



NZX and Media Release

HEARTLAND POSTS FULL YEAR PROFIT OF \$54.2M

16 August 2016

Heartland Bank Limited (**Heartland**) (NZX: HBL) achieved a net profit after tax (**NPAT**) of \$54.2m for the year ended 30 June 2016 (**FY 2016**), an increase of 12.5% from the previous financial year ended 30 June 2015 (**FY 2015**). The result was driven by growth in core receivables across all core divisions – Household, Business and Rural.

Achievements for full year

- Continued growth in core receivables
- Increase in profitability
- Return on average equity (**ROE**) of 11.1%
- Strongest Net Interest Margin amongst competitors¹
- Successful amalgamation of Heartland New Zealand Limited and Heartland Bank Limited
- Growth in direct personal loan product
- Launch of *Open For Business* product

FINANCIAL PERFORMANCE²

Profitability

NPAT was \$54.2m for FY 2016. This is an increase of \$6.0m against NPAT of \$48.2m for FY 2015.

Earnings for FY 2016 equate to a ROE of 11.1%, an increase from 10.4% when compared with ROE for FY 2015.

Earnings Per Share (**EPS**) was 11c calculated on the weighted average number of shares on issue during FY 2016.

Balance sheet

Net finance receivables increased by \$251.9m, to \$3.1b (9%), during FY 2016. Total assets increased by \$187.9m, with the difference between net finance receivables and total assets being primarily attributable to a \$45.8m reduction in cash and cash equivalents and investments.

Major balance sheet movements included:

- Motor vehicle lending, which continued to grow strongly and increased by \$66.6m (9.5%).
- Reverse mortgages, which grew by \$27.4m (8.2%) in New Zealand and A\$38.6m (10.3%) in Australia, for combined growth of \$39.1m after foreign exchange translation.

¹ See KPMG's Financial Institutions Performance Survey March 2016 Quarterly Results.

² This announcement is based on the 30 June 2016 audited consolidated financial statements of Heartland Bank Limited. For more detailed analysis and explanation please refer to the attached full year financial statements.

- Personal lending, including lending through the Harmoney platform, which increased by \$19.3m (55.2%).
- The Business and Rural divisions, which increased by \$95.0m (11.8%) and \$64.8m (13.3%) respectively.
- Non-core residential mortgages, which decreased by \$32.8m (41.8%).
- Cash and cash equivalents and investments, which decreased by \$45.8m (12.5%) to \$320.6m.
- Borrowings, which increased by \$174.7m, reflecting the need to fund growth.

Net Tangible Assets (**NTA**) increased from \$420.3m to \$433.5m during FY 2016. On a per share basis, NTA was \$0.91 at 30 June 2016 compared with \$0.89 at 30 June 2015.

Net Operating Income

Net Operating Income (**NOI**) was \$157.6m for FY 2016, compared with \$144.7m for FY 2015, an increase of \$12.9m. The increase in NOI was primarily attributable to the increase in receivables and to a reduction in cost of funds.

Costs

Operating costs were \$69.9m for FY 2016, a small increase of \$1.5m from FY 2015, the increase primarily attributable to \$1.6m of additional marketing spend. However, the operating expense ratio improved from 47% in FY 2015 to 44% in FY 2016, highlighting the scalability of the business model.

Impairments

Impaired asset expense was \$13.5m for FY 2016, compared with \$12.1m for FY 2015, an increase of \$1.4m.

In the Household division, impairment expense was up \$1.3m against FY 2015. The increase was primarily due to growth in the personal loan and motor vehicle loan books, and an increase in write offs for motor vehicle loans (which are coming off recent lows).

In the Rural division, impairment expense was up \$2.4m against FY 2015. Separately, collective provisions in the Rural division were up by \$2.3m to \$2.9m at 30 June 2016 (compared with \$0.6m at 30 June 2015), whilst provisions for individually impaired assets increased just \$0.1m to \$0.8m at 30 June 2016. The collective provisions provide Heartland with a buffer against any continued downturn in the rural sector, particularly dairy.

In the Business Division, impairment expense was \$2.3m lower than FY 2015. This reduction was the result of an improvement in the quality of the book as the division reduced its larger exposures and focused more on small to medium size loans.

Net impaired, restructured and past due loans over 90 days reduced from \$39.0m (or 1.4% of net finance receivables) as at 30 June 2015 to \$37.9m (or 1.2% of net finance receivables) as at 30 June 2016.

BUSINESS PERFORMANCE – CORE BUSINESS DIVISIONS

Business³

NOI for the Business division was \$43.0m, an increase of \$2.2m from FY 2015. Strong growth in receivables drove the increase in NOI.

³ During FY 2016, non-core property assets which were previously reported separately were moved to the Business division. In addition a business unit previously reported in the Household division was moved to the Business division. Lending through Harmoney, which was previously reported in the Business division, was moved to the Household division. The comparative information for the Business and Household divisions has been restated to be consistent with FY 2016.

Net receivables for the Business division increased by \$95.0m (11.8%) during FY 2016 to \$898.8m. The growth was primarily attributable to further development of the intermediary distribution network, and a focus on product offerings to meet the needs of small to medium sized business customers. Development and improvement of the *Open for Business* online origination platform (for small business loans) continued during the year, and distribution was extended to intermediaries. The *Open for Business* book grew to \$11.2m as at 30 June 2016, with growth accelerating from April 2016 following a comprehensive upgrade of the platform.

Non-Core Property

As non-core property assets have now largely been realised (reducing by \$16.3m (60.2%) during FY 2016), non-core property will no longer be reported as a separate division. The remaining assets as at 30 June 2016 (being net receivables of \$2.4m and investment properties of \$8.4m) are now reported within the Business division.

Rural

NOI for the Rural division was \$26.3m, an increase of \$2.2m from FY 2015. The increase was driven by receivables growth, despite the challenging rural finance environment. Net receivables for the Rural division increased by \$64.8m (13.3%) during FY 2016 to \$552.5m. Growth primarily came from the sheep and beef sector, where Heartland utilised its livestock lending expertise through both relationship and intermediated channels to originate new business in term, working capital and livestock finance. Heartland's exposure to the dairy sector also grew, primarily through additional support to existing clients. Notwithstanding the difficult circumstances facing the dairy industry, Heartland continues to support existing clients and has appetite for new business with sharemilkers and dairy farmers who meet lending criteria.

As stated above, collective provisions in the Rural division were up \$2.3m, while provisions for individually impaired assets increased by just \$0.1m. The collective provisions provide Heartland with a buffer against any continued downturn in some rural sectors, particularly the dairy sector. However, Heartland's direct exposure to dairy farmers remains small at only 7% of its total lending book as at 30 June 2016, and the average loan to value ratio (LVR) for Heartland's dairy exposures is just 64%.

Household³

The Household division comprises Consumer, reverse mortgages and non-core residential mortgages. NOI for the Household division was \$86.1m, an increase of \$9.5m from FY 2015. Net receivables increased by \$92.1m (5.9%) during FY 2016 to \$1.7b.

NOI for Consumer (which includes motor vehicle loans, personal loans and lending through the Harmony platform) was \$59.2m, an increase of \$7.7m (14.9%) from FY 2015. Consumer net receivables grew \$85.8m (11.7%) to \$822.1m during FY 2016. Net receivables from motor vehicle loans continued to grow strongly, increasing by \$66.6m (9.5%) to \$767.4m during FY 2016. Net receivables from personal loans increased by \$15.2m (616.0%) to \$17.9m, while lending through the Harmony platform increased by \$4.0m (12.3%) to \$36.9m.

NOI for reverse mortgages was \$24.2m, an increase of \$3.9m from FY 2015. During FY 2016, net receivables from reverse mortgages grew by \$27.4m (8.2%) in New Zealand and A\$38.6m (10.3%) in Australia, however, overall growth was \$39.1m, to a total book size of \$794.8m as at 30 June 2016, after foreign exchange translation.

Net receivables from residential mortgages continued to reduce during FY 2016, down \$32.8m (41.8%) from FY 2015 to \$45.8m, as Heartland continued to withdraw from this segment.

STRATEGY AND STRATEGIC PRIORITIES

Heartland's strategic focus continues to be to provide innovative 'best or only' banking products in niche markets that are under-serviced by the major banks. Going forward, the aim is to deliver those products through 'best or only' channels, tailored for each niche market, in particular:

- by providing a high touch, personal service to seniors (65+), a *growing* demographic with specific financial needs;
- by providing a frictionless digital experience to the *emerging* ‘millennial’ market, who value speed and ease; and
- by providing a fast and responsive service to the *neglected* segment of the small business market, through online origination for working capital and plant and equipment finance.

Organic growth in each core business division is expected, which Heartland aims to consolidate by continuing the implementation of its strategic priorities, those being:

- enhanced digital distribution and digital marketing of target products to deliver a better customer experience based on ‘ease and speed’, while also reducing the cost of customer acquisition;
- expansion of certain offerings into Australian markets; and
- strong systems infrastructure to support Heartland’s ambitions for growth, especially following the conversion of core systems to Oracle.

Acquisitions remain a part of Heartland’s growth strategy, but they must be value accretive and either deliver innovation or a compelling distribution capability. Heartland also remains focussed on growing quality sustainable earnings and improving return on equity.

BOARD

Heartland recognises the need for the board to have a range of complementary skills, knowledge and experience which support the implementation of its strategic priorities, and will provide a further update regarding board composition prior to its 2016 Annual Meeting.

DIVIDEND

The directors of Heartland have resolved to pay a final dividend of 5.0 cents per share, an 11% increase on last year’s final dividend of 4.5 cents per share. This brings total dividends relating to FY 2016 to 8.5 cents per share. The final dividend will be paid on 7 October 2016 to shareholders on the company’s register as at 5.00pm on 23 September 2016 (**Record Date**) and will be fully imputed.

The Dividend Reinvestment Plan (**DRP**) will apply to the final dividend with a 2.5% discount (that is the strike price under the **DRP** will be 97.5% of the volume weighted average sale price of Heartland shares over the five trading days following the Record Date)⁴. Participation in the **DRP** is entirely optional, and shareholders who do not currently participate in the **DRP** but wish to do so should make a participation election in one of the ways specified in the **DRP** offer document by 23 September 2016.

LOOKING FORWARD

Looking forward, Heartland expects underlying asset growth to continue for the 2017 financial year, with increased Household, Business and Rural volumes projected. Products which are distributed online (personal loans and *Open for Business* loans) are expected to grow comparatively more quickly, given their modest size currently and the size of the market opportunity available.

At last year’s Annual Meeting, Heartland advised shareholders of its intention to undertake a regulatory capital issue and to subsequently undertake a return of capital. Since then, there has been continuing volatility in the

⁴ For the full details of the **DRP** and the Strike Price calculation, refer to Heartland’s **DRP** offer document dated 1 January 2016.

financial markets, which Heartland believes creates greater opportunity for acquisitions. Accordingly, as announced on 18 May 2016, the Board elected not to proceed with the regulatory capital issue and/or return of capital in FY 2016, but may do so in the future. Heartland continues to focus on assessing acquisition opportunities (if any) as they arise, and continues to monitor its capital position.

Heartland expects its NPAT for the year ended 30 June 2017 to be in the range of \$57m to \$60m. This guidance range does not take into account the impact of any potential capital management initiatives.

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For further information, please contact:

Jeff Greenslade
Chief Executive Officer
Heartland Bank Limited
DDI 09 927 9149
M 021 563 593

Simon Owen
Chief Financial Officer
Heartland Bank Limited
DDI 09 927 9195
M 027 629 4602