HEARTLAND BANK

2017 ANNUAL MEETING

CHIEF EXECUTIVE OFFICER'S REPORT

1. OUTLINE

Thank you for joining us this afternoon. I will cover some aspects of Heartland's financial results for the 2017 financial year and the outlook for the current 2018 financial year. Mainly, I wish to talk about Heartland's strategy and the progress we have made to date in execution of that strategy. I will finish with an update on Heartland's diversity journey and our key areas of focus for the coming year.

2. FINANCIAL PERFORMANCE

As the Chairman stated, Heartland's net profit after tax of $60.8m was up 12% from last year. Highlights of this include:

- growth occurred across all of our lending divisions – with asset growth at 14%;
- the highest net interest margin amongst our bank peers was maintained;
- we reduced the cost to income ratio to 42% from 44% (such that it is now similar to the major banks and the lowest cost to income ratio amongst the local banks); and finally
- impairments ratio stayed below 0.5%.

What this means is that asset growth was achieved without compromising our risk/return criteria and without incurring higher costs to generate that growth. Continuing to develop ways to grow while reducing the cost/income ratio, is a key part of our strategy. We are very proud that in a relatively short space of time we have become NZ's second most profitable local bank.

Asset growth occurred across the Household, Business and Rural divisions and came from increased demand for motor vehicle finance, growth in personal lending through the Harmoney platform (reflecting increased consumer confidence, on the back of high employment and low inflation), progress in our livestock campaigns, faster growth in reverse mortgages (particularly in Australia) and the success of our digital platforms particularly for SME working capital finance.

Reverse mortgages continue to be a strategically important product for Heartland. We remain the largest provider of reverse mortgages in New Zealand and the largest non-bank provider in Australia. This product is becoming increasingly recognised as a valuable tool in managing retirement on both sides of the Tasman. Westpac and Macquarie Bank have recently ceased offering new reverse mortgages in Australia, removing competition and providing greater market opportunity for us.

On the funding side, we grew our retail deposits by 13% to support our asset growth. Deposits remain Heartland's primary source of funding and we appreciate the continued support and confidence of our deposit customers.

FY18 Outlook

Turning now to the outlook for FY18, asset growth has continued for the first three months of the 2018 financial year and we expect this growth to continue.

On the other side of the balance sheet, we are seeing some signs of competitive activity in deposits due to the fact that after a sustained period of growth of NZ savings, credit growth is now outstripping Household deposit growth. Partially off-setting this has been a reduction in our wholesale cost of funds. We also successfully completed a $150m retail note offer in September of this year to further diversify our funding.

Generally speaking, the industry is moving off historically low levels of impairments – we are no different. The macro-economic environment for New Zealand is favourable but internationally, markets are prone to event driven volatility. It is still necessary to be cautious and watchful in terms of exposure to global markets.

We remain confident in achieving our FY18 NPAT range of $65m-$68m.

3. **STRATEGY**

Heartland's strategy is different to the other banks operating in New Zealand and we are pleased that this point of difference is continuing to deliver strong results.

There are two key planks to our strategy.

First, as a relatively small organisation, with around 360 staff members across New Zealand and Australia, we endeavour to use technology and other partnerships with intermediaries so that we can reach more customers.

Secondly, through these means we strive to offer “best or only” products in the markets in which we operate - either through products the major banks don’t offer like reverse mortgages, motor vehicle loans or livestock finance, or products where we can offer better features, such as faster approvals for small business working capital loans.

We interact currently with our customers online, over the phone or in person but increasingly, the aim is to shift our origination – how we acquire customers – as much as possible onto digital platforms. People will remain a key part of our customer interaction, but will be positioned to where we can best add value.

This strategy is in contrast to many other banks operating in New Zealand which tend to operate a “one-stop shop”. They offer a suite of products hoping to use one to entice customers to buy more, this is otherwise known as cross-selling. Pricing often plays a major part in this, as does physical distribution; two areas where we have no competitive advantage.

This traditional model is increasingly coming under pressure from disruptors who offer simpler single lines of services or products that can be accessed quickly. This is responding to a growing customer preference for clarity and speed. Put simply, people of all ages and demographics are becoming less inclined to stand in queues. Less inclined to be cross-sold to, they just want what they want and preferably now. It is the demands of this segment of the market that we wish to target, whether it be in the Business, Household or Rural sectors.

The best, least expensive way to do this is through digital distribution or through intermediaries.

We have used intermediaries successfully in the past, whether motor dealers or the Harmoney platform but the future direction will be increasingly based on digital distribution.

What do we mean by “Digital”? First, it is important to make the distinction between digital and internet banking. Digital is about transacting online; buying and selling. The best example of this is Amazon. Initially, with books, Amazon changed the way items can be purchased. Heartland’s aim is to follow a similar path with financial products.

Internet banking by contrast is an administration tool, particularly associated with payments which is the domain of the major banks. Heartland is different to the major banks in that payments are not core. Worldwide, payments are either an oligopoly (as in New Zealand) or are commoditised. In either case, payments are now prone to disruption by non-bank providers; not an area where Heartland can be “best or only”.

An adjacent aspect of the digital strategy is the harnessing of data to identify risks and opportunities. We are investing in analytical tools to provide streamlined credit decisioning with the capability to create more predictable outcomes. Similarly, we are developing means to anticipate customer needs. Traditionally, the financial industry has been built on the assumption that we, the bank will give you what we’ve got when you come to us. Ultimately we must be able to tell our customers what they need before they know it. If we wait for our customers to come to us, it is too late.

Accordingly, we will continue to expand our digital analytics and platforms; this is the pathway to lower marginal costs and scalable reach.

While some understandably lament the decline of branch banking, the bricks and mortar approach is not something we can compete in and is showing signs of obsolescence.

We do not have branches in a conventional sense any more. This has not impacted on our all-important deposit raising needs. Our customers are busy, live remotely or are unwilling to fight the traffic to go to a bank. With digital platforms, Heartland can get to every New Zealander at a lower marginal cost. For example, we regularly get up to 1,000 potential customers visiting our deposit platform each week and 600 visiting our SME working capital platform compared to the 20-40 customers per week that used to visit some of our branches. Digital allows a small bank to operate with the similar scale of larger banks and to offer speed as a point of difference.

We have made excellent progress to date in executing this strategy, having launched a number of digital platforms including for livestock finance, personal loans, SME working capital finance and deposits. However, we see significant opportunity to build on this progress. We aim to have one of the world’s first end-to-end deposit platforms. For small business finance, we have the largest SME platform in New Zealand and our aim is to have one of the largest in Australasia. We will continue to provide telephone or in-person based services, but our objective is to have the majority of our products initiated or sold online.

4. DIVERSITY

At Heartland, we recognise it is our people that make Heartland's success possible. Our people are Heartland's prime value driver. Diversity is vital to accessing and delivering this value. Diversity means having the broadest range of perspectives, the widest access to talent and a rich diversity of thought. We want people who bring different points of view, who challenge why we do things and who make things happen. Ultimately our future depends on the quality of our people.

To demonstrate our commitment to diversity, we have established a diversity committee comprised of staff from across the business. The purpose of the committee is to recommend measurable objectives to the Board, set the initiatives aimed at achieving those objectives and oversee and assess Heartland's progress towards achieving them.

Although we are still at the beginning of our diversity journey, the Board and Executive team are thoroughly committed to making positive change and are keen to move quickly to make those changes. We are currently developing a diversity roadmap towards our goals. As part of this, we are reviewing Heartland's recruitment, retention and communication processes, as well as our culture more generally, to identify opportunities to ensure Heartland is a welcoming and inclusive place for everyone.

Although the committee is tasked with addressing diversity of all kinds, our first priorities are gender and ethnic diversity. In terms of gender diversity, we have made good progress in recent years, and now have approximately 50% male and 50% female staff across the business. In terms of senior leadership, my Strategic Management Group is 50/50 male/female. For the wider Executive team, which is currently around 20 people, it's 30% female and 70% male; clearly more progress is required.

Turning then to ethnic diversity, we recently conducted a voluntary survey across to business which told us that our people identify with 47 unique ethnic groups. This rich diversity is important to us and is something to be celebrated. However, there are some gaps in key areas of representation. In addressing this it is important not to fragment our efforts.

One of our priorities is to address the under-representation of Maori at Heartland when compared to New Zealand's working population. We are taking a number of steps to ensure our workplace is welcoming and inclusive to Maori and enable us to demonstrate a greater understanding and appreciation for the Maori culture. For example, we offer our staff the opportunity to participate in free Te Reo Maori lessons and have had a great level of uptake. We also believe the support we provide through the Heartland Trust to organisations such as The InZone Education Foundation (which Geoff talked about earlier) are helping to make a difference in developing the young Maori leaders of tomorrow.

5. SUMMING UP

I wish to conclude by expressing my thanks and acknowledgement to the Heartland team for their support, commitment and hard work towards Heartland's strong financial performance and execution of its strategic priorities.

Thank you, our shareholders and depositors for your continued support.

Thank you for your time. I will now hand you back to the Chair, Geoff Ricketts.