2,818,106**
Securitised				
Neither at least 90 days past due nor impaired		318,373	273,770	295,166
At least 90 days past due		3,786	1,619	1,897
Individually impaired		14	12	13
Gross finance receivables		**322,173**	**275,401**	**297,076**
Less provision for impairment		1,195	1,068	1,225
Total securitised finance receivables		**320,978**	**274,333**	**295,851**
Total				
Neither at least 90 days past due nor impaired		3,306,154	2,899,454	3,081,093
At least 90 days past due		36,191	21,207	21,967
Individually impaired		15,935	27,179	33,764
Restructured assets		3,654	3,235	3,281
Gross finance receivables		**3,361,934**	**2,951,075**	**3,140,105**
Less provision for impairment	13(d)	22,730	16,875	21,161
Less fair value adjustment for present value of future losses		4,404	5,599	4,987
Total finance receivables		**3,334,800**	**2,928,601**	**3,113,957**

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

7 Borrowings

	Unaudited 6 mths to Dec 2016 $000	Unaudited 6 mths to Dec 2015 $000	Audited 12 mths to Jun 2016 $000
Deposits	2,512,629	2,174,533	2,282,876
Subordinated Bonds	3,379	3,381	3,378
Bank borrowings	454,317	377,605	429,304
Borrowings - securitised	276,696	258,819	284,429
Total borrowings	**3,247,021**	**2,814,338**	**2,999,987**

Deposits rank equally and are unsecured. The Subordinated Bonds rank below all other general liabilities of the banking group.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

7 Borrowings (continued)

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. The banking group has securitised bank facilities of $350 million (December 2015: $350 million; June 2016: $350 million) in relation to the ABCP Trust, which matures on 3 August 2017.

The banking group has an Australian bank facility provided by Commonwealth Bank of Australia (CBA bank facility) totalling $415 million (December 15: $373 million; June 2016: $379 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 the ASF Group.

8 Share capital and dividends

	Unaudited Dec 2016 000	Unaudited Dec 2015 000	Audited Jun 2016 000
Issued shares			
Opening balance	476,469	469,890	469,890
Shares issued during the period	19,123	46	213
Dividend reinvestment plan	3,573	3,711	6,366
Closing balance	**499,165**	**473,647**	**476,469**

On 15 December 2016, the bank issued 13,698,630 fully paid new ordinary shares at $1.46 per share. Other shares issued during the period relate to staff share schemes.

Under dividend reinvestment plans, the banking group issued 3,573,104 new shares at $1.477 per share on 7 October 2016 (December 2015: 3,711,076 new shares at $1.110 per share on 2 October 2015; June 2016: 3,711,076 new shares at $1.110 per share on 2 October 2015 and 2,655,142 new shares at $1.198 per share on 5 April 2016).

(i) Dividends

On 7 October 2016 the banking group paid total dividends of $24.04 million (5 cents per share) (31 December 2015: $21.44 million (4.5 cents per share); 30 June 2016: $37.69 million (8 cents per share)).

9 Related party transactions and balances

Transactions with key management personnel

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

	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Transactions with key management personnel			
Interest income	3	51	104
Interest expense	(382)	(265)	(460)
Total transactions with key management personnel	**(379)**	**(214)**	**(356)**
Due from / (to) key management personnel			
Finance receivables	79	1,446	1,428
Borrowings - deposits	(22,928)	(21,833)	(26,526)
Total due (to) key management personnel	**(22,849)**	**(20,387)**	**(25,098)**

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.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

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.

	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Unaudited - Dec 2016				
Assets				
Investments	287,228	-	11,291	298,519
Finance receivables	-	17,733	-	17,733
Derivative assets held for risk management	-	178	-	178
Total	**287,228**	**17,911**	**11,291**	**316,430**
Liabilities				
Derivative liabilities held for risk management	-	2,860	-	2,860
Total	**-**	**2,860**	**-**	**2,860**
Unaudited - Dec 2015				
Assets				
Investments	251,489	10,989	7,291	269,769
Finance receivables	-	22,477	-	22,477
Derivative assets held for risk management	-	365	-	365
Total	**251,489**	**33,831**	**7,291**	**292,611**
Liabilities				
Derivative liabilities held for risk management	-	5,277	-	5,277
Total	**-**	**5,277**	**-**	**5,277**

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

10 Fair value (continued)

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

	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Audited - Jun 2016				
Assets				
Investments	229,144	-	7,291	236,435
Finance receivables	-	21,884	-	21,884
Derivative assets held for risk management	-	148	-	148
Total	**229,144**	**22,032**	**7,291**	**258,467**
Liabilities				
Derivative liabilities held for risk management	-	5,866	-	5,866
Total	**-**	**5,866**	**-**	**5,866**

(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.

	Unaudited Total Fair Value Dec 2016 $000	Unaudited Total Carrying Value Dec 2016 $000	Unaudited Total Fair Value Dec 2015 $000	Unaudited Total Carrying Value Dec 2015 $000	Audited Total Fair Value Jun 2016 $000	Audited Total Carrying Value Jun 2016 $000
Assets						
Cash and cash equivalents	69,655	69,655	31,879	31,879	84,154	84,154
Finance receivables	2,986,751	2,996,089	2,631,115	2,631,791	2,792,936	2,796,222
Finance receivables - securitised	321,398	320,978	276,092	274,333	297,371	295,851
Other financial assets	5,030	5,030	6,433	6,433	5,452	5,452
Total financial assets	**3,382,834**	**3,391,752**	**2,945,519**	**2,944,436**	**3,179,913**	**3,181,679**
Liabilities						
Borrowings	2,974,043	2,970,325	2,566,302	2,555,519	2,727,417	2,715,558
Borrowings - securitised	276,696	276,696	258,819	258,819	284,429	284,429
Other financial liabilities	22,604	22,604	18,467	18,467	21,995	21,995
Total financial liabilities	**3,273,343**	**3,269,625**	**2,843,588**	**2,832,805**	**3,033,841**	**3,021,982**

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 2016.

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 2016.

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.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

12 Credit risk exposure (continued)

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.

	Unaudited Dec 2016 $000
Cash and cash equivalents	69,655
Investments	287,228
Finance receivables	3,334,800
Derivative financial assets	178
Other financial assets	5,030
Total on balance sheet credit exposures	**3,696,891**

(b) Concentration of credit risk by geographic region

New Zealand:	
Auckland	838,352
Wellington	285,164
Rest of North Island	822,142
Canterbury	505,254
Rest of South Island	653,353
Australia:	
Queensland	92,361
New South Wales	211,240
Victoria	134,751
Western Australia	32,953
South Australia	11,896
Rest of Australia	7,816
Rest of the world [1]	123,508
	3,718,790
Collective provision	(17,495)
Less acquisition fair value adjustment for present value of future losses	(4,404)
Total on balance sheet credit exposures	**3,696,891**

(c) Concentration of credit risk by industry sector

Agriculture	712,072
Forestry and Fishing	65,980
Mining	17,652
Manufacturing	47,305
Finance & Insurance	382,790
Wholesale Trade	38,182
Retail Trade	282,155
Households	1,598,955
Property and Business Services	396,383
Transport and Storage	33,822
Other	143,494
	3,718,790
Collective provision	(17,495)
Less acquisition fair value adjustment for present value of future losses	(4,404)
Total on balance sheet credit exposures	**3,696,891**

[1] These overseas assets are not Finance Receivables. They are Investments representing NZD-denominated investments in AA+ and higher rated securities issued by offshore supranational agencies ("Kauri Bonds").

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For the six months ended 31 December 2016

12 Credit risk exposure (continued)

(d) Credit exposure to individual counterparties

At 31 December 2016 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 2015: nil; June 2016: 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:

Corporate

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 All other lending that does not fall into another category.

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 Consumer lending to individuals.

(a) Finance receivables by credit risk concentration

	Corporate Rural $000	Corporate Other $000	Residential $000	All Other $000	Total $000
Unaudited - Dec 2016					
Neither at least 90 days past due nor impaired	761,155	958,254	901,157	685,588	3,306,154
At least 90 days past due	14,211	12,413	-	9,567	36,191
Individually impaired	979	14,956	-	-	15,935
Restructured assets	51	836	-	2,767	3,654
Fair value adjustment for present value of future losses	-	-	(4,404)	-	(4,404)
Provision for impairment	(4,714)	(10,650)	(3,613)	(3,753)	(22,730)
Total net finance receivables	**771,682**	**975,809**	**893,140**	**694,169**	**3,334,800**

(b) Past due but not impaired

	Corporate Rural $000	Corporate Other $000	Residential $000	All Other $000	Total $000
Unaudited - Dec 2016					
Less than 30 days past due	13,143	14,347	554	18,113	46,157
At least 30 days but less than 60 days past due	5,874	9,021	865	5,736	21,496
At least 60 days but less than 90 days past due	627	1,244	-	2,953	4,824
At least 90 days past due	14,210	12,413	-	9,567	36,190
Total past due but not impaired	**33,854**	**37,025**	**1,419**	**36,369**	**108,667**

(c) Individually impaired assets

	Corporate Rural $000	Corporate Other $000	Residential $000	All Other $000	Total $000
Unaudited - Dec 2016					
Opening	22,667	11,097	-	-	33,764
Additions	2,398	20,555	-	-	22,953
Deletions	(23,788)	(15,030)	-	-	(38,818)
Write offs	(298)	(1,666)	-	-	(1,964)
Closing gross individually impaired assets	**979**	**14,956**	**-**	**-**	**15,935**
Less: provision for individually impaired assets	938	4,173	124	-	5,235
Total net impaired assets	**41**	**10,783**	**(124)**	**-**	**10,700**

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13 Asset quality (continued)

(d) Provision for impairment

	Corporate Rural $000	Corporate Other $000	Residential $000	All Other $000	Total $000
Unaudited - Dec 2016					
Provision for individually impaired assets					
Opening provision for individually impaired assets	869	4,033	-	-	4,902
Impairment loss for the period					
- charge for the period	367	706	124	-	1,197
- recoveries	-	1,100	-	-	1,100
- write offs	(298)	(1,666)	-	-	(1,964)
Closing provision for individually impaired assets	**938**	**4,173**	**124**	**-**	**5,235**
Provision for collectively impaired assets					
Opening provision for collectively impaired assets	3,595	6,032	3,046	3,586	16,259
Impairment loss for the period					
- charge / (credit) for the period	363	983	443	3,906	5,695
- recoveries	23	88	-	18	129
- write offs	(205)	(626)	-	(3,757)	(4,588)
Closing provision for collectively impaired assets	**3,776**	**6,477**	**3,489**	**3,753**	**17,495**
Total provision for impairment	**4,714**	**10,650**	**3,613**	**3,753**	**22,730**

(e) Undrawn balances for individually impaired assets

As at 31 December 2016 there are no undrawn lending commitments to counterparties for whom drawn balances are classified as individually impaired (December 2015: nil; June 2016: nil).

(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 2016, the banking group had $1.31 million of assets under administration (December 2015: $2.76 million; June 2016: $3.02 million).

14 Liquidity risk

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

	Unaudited Dec 2016 $000
Cash and cash equivalents	69,655
Investments	287,228
Undrawn committed bank facilities	49,294
Total liquidity	**406,177**

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.

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14 Liquidity risk (continued)

	On Demand $000	0-6 Months $000	6-12 Months $000	1-2 Years $000	2-5 Years $000	5+ Years $000	Total $000
Unaudited - Dec 2016							
Financial assets							
Cash and cash equivalents	69,655	-	-	-	-	-	69,655
Investments	-	20,424	69,696	57,534	167,088	11,291	326,033
Finance receivables	-	678,954	392,450	543,642	948,056	3,076,191	5,639,293
Finance receivables - securitised	-	97,488	76,302	104,940	81,205	-	359,935
Derivative financial assets	-	178	-	-	-	-	178
Other financial assets	-	5,030	-	-	-	-	5,030
Total financial assets	**69,655**	**802,074**	**538,448**	**706,116**	**1,196,349**	**3,087,482**	**6,400,124**
Financial liabilities							
Borrowings	754,583	1,016,485	611,660	144,849	528,922	-	3,056,499
Borrowings - securitised	-	5,207	277,531	-	-	-	282,738
Derivative financial liabilities	-	2,860	-	-	-	-	2,860
Other financial liabilities	-	22,604	-	-	-	-	22,604
Total financial liabilities	**754,583**	**1,047,156**	**889,191**	**144,849**	**528,922**	**-**	**3,364,701**
Net financial (liabilities) / assets	**(684,928)**	**(245,082)**	**(350,743)**	**561,267**	**667,427**	**3,087,482**	**3,035,423**
Unrecognised loan commitments	99,061	-	-	-	-	-	99,061
Undrawn committed bank facilities	49,294	-	-	-	-	-	49,294

Undrawn committed bank facilities of $49.3 million are available to be drawn down on demand via the ABCP Trust. To the extent drawn, $49.3 million is contractually repayable in 6-12 months' time upon facility expiry.

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.

	0-3 Months $000	3-6 Months $000	6-12 Months $000	1-2 Years $000	2+ Years $000	Non-interest bearing $000	Total $000
Unaudited - Dec 2016							
Financial assets							
Cash and cash equivalents	69,573	-	-	-	-	82	69,655
Investments	77,675	4,753	50,670	28,001	126,129	11,291	298,519
Finance receivables	2,220,380	96,933	171,854	241,747	282,758	150	3,013,822
Finance receivables - securitised	44,501	40,151	66,878	94,010	75,438	-	320,978
Derivative financial assets	178	-	-	-	-	-	178
Other financial assets	-	-	-	-	-	5,030	5,030
Total financial assets	**2,412,307**	**141,837**	**289,402**	**363,758**	**484,325**	**16,553**	**3,708,182**
Financial liabilities							
Borrowings	1,754,637	443,664	586,228	122,338	55,388	8,070	2,970,325
Borrowings - securitised	276,696	-	-	-	-	-	276,696
Derivative financial liabilities	2,860	-	-	-	-	-	2,860
Other financial liabilities	-	-	-	-	-	22,604	22,604
Total financial liabilities	**2,034,193**	**443,664**	**586,228**	**122,338**	**55,388**	**30,674**	**3,272,485**
Effect of derivatives held for risk management	257,453	(34,151)	(59,946)	(87,716)	(75,640)	-	-
Net financial assets / (liabilities)	**635,567**	**(335,978)**	**(356,772)**	**153,704**	**353,297**	**(14,121)**	**435,697**

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16 Concentrations of funding

(a) Concentration of funding by industry

	Unaudited Dec 2016 $000
Finance	879,735
Other	2,367,286
Total borrowings	**3,247,021**

(b) Concentration of funding by geographical area

Auckland	778,925
Wellington	300,497
Rest of North Island	565,465
Canterbury	866,223
Rest of South Island	226,980
Overseas	508,931
Total borrowings	**3,247,021**

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:

	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Deposits	90,078	71,698	80,527

(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:

	NOTE	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Cash and cash equivalents - securitised		9,699	9,991	15,208
Finance receivables - securitised	6	320,978	274,333	295,851
Borrowings - securitised	7	(276,696)	(258,819)	(284,429)
Derivative financial assets - securitised		-	120	-
Derivative financial liabilities - securitised		(1,043)	(2,001)	(2,833)

(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:

	Unaudited Dec 2016 $000	Unaudited Dec 2015 $000	Audited Jun 2016 $000
Cash and cash equivalents	3,315	5,837	2,503
Finance receivables	472,161	422,706	434,688
Borrowings	(414,527)	(373,678)	(379,299)
Derivative financial liabilities	(1,309)	(2,754)	(2,083)

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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's 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 (RWA's).
- 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 Basel III requirements have not effected the banking group's minimum capital requirements as the banking group's Conditions of Registration prescribe minimum capital requirements higher than the Basel III requirements.

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 2016.

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.

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18 Capital adequacy (continued)

(a) Capital ratios

	Unaudited Dec 2016 $000
Tier 1 capital	
Common Equity Tier 1 (CET1) capital	
Paid-up ordinary shares issued by the bank plus related share premium	448,044
Retained earnings (net of appropriations)	83,862
Accumulated other comprehensive income and other disclosed reserves	(1,809)
Less deductions from CET1 capital	
Intangible assets	(65,584)
Deferred tax assets	(7,334)
Hedging reserve	970
Defined benefit superannuation fund asset	(406)
Reverse residential mortgage loan greater than value of security	(112)
Total CET1 capital	**457,631**
Additional Tier 1 (AT1) capital	
Nil	-
Total Tier 1 capital	**457,631**
Tier 2 capital	
Subordinated bond	970
Foreign currency translation reserve	(2,095)
Total Tier 2 capital	**(1,125)**
Total capital	**456,506**

(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. These are scheduled to vest on 30 June 2017 and 30 June 2019 depending on the employee share option plan the options relate to.
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.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

18 Capital adequacy (continued)

Subordinated bonds

Heartland's 2018 Subordinated Bonds (the bonds) constitute Tier 2 capital of the banking group. The bonds had an issue period from 12 July 2013 to 15 December 2013 and have a maturity date of 15 December 2018. The 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 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 RBNZ has consented to the repayment. The bonds are subordinated to all other general liabilities of the banking group and are denominated in New Zealand dollars.

If the RBNZ or a Statutory Manager requires the bank to write down the principal amount and/or the interest on the bonds, the bonds will be written down and could be reduced to zero to comply with the RBNZ's loss absorbency requirements. The bank has not had any defaults of principal, interest or other breaches with respect to these bonds.

(c) Credit risk

(i) On-balance-sheet exposures

	Total exposure after credit risk mitigation	Risk weight	Risk weighted exposure	Minimum Pillar 1 capital requirement
	$000	%	$000	$000
Unaudited - Dec 2016				
Cash and gold bullion	79	0%	-	-
Multilateral development banks	59,747	0%	-	-
Multilateral development banks	75,580	20%	15,116	1,209
Banks - Tier 1	129,789	20%	25,958	2,077
Banks - Tier 2	12,644	50%	6,322	506
Banks - Tier 3	23,725	50%	11,863	949
Public sector entity (AA- and above)	49,242	20%	9,848	788
Public sector entity (A- and above)	1,062	50%	531	42
Corporates (A- and above)	5,015	50%	2,508	201
Welcome Home Loans - loan to value ratio (LVR) <= 90%[1]	2,731	35%	956	76
Welcome Home Loans - LVR 90% >= 100%[1]	1,826	35%	639	51
Welcome Home Loans - LVR > 100%[1]	1,599	50%	800	64
Reverse Residential mortgages <= 60% LVR	820,055	50%	410,028	32,802
Reverse Residential mortgages 60 <= 80% LVR	31,666	80%	25,333	2,027
Reverse Residential mortgages > 80% LVR	4,543	100%	4,543	363
Past due residential mortgages	2,508	100%	2,508	201
Other past due assets - provision 20%+	12,345	100%	12,345	988
Other past due assets - provision < 20%	36,950	150%	55,425	4,434
Non Property Investment Mortgage Loan <=80% LVR	39,099	35%	13,685	1,095
Non Property Investment Mortgage Loan 80 <= 90% LVR	3,535	50%	1,768	141
Non Property Investment Mortgage Loan 90 <= 100% LVR	3,831	75%	2,873	230
Non Property Investment Mortgage Loan > 100% LVR	6,644	100%	6,644	532
Property Investment Mortgage Loan <= 80% LVR	12,636	40%	5,054	404
Property Investment Mortgage Loan 80 <= 90% LVR	745	70%	522	42
Property Investment Mortgage Loan < 100% LVR	4,463	100%	4,463	357
All other equity holdings	11,291	400%	45,164	3,613
Other assets	2,393,473	100%	2,393,473	191,478
Not risk weighted assets	73,324	0%	-	-
Total on balance sheet exposures	**3,820,147**		**3,058,369**	**244,670**

[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 2016

18 Capital adequacy (continued)

(c) Credit risk (continued)

(ii) Off-balance sheet exposures

	Total exposure	Credit conversion factor	Credit equivalent amount	Average risk weight	Risk weighted exposure	Minimum Pillar 1 capital requirement
	$000	$000	$000	%	$000	$000
Unaudited - Dec 2016						
Off balance sheet exposures						
Direct credit substitute	1,753	100%	1,753	100%	1,753	140
Commitments with uncertain drawdown	9,168	100%	9,168	50%	4,584	2,292
Performance-related contingency	8,814	50%	4,407	100%	4,407	353
Other commitments where original maturity is more than one year	112,113	50%	56,057	100%	56,057	4,485
Other commitments where original maturity is less than or equal to one year	98,600	20%	19,720	100%	19,720	1,578
Market related contracts: [1]						
Interest rate contracts > 1 year	284,670	0.5%	1,423	20%	285	23
Interest rate contracts <= 1 year	30,677	0.0%	-	20%	-	-
Total off balance sheet exposures	**545,795**		**92,528**		**86,806**	**8,870**

(d) Additional mortgage information - LVR range

	On balance sheet exposures	Off balance sheet exposures [2]	Total exposures
	$000	$000	$000
Unaudited - Dec 2016			
Does not exceed 80%	903,458	10,044	913,502
Exceeds 80% but not 90%	13,134	6	13,140
Exceeds 90%	19,289	528	19,817
Total exposures	**935,881**	**10,578**	**946,459**

At 31 December 2016, $3.4 million relating to Welcome Home loans, whose credit risk is mitigated by the Crown is included in "Exceeds 90%" above.

(e) Reconciliation of mortgage related amounts

	NOTE	Unaudited Dec 2016 $000
Loans and advances - loans with residential mortgages	18(d)	935,881
On balance sheet residential mortgage exposures subject to the standardised approach		**935,881**
Net residential receivables as reported in credit concentration note	13(a)	893,140
Net non-residential receivables fully secured by residential property		42,741
On balance sheet residential mortgage exposures subject to the standardised approach		**935,881**

(f) Credit risk mitigation

As at 31 December 2016 the banking group has $6.2 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.

[1] The credit equivalent amount for market related contracts was calculated using the current exposure method.
[2] Off balance sheet exposures represent unutilised limits.

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

18 Capital adequacy (continued)

(g) Operational risk

	Implied risk weighted exposure	Total operational risk capital requirement
	$000	$000
Unaudited - Dec 2016		
Operational risk	201,976	16,158

(h) Market risk

		Implied risk weighted exposure	Aggregate capital charge
		$000	$000
Unaudited - Dec 2016			
Market risk end-of-period capital charge	Interest rate risk only	115,127	9,210
Market risk peak end-of-day capital charge	Interest rate risk only	115,127	9,210
Market risk end-of-period capital charge	Foreign currency risk only	60,279	4,822
Market risk peak end-of-day capital charge	Foreign currency risk only	60,279	4,822

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

	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
	$000	$000	$000
Unaudited - Dec 2016			
Total credit risk			
On balance sheet	3,820,147	3,058,369	244,670
Off balance sheet	545,795	86,806	8,870
Operational risk		201,976	16,158
Market risk		175,406	14,032
Total	**4,365,942**	**3,522,557**	**283,730**

(j) Capital ratios

	Unaudited Dec 2016	Unaudited Dec 2015
	%	%
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 capital expressed as a percentage of total risk weighted exposures	12.99%	14.41%
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	12.99%	14.41%
Minimum Tier 1 capital as per Conditions of Registration	6.00%	6.00%
Total capital expressed as a percentage of total risk weighted exposures	12.96%	14.46%
Minimum Total capital as per Conditions of Registration	8.00%	8.00%
Buffer ratio	4.96%	6.46%
Buffer ratio requirement	2.50%	2.50%

Notes to the Interim Financial Statements

For the six months ended 31 December 2016

18 Capital adequacy (continued)

(k) Solo capital adequacy

	Unaudited Dec 2016	Unaudited Dec 2015
	%	%
Common Equity Tier 1 capital expressed as a percentage of total risk weighted exposures	14.34%	15.96%
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	14.34%	15.96%
Minimum Tier 1 capital as per Conditions of Registration	6.00%	6.00%
Total capital expressed as a percentage of total risk weighted exposures	14.34%	16.01%
Minimum Total capital as per Conditions of Registration	8.00%	8.00%

(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 2016, the banking group has made an internal capital allocation of $55.2 million (December 2015: $60.3 million) to cover these risks.

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

Insurance business

The banking group conducts insurance business through its subsidiary MARAC Insurance.

The banking group's aggregate amount of insurance business comprises the total consolidated assets of MARAC Insurance of $8.03 million, which is 0.21% 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 MARAC Insurance, a subsidiary of the bank, or sold by MARAC Insurance 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.

Securitisation, funds management and other fiduciary activities

In July 2016, the Trust Manager of Heartland ABCP Trust 1 (ABCP Trust) changed from the bank to an external third party, AMAL New Zealand Limited. The residual beneficiary of ABCP Trust also changed from the bank to Heartland Trust. There have been no other 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

	Unaudited Dec 2016	Unaudited Dec 2015	Audited Jun 2016
	$000	$000	$000
Letters of credit, guarantee commitments and performance bonds	10,567	13,124	12,873
Total contingent liabilities	**10,567**	**13,124**	**12,873**
Undrawn facilities available to customers	99,061	102,801	147,903
Conditional commitments to fund at future dates	120,820	118,621	114,855
Total commitments	**219,881**	**221,422**	**262,758**

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.

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

We have examined the interim financial statements and supplementary information on pages 17 to 39 and based on our review nothing has come to our attention that causes us to believe that:

i. the interim financial statements (excluding the supplementary information disclosed in accordance with schedules 3, 5, 7, 9, 13, 16 and 18 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order")) do not comply with NZ IAS 34 *Interim Financial Reporting* and do not give a true and fair view of the financial position of the banking group as at 31 December 2016, and its financial performance and cash flows for the six month period ended on that date;

ii. the supplementary information (excluding supplementary information relating to capital adequacy) disclosed in accordance with schedules 3, 5, 7, 13, 16 and 18 of the Order, does not give a true and fair view of the matters to which it relates in accordance with those schedules; and

iii. the supplementary information relating to capital adequacy disclosed in accordance with schedule 9 of the Order, is not, in all material respects prepared in accordance with bank's conditions of registration and disclosed in accordance with schedule 9 of the Order.

Our review was completed on 21 February 2017 and our opinion is expressed as at that date.

We have reviewed the half year disclosure statement which comprises:

- the interim financial statements prepared and disclosed in accordance with the Order, formed of:
  - the interim statement of financial position as at 31 December 2016;
  - the interim statements of comprehensive income, changes in equity, and cash flows for the six 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 3, 5, 7, 9, 13, 16 and 18 of the Order.

Basis for Conclusion

We have performed our review in accordance with the New Zealand Standard on Review Engagements 2410, *Review of Financial Statements Performed by the Independent Auditor of the Entity* ("NZ SRE 2410") issued by the External Reporting Board. As the auditor of the bank, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual disclosure statement.

A review is limited primarily to enquiries of the bank's personnel and analytical review procedures applied to the financial data, and thus provides less assurance than an audit. 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 half year disclosure statement.

Our firm has also provided other services to the banking group in relation to other assurance services, general accounting services and advisory services. 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 auditor of the banking group for this engagement. The firm has no other relationship with, or interest in, the banking group.

Use of this Review Report

This 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 auditor's 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 report, or any of the conclusions we have formed.

Responsibilities of Directors for the bank and banking group half year disclosure statement

The Directors, on behalf of the company and group, are responsible for:

- the preparation and fair presentation of the half year disclosure statement, which includes interim financial statements prepared in accordance with Clause 25 of the Order and NZ IAS 34 *Interim Financial Reporting,* which gives a true and fair view of the financial position of the bank as at 31 December 2016 and its financial performance and cash flows for the six-month period ended on that date.
- implementing necessary internal control to enable the preparation of a half year disclosure statement that is fairly presented and free from material misstatement, whether due to fraud or error; and
- the preparation of supplementary information in the half year disclosure statement which fairly states the matters to which it relates in accordance with schedules 3, 5, 7, 9, 13, 16 and 18 of the Order.

Auditor's Responsibilities for the review of the bank and banking group half year disclosure statement

Our responsibility is to express an independent review opinion on the half year disclosure statement, which includes interim financial statements disclosed in accordance with Clause 25 of the Order, and supplementary information disclosed in accordance with schedules 3, 5, 7, 9, 13, 16 and 18 of the Order, as presented to us by the Directors, and report our conclusions to you.

We are responsible for reviewing the interim financial statements (excluding the supplementary information) in order to report to you whether, on the basis of the procedures described above, anything has come to our attention that would cause us to believe that the interim financial statements do not comply with NZ IAS 34

Interim Financial Reporting or do not give a true and fair view of the financial position of the bank as at 31 December 2016 and its financial performance and cash flows for the six-month period ended on that date.

We are responsible for reviewing the supplementary information (excluding the supplementary information relating to capital adequacy) in order to report to you whether, on the basis of the procedures described above, anything has come to our attention that would cause us to believe that the supplementary information does not give a true and fair view of the matters to which it relates in accordance with schedules 3, 5, 7, 13, 16 and 18 of the Order.

We are responsible for reviewing the supplementary information relating to capital adequacy in order to state whether, on the basis of the procedures described above, anything has come to our attention that would cause us to believe that the information disclosed in accordance with schedule 9 is not, in all material respects, prepared in accordance with the bank's conditions of registration and disclosed in accordance with schedule 9 of the Order.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the bank and banking group half year disclosure statement.

KPMG

KPMG
Auckland

21 February 2017

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Vanessa Stoddart	Director
Greg Tomlinson	Director

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