HEARTLAND GROUP

*NZX/ASX Release*

# Heartland announces full year profit of $73.6 million

15 August 2019

Heartland Group Holdings Limited (**Heartland**) (**NZX/ASX: HGH**) achieved a net profit after tax (**NPAT**) of $73.6 million for the financial year ended 30 June 2019 (**FY2019**), an increase of 9.0% from the previous financial year ended 30 June 2018 (**FY2018**)[1].

**Achievements for the year ended 30 June 2019**

- Financial:
  - Gross Finance Receivables (**Receivables**)[2] $4.4 billion, up 10.5% (excluding the impact of changes in foreign currency exchange rates).
  - Net profit after tax $73.6 million, up 9.0%.
  - FY2019 Final Dividend 6.5 cents per share (**cps**), taking FY2019 total dividends to 10.0cps. A 1.0cps increase on FY2018, up 11%, and a dividend yield of 8.6%[3].
  - Return on equity (**ROE**) 11.1%, unchanged from FY2018.
  - Earnings per share (**EPS**) 13.0cps, unchanged from FY2018.
  - Net interest margin (**NIM**) 4.33%, down 0.09% from 4.42%.
  - Net operating income $205.8 million up 4.6%.
  - Cost to income ratio 39.9% (excluding costs associated with the corporate restructure), improved from 40.9%.
- Business:
  - New Zealand Reverse Mortgage Receivables increased $52.0 million (11.4% growth excluding the impact of foreign exchange and transfers).
  - Motor Receivables increased $127.6 million (13.3% growth).
  - Harmoney and other personal lending Receivables increased $45.1 million (24.9% growth excluding the impact of foreign exchange).

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[1] This announcement is based on the audited consolidated financial statements of Heartland for FY2019. Following a corporate restructure on 31 October 2018, Heartland Bank Limited (**Heartland Bank**) became a 100% controlled subsidiary of Heartland, and ownership of the Australian group of companies (comprising Heartland Australia Holdings Pty Limited and its subsidiaries) transferred from Heartland Bank to Heartland. The unaudited consolidated financial statements of Heartland for the six months ended 31 December 2018 comprise results for Heartland Bank and its subsidiaries up to 31 October 2018, and Heartland and its subsidiaries from 1 November 2018 to 30 June 2019. As common control has remained the same both before and after the corporate restructure, management believes that the operations of Heartland from 1 November 2018 are directly comparable to those of Heartland Bank prior to 1 November 2018. All comparative results are based on 30 June 2018 audited full year consolidated financial statements of Heartland Bank.

[2] Receivables includes Finance Receivables and Finance Receivables - Reverse Mortgages.

[3] Share price of $1.62 as at 14 August 2019.

  - Business Receivables increased $38.1 million (3.5% growth), with Business Intermediated lending up $101.7 million (31.4% growth) and Open for Business lending up $43.4 million (48.2% growth).
  - Australian Reverse Mortgage Receivables increased $163.0 million (24.0% excluding the impact of foreign exchange and transfers).
- Strategic:
  - Corporate restructure successfully completed – creating funding flexibility.
  - ASX foreign exempt listing successfully completed.
  - Diversification and expansion of Australian funding through an A$50 million medium-term note issue and a new A$250 million reverse mortgage funding facility.
  - Heartland Bank issue of $125 million five-year unsubordinated unsecured fixed rate notes.
- Customer outcomes:
  - Uptake of the Heartland Mobile App continues to rise, increasing by 72% in the last six months[4].
  - Awarded Canstar's 2019 Bank of the Year – Savings Award for the second year running.
  - Awarded Canstar's 5-Star Rating for Outstanding Value Savings Account for Heartland's Direct Call Account for the fourth year in a row.
  - Heartland Seniors Finance Australia awarded Best Reverse Mortgage 2019 by Money Magazine for the fourth consecutive year.
  - Work plan submitted to the Financial Markets Authority (**FMA**) and Reserve Bank of New Zealand (**RBNZ**) in response to the recent Conduct and Culture Review.
- Culture:
  - Increase in gender diversity among people in the strategic management group, currently 37.5% male and 62.5% female.
  - Internship initiative has contributed to Māori constituting 4% of Heartland's population. This is positive compared to the sector where 2.3% of people in the financial and insurances services sector identify as Māori[5].
  - Heartland launched its new mātāpono (values) with a focus on customer outcomes. The mātāpono are: Mahi Tika – do the right thing, Mahi Tahi – be one team, Mahi Toa – have big ambition and Mahi Tipu – be always evolving.

**FINANCIAL POSITION**

Net Receivables increased by $424.8 million (10.7% growth). However, reported net receivables increased by $363.1 million (9.1% growth) to $4,348 million due to an adverse foreign exchange impact on Australian receivables of $34.5 million, and the impact of the adoption of IFRS9 of $27.3 million.

[4] Based on the combined cumulative number of Heartland Mobile App installs from the Android Google Play Store and Apple App Store in June 2019, compared with the combined cumulative installs across both stores in January 2019.
[5] Source: New Zealand Census 2013, Statistics New Zealand.

Total assets increased by $429.6 million (9.6% growth) primarily due to the increase in net finance receivables. Cash and cash equivalents increased by $31.0 million and investments increased by $14.3 million.

Total borrowings[6] increased by $414.3 million (10.9% growth).

During the reporting period, Net Assets increased by $11.5 million to $675.7 million after taking into account a reduction of $19.3 million as a result of the initial adoption of IFRS9. Net Tangible Assets (**NTA**) increased by $9.0 million to $593.5 million. NTA per share was $1.04, unchanged from FY2018.

**FINANCIAL PERFORMANCE**

**Profitability**

NPAT was $73.6 million for FY2019, an increase of $6.1 million (9.0% growth).

ROE was 11.1%, unchanged from FY2018, however, ROE in the second half of FY2019 improved to 12.2% from 10.3% in the first half.

EPS was 13.0 cents per share, unchanged from FY2018 due to the full year impact of the December 2017 rights issue on average shares.

FY2019 performance was impacted by costs associated with the corporate restructure. The impact on key metrics is set out in the following table.

| | Reported | Impact of restructure and ASX | Excluding impact of Restructure and ASX |
|---|---:|---:|---:|
| Net interest margin | 4.33% | 0.02% | 4.35% |
| Cost income ratio | 41.6% | -1.7% | 39.9% |
| ROE | 11.1% | 0.6% | 11.7% |
| NPAT | $73.6 million | $3.5 million | $77.1 million |

**Net Operating Income**

Net Operating Income (**NOI**) was $205.8 million, an increase of $8.2 million (4.6% growth).

Heartland's NIM for FY2019 was 4.33% compared to 4.42% for FY2018. NIM was impacted by the proportional changes in Receivables, in particular the strong growth in reverse mortgages which has a lower NIM relative to other products (but with correspondingly lower impairments). NIM was impacted by $1.1 million of break cost incurred due to the early repayment of the Tier 2 Australian dollar subordinated bond. Excluding these costs, NIM was 4.35%.

**Costs**

[6] Total borrowings includes Retail deposits and Other borrowings.

Operating costs were $85.6 million, an increase of $5.1 million (6.4% growth). Higher operating expenses were due to growth, one-off corporate restructure and ASX listing costs of $1.8 million and one-off foreign currency costs of $1.3 million also incurred in relation to the corporate restructure.[7]

The cost to income ratio increased to 41.6%, compared to 40.9% in FY2018. However, excluding one-off costs related to the corporate restructure and ASX listing referred to above, the cost to income ratio was 39.9%.

**Impairments**

The new accounting standard relating to impairments, IFRS9, came into effect on 1 July 2018. This new standard requires impairments to be provided for on an expected loss basis at the date of loan origination. As a result, FY2019 impairment expense is not directly comparable to FY2018 primarily due to the new requirement to provide for impairment losses on all loans, not just those past due or impaired. This particularly impacted Harmoney and Motor which had high growth and, in the case of Harmoney, higher expected loss rates than other segments.

Impaired asset expense increased by $1.1 million (5.2%) to $20.7 million. $3.1 million of that was the result of increases in provisions on loans not past due or impaired as a result of the application of the new IFRS9 methodology. This would not have been recognised in FY2019 under the previous applicable accounting standard.

Impaired asset expense as a percentage of average Receivables decreased from 0.58% in FY2018 to 0.49% in FY2019. Excluding the impact of IFRS9, the ratio was 0.42% in FY2019.

Impairment and collection rates in Motor improved during the year following changes to collection processes, and as a result reduced impairment expense by $2.1 million.

Impaired and past due loans over 90 days decreased by $3.0 million to $70.9 million, and decreased from 1.84% to 1.61% as a percentage of Receivables.

**IFRS adjustments**

The initial adoption of IFRS9 also resulted in opening adjustments to provisions for impairments of $25.3 million and retained earnings of $17.9 million, after allowance for a deferred tax benefit. IFRS9 also introduced a change in the way Reverse Mortgages are valued. Under IFRS9 they are 'fair-valued'. Currently, it has been determined that fair value equals current carrying value. However, should consistent evidence of a market value emerge, this may result in a revaluation.

**BUSINESS PERFORMANCE**

**New Zealand Reverse Mortgages**

New Zealand Reverse Mortgages net operating income was $20.9 million, an increase of $2.4 million (13.3% growth).

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[7] These costs arose from adverse foreign currency movements due to a foreign exchange exposure at the time of the corporate restructure. This exposure has subsequently been hedged, removing the potential for any further negative impact.

New Zealand Reverse Mortgage Receivables increased $52.0 million (11.4% growth). Reported growth was $104.4 million (22.8% growth) to $561.2 million due to $54.7 million of Australian Reverse Mortgages transferred from Australia to New Zealand, offset by an adverse foreign exchange impact of $2.0 million.

**Motor**

Motor net operating income was $57.1 million, an increase of $4.2 million (8.0% growth).

Motor Receivables increased $127.6 million (13.3% growth) to $1,088.6 million through Motor dealer lending (car dealerships, brokers and partnerships such as Holden and Jaguar/Land Rover).

**Harmoney and other personal lending**

Harmoney and other personal lending net operating income was $18.9 million, an increase of $4.1 million (27.6% growth).

Harmoney and other personal lending Receivables increased $45.1 million (24.9% growth), excluding the impact of changes in foreign currency exchange rates. New Zealand Harmoney and other personal lending increased $31.5 million (20.3% growth) to $186.3 million and Australia Harmoney increased $13.6 million (52.0% growth), excluding the impact of changes in foreign currency exchange rates, to $38.3 million.

**Business**

Business lending net operating income was $55.9 million, an increase of $3.5 million (6.8% growth).

Business Receivables increased by $38.0 million (3.5% growth) to $1,118.2 million. Heartland's growth focus continues to be on Intermediated Business and lending through our digital platform, Open for Business. These markets continue to deliver results with Business Intermediated lending up $101.7 million (31.4% growth) to $425.4 million and Open for Business lending up $43.4 million (48.2% growth) to $133.3 million. Business Relationship lending continues to be managed down as part of our strategy to reduce low margin risk concentration resulting in Business Relationship Receivables reducing by $107.0 million.

**Rural**

Rural lending net operating income was $31.7 million, a decrease of $0.6 million (1.9% reduction).

Rural Receivables decreased by $4.1 million (0.6% reduction) to $656.4 million. We continue to manage down large Rural Relationship lending to reduce low margin risk concentration in this area resulting in Rural Relationship Receivables reducing by $23.4 million. Livestock Receivables increased by $19.3 million (18.8% growth) to $121.6 million.

**Australia**

Net operating income from Australian operations was $22.7 million, an increase of $2.2 million (10.7% growth).

Australian Reverse Mortgage Receivables increased $163.0 million (24.0% growth) excluding the impact of changes in foreign currency exchange rates and reverse mortgage transfers to New Zealand. Reported growth was $79.6 million (11.7% growth) to $757.6 million due to $54.7 million of reverse mortgage transfers to New Zealand and an adverse foreign exchange impact of $31.0 million.

**FUNDING AND LIQUIDITY**

Heartland operates a diversified funding base that continues to grow with the business.

Deposits increased by $271.9 million (9.4% growth) to $3.2 billion. Heartland continues to provide market leading call and competitive term deposit offerings, providing customers with competitive interest rates and unlimited on call access to their money through the Heartland Direct Call Account.

In August 2018, the Asset-Backed Commercial Paper programme was replaced with a new externally rated auto loan warehouse which is bank funded. The facility was utilised during the year but undrawn as at 30 June 2019.

In April 2019, Heartland Bank issued $125 million of five-year unsubordinated unsecured fixed rate notes, which included $50 million of oversubscriptions.

Australian borrowings increased $97.0 million, through $47.0 million of reverse mortgage borrowings and an A$50 million medium-term (2-year) note issued by Heartland Australia Group Pty Limited in March 2019.

In May 2019, Heartland introduced leverage capacity to the holding company with a $50 million corporate debt facility, which was undrawn as at 30 June 2019.

**CORPORATE RESTRUCTURE AND ASX LISTING**

The corporate restructure was completed in October 2018. The Tier 2 Notes (A$20 million) were repaid as part of this corporate restructure.

Under the corporate restructure, all of the shares in Heartland Bank were exchanged for shares in Heartland, and Heartland Bank became a wholly owned subsidiary of Heartland. In addition, the Australian group companies were transferred from Heartland Bank to Heartland.

The corporate restructure provides Heartland greater flexibility to explore and take advantage of future growth opportunities and funding options in New Zealand and Australia outside of the banking group.

**REGULATORY UPDATE**

The financial services sector has seen considerable regulatory activity with the FMA and RBNZ reporting on their findings following a review of conduct and culture in New Zealand retail banks.

The “Bank Conduct and Culture – Findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks” report, dated November 2018 and published by the FMA and RBNZ, which summarised the results of their joint review on conduct and culture found that “conduct and culture issues do not appear to be widespread in banks in New Zealand”. However, the findings did reveal opportunities to strengthen the governance and management of conduct risks industry-wide. Heartland supports the review and is committed to continuous improvement in all areas identified by the FMA and RBNZ. On 29 March 2019, as required of all banks, Heartland submitted a workplan to the FMA and RBNZ addressing improvement in conduct and culture and is currently working through the plan and focusing on iterative improvement of conduct and culture across the organisation. Embedding Heartland's mātāpono (values) is one of the workplan activities.

In December 2018, the RBNZ released a consultation paper seeking public feedback on the minimum amount of regulatory capital required for locally incorporated banks. Heartland Bank submitted a proposal in support of the RBNZ's goal to promote a sound and efficient financial system. The RBNZ published a summary of submissions to its website in July 2019 and a response and final decision is expected to be made in November 2019.

Due to regulatory demands, Heartland is only at the start of our journey to better understand our environmental impact. While we have taken some small steps toward this, we know we need to do more and will be evaluating our overall Environmental, Social and Governance (ESG) strategy in FY2020.

**STRATEGIC PRIORITIES**

Heartland's activity comprises three areas of strategic focus: New Zealand, Australia and Digital.

**New Zealand**

Heartland Bank's focus remains on delivering best or only products to depositors and borrowers through continued growth in niche markets:

- Reverse Mortgages – supporting people to live a more comfortable retirement by releasing equity from their homes
- Motor Finance – helping New Zealanders to purchase safer, more reliable cars
- Business Lending – supporting small businesses to grow with secured or unsecured finance – so they don't necessarily have to own a home or other big asset to receive a loan
- Business Intermediated – targeting manufacturers and distributors of plant and equipment
- Livestock Finance – helping farmers to purchase and trade livestock without having to mortgage their farm
- Deposits – providing New Zealanders with competitive on call and term deposit rates to reach their savings goals.

There are significant growth opportunities for New Zealand Reverse Mortgages and increased investment in marketing is underway to raise product awareness.

FY2019 also saw Heartland Bank enter into a new Retail market with its YouChoose product – a savings account with an arranged overdraft. YouChoose offers customers the flexibility to save when they can and spend when they want to.

Recognising areas of significant growth opportunity, Heartland is investing in supporting future processing capacity. This includes investing in customer service capability and technology in Ashburton to support customers from across the business.

**Australia**

Heartland is the primary originator of reverse mortgages in Australia. The combination of population demographics[8], limited active originators and a product focused on simplicity and customer needs, positions Heartland well in the larger Australian market. Heartland expects to expand its market share further from its current 24%[9].

Heartland intends to increase product awareness through dedicated marketing initiatives in the coming financial year. In July 2019, the Heartland Seniors Finance website was refreshed to reflect an updated brand and deliver a better user experience and customer journey. This was timed with the launch of a television campaign (**TVC**) to help reach the total estimated market of approximately A$6 billion.[10]

To support this growth opportunity, Heartland continues to diversify its sources of funding with a focus on expanding capacity and improving capital efficiency. This includes the following.

- In February 2019, Heartland established an A$ medium-term note programme and conducted its first A$50 million issuance in March 2019.
- In July 2019, Heartland completed a new A$250 million committed reverse mortgage funding facility.
- An additional reverse mortgage funding facility is being developed with a potential new funder.
- Heartland is actively working on a long-term reverse mortgage-backed securitisation structure.

**Digital**

Heartland continues to evolve into a Financial Technology group with a bank licence, as opposed to a conventional bank.

This is an important distinction, because superior customer experiences are increasingly important to high quality customer outcomes, in particular, by delivering simple and fast access to products and services. This is the essence of our digital strategy.

Alongside this, Heartland must remain responsive to all customer needs and recognise that, even in a digital world, people to people contact is important. Accordingly, increased investment is being made in telephony and customer service capability in Ashburton.

Heartland's digital strategy has two key objectives:

- to make our products available to customers online or via an app, providing simple, frictionless and fast on-boarding and processing; and

[8] The number of Australians aged over 65 is projected to grow from 15% of the population in 2017 to 22% by 2057.
[9] Based on APRA ADI Property Exposure statistics, plus Heartland Seniors Finance, as at 31 March 2019.
[10] Based on peak penetration from the Deloitte annual reverse mortgage report 2015, combined with current Australian Bureau of Statistics population and housing statistics and APRA and Heartland Seniors Finance reverse mortgage data.

- to achieve low cost reach to the broadest target market, through online and smartphone access and highly automated processes.

Major achievements include the following.

- In Deposits, the Heartland Mobile App has been installed more than 5,900 times – an increase of 72% since January 2019.
- YouChoose was launched, an online offering that provides both debit and credit capabilities.
- Online EFTPOS has also been added, allowing YouChoose customers greater flexibility to shop online without an EFTPOS or Direct Debit card.
- O4B, Heartland's digital-led small business lending product, has continued to grow. The number of people visiting the O4B webpages in FY2019 increased by 163%[11] and the number of online applications increased by 160%[12].

The O4B platform has reached a stage where increased marketing is required to develop awareness and extend reach into a target market estimated to be $5.6 billion[13]. In July 2019 a new television campaign, accompanied by other marketing activity, was launched to help achieve this.

**FINAL DIVIDEND**

Heartland is pleased to declare a 2019 final dividend of 6.5cps. This represents a 1.0cps increase on the FY2018 final dividend, and takes total dividend for FY2019 to 10.0cps (11% growth). Dividend yield was 8.6%[14]. The dividend increase reflects the continues consistent performance of the bank and an inaugural contribution from the Australian business following growth in assets and profitability.

The final dividend will be paid on Friday 6 September 2019 (**Payment Date**) to shareholders on the company's register as at 5.00pm on Friday 23 August 2019 (**Record Date**) and will be fully imputed.

In December 2018, Heartland established a Dividend Reinvestment Plan (**DRP**), giving eligible shareholders the opportunity to reinvest some or all of their dividend payments into new ordinary shares. The DRP will apply to the final dividend with a 2.0% discount[15].

The DRP offer document and participation form is available on our shareholder website at: https://shareholders.heartland.co.nz/shareholder-resources/dividends.

[11] Data source: Google Analytics, 30 June 2019.
[12] Data source: Proprietary data collection platform, 30 June 2019.
[13] Based on the number of SMEs in New Zealand (Ministry of Business, Innovation and Employment Small Business Fact Sheet 2017) with turnover, risk profile and needs consistent with O4B.
[14] FY2019 total fully imputed dividends divided by share price as at 14 August 2019 of $1.62.
[15] That is, the strike price under the DRP will be 98.0% of the volume weighted average sale price of Heartland shares over the five trading days following the Record Date. For the full details of the DRP and the Strike Price calculation, refer to Heartland Group Holdings Limited DRP offer document dated 10 December 2018.

**LOOKING FORWARD**

We expect to see continued asset growth from core lending activities in FY2020, particularly in Australian and New Zealand reverse mortgages and small business lending, combined with the continuation of a managed reduction in Business and Rural relationship lending.

Investment in growth will be made to build awareness for reverse mortgages (in Australia and New Zealand) and O4B, and to increase processing capacity in the areas of new growth. Some of these costs are anticipated to be one-off and will contribute to growth beyond FY2020.

Additional investment is also planned in Finance and Compliance reflecting increased regulatory requirements and heightened demands in these areas.

Heartland expects its NPAT for the year ending 30 June 2020 to be in the range of $77 million to $80 million.

**- Ends -**


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# 2019 Annual Results

15 August 2019

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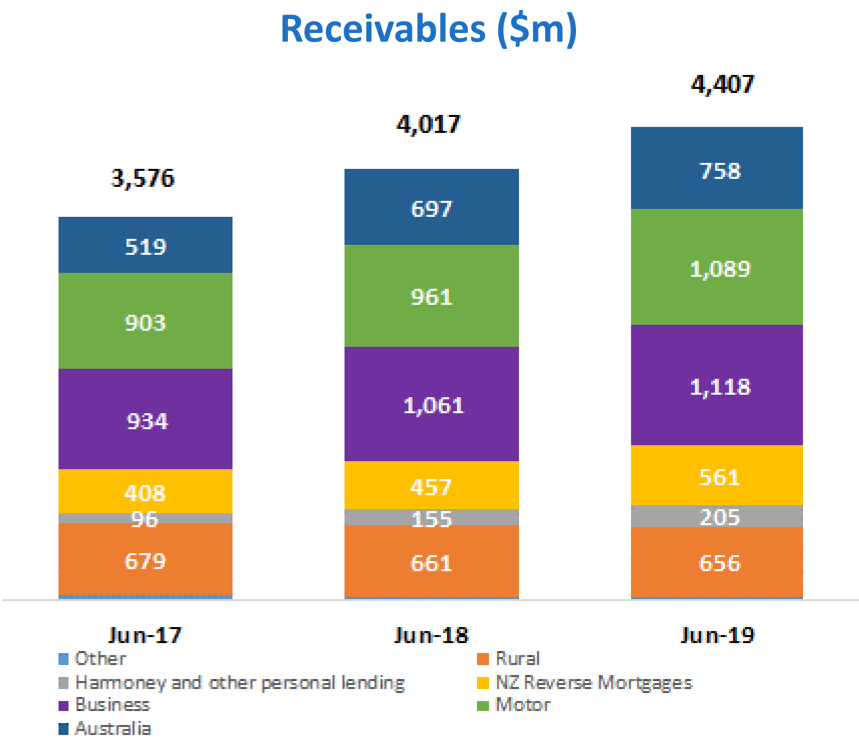
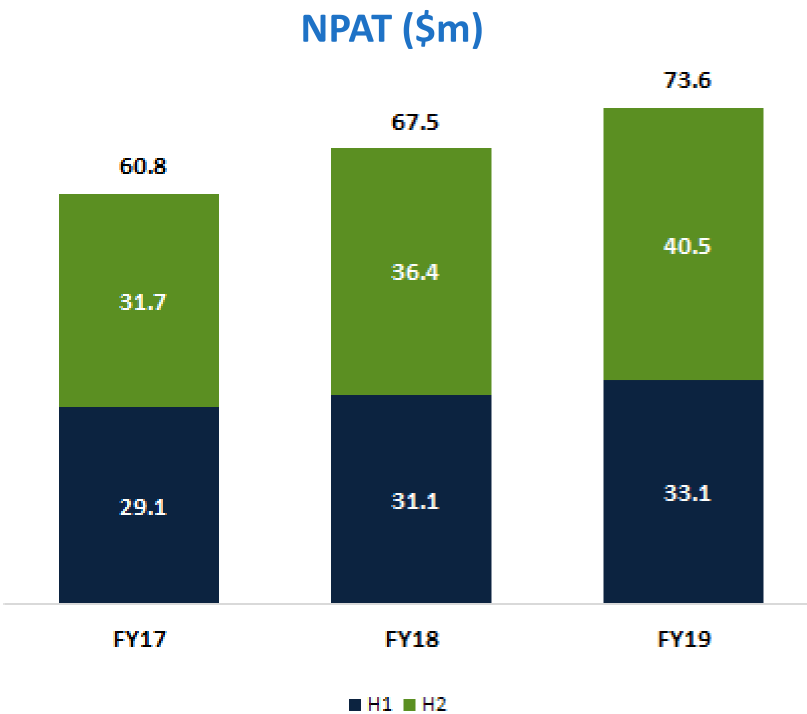
- The information in this presentation is of a general nature and does not constitute financial product advice, investment advice or any recommendation. Nothing in this presentation constitutes legal, financial, tax or other advice.
- This announcement is based on the 30 June 2019 audited full year consolidated financial statements of Heartland Group Holdings Limited (**HGH**). Following a corporate restructure on 31 October 2018, Heartland Bank Limited (**HBL**) became a 100% controlled subsidiary of HGH and ownership of the Australian group companies (comprising Heartland Australia Holdings Pty Limited and its subsidiaries) transferred from HBL to HGH. The interim consolidated financial statements of HGH comprise results for HBL and its subsidiaries up to 31 October 2018, and HGH and its subsidiaries from 1 November 2018 to 30 June 2019. As common control has remained the same both before and after the corporate restructure, management believe that the operations of HGH from 1 November 2018 are directly comparable to those of HBL prior to 1 November 2018. All comparative results are based on 30 June 2018 audited full year consolidated financial statements of HBL.

# FY2019 Highlights

# 2019 Financial Highlights

- Gross finance receivables (**Receivables**) increased 10.5% to **$4.4b** (excl. FX[(1)]).
- Net profit after tax (**NPAT**) increased 9.0% to **$73.6m**.
- Final dividend increased 1.0 cents per share (**cps**) to **6.5cps**, taking total dividends for FY2019 to 10.0cps.




1. Excluding the impact of changes in foreign currency exchange rates (**FX**) of $34.5m.

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# Business and Strategic Highlights

**Business**

- Receivables growth
  - Australian reverse mortgages up 24.0%.
  - New Zealand reverse mortgages up 11.4%.
  - Open for Business up 48.2%.
  - Business Intermediated up 31.4%.
  - Motor up 13.3%.
  - Harmoney and other personal lending up 32.9% (excl. Retail mortgages).

**Strategic**

- Corporate restructure successfully completed.
- ASX foreign exempt listing successfully completed.
- Diversification and expansion of Australian funding.
- Heartland Bank issued $125m of five-year unsubordinated unsecured notes.

# Customer and Culture Highlights

## Customer

- Uptake of the Heartland Mobile App continues to rise, increasing by 72% since January 2019.
- 2 Canstar Savings product awards, and 1 money magazine reverse mortgage product award.
- Work plan submitted to the FMA and RBNZ in response to the recent Conduct and Culture Review.

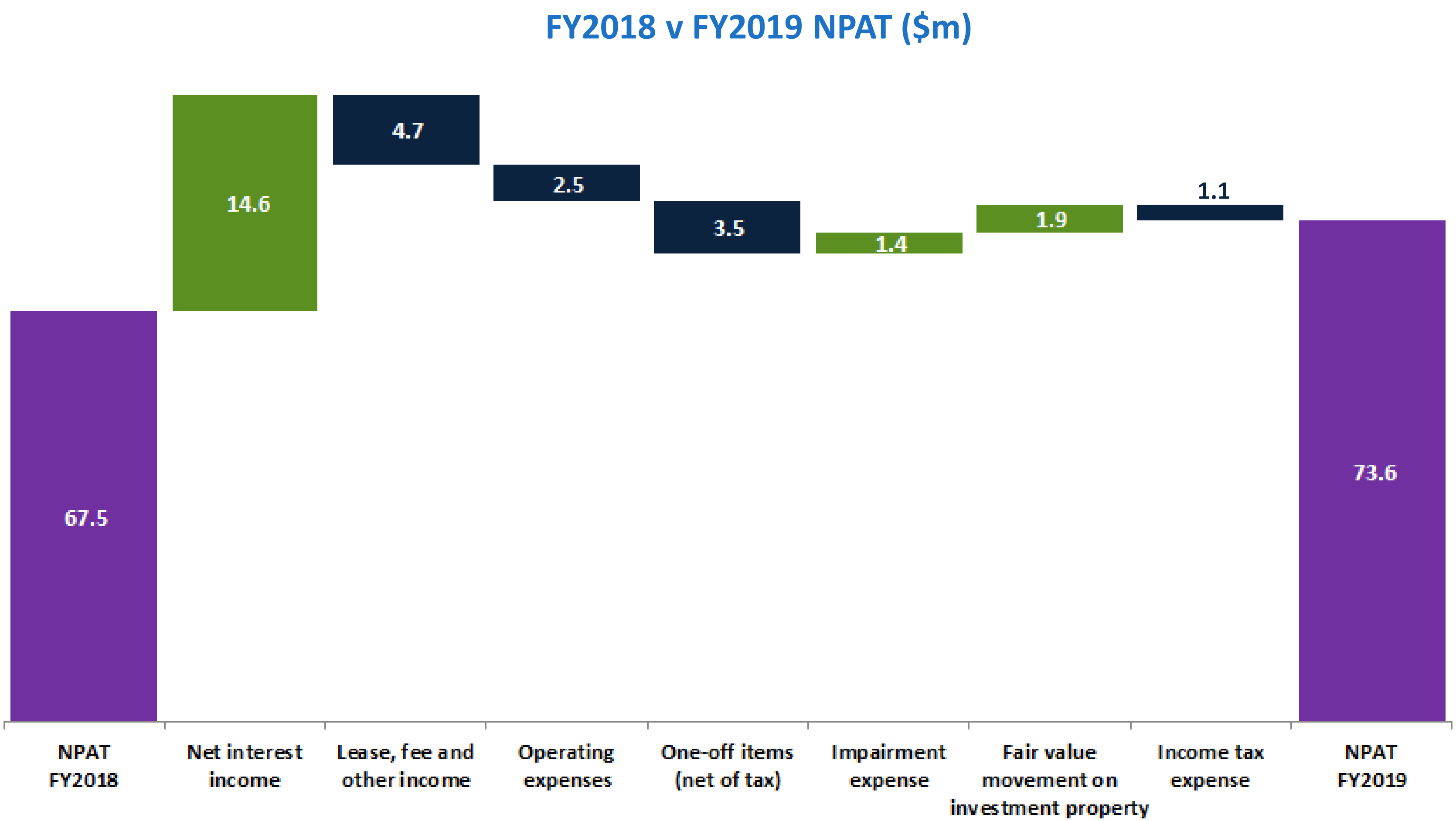
## People and Culture

- Heartland launched its new mātāpono (values) with a focus on customer outcomes. The mātāpono are: Mahi Tika – do the right thing, Mahi Tahi – be one team, Mahi Toa – have big ambition and Mahi Tipu – be always evolving.
- Increase in gender diversity among people in key leadership roles, currently 62.5% female and 37.5% male.
- Internship initiative has contributed to Māori constituting 4.0% of Heartland's population. This is positive compared to the sector where 2.3% of people in the financial and insurances services sector identify as Māori(1).

1. Source: New Zealand Census 2013, Statistics New Zealand.

# Financial Results

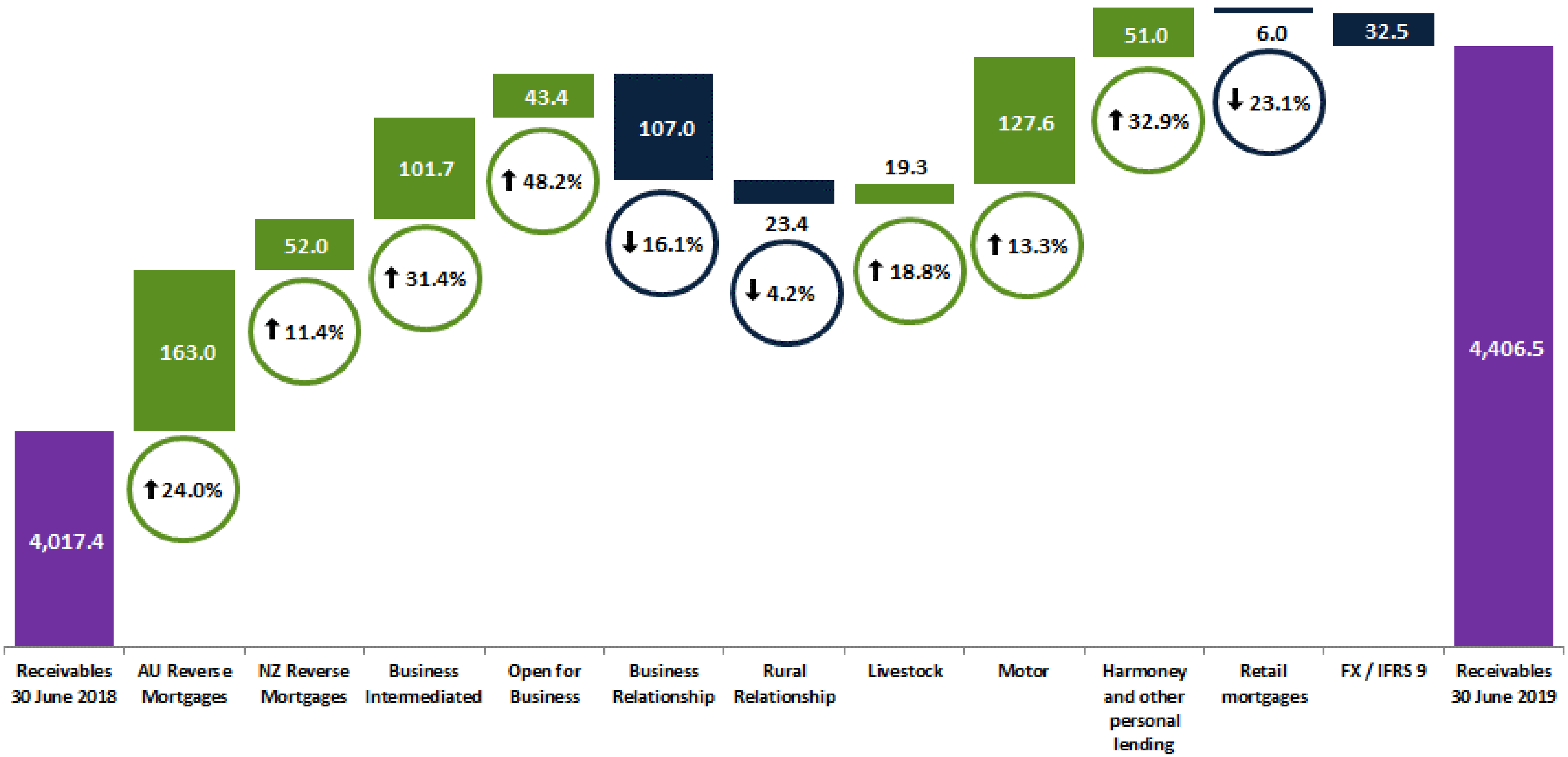
# Growth in Profitability




1. Included in FY2018 lease, fee and other income, were one-off gains of $4.8m on sale of property, and $0.6m on sale of the invoice finance business.
2. One-off items (net of tax) include corporate restructure and ASX listing costs of $1.8 million, adverse impact of foreign currency movements of $0.9m, and Tier 2 break fees of $0.8m.

# Growth in Receivables

## FY2018 v FY2019 Receivables ($m)




1. The graph shows growth in Receivables, excluding the impact of changes in foreign currency exchange rates (**FX**) of $34.5m and IFRS9 adjustments of ($2.0m) which are shown separately.
2. There was a $54.7m transfer from AU Reverse Mortgages to NZ Reverse Mortgages which has been excluded in the above.

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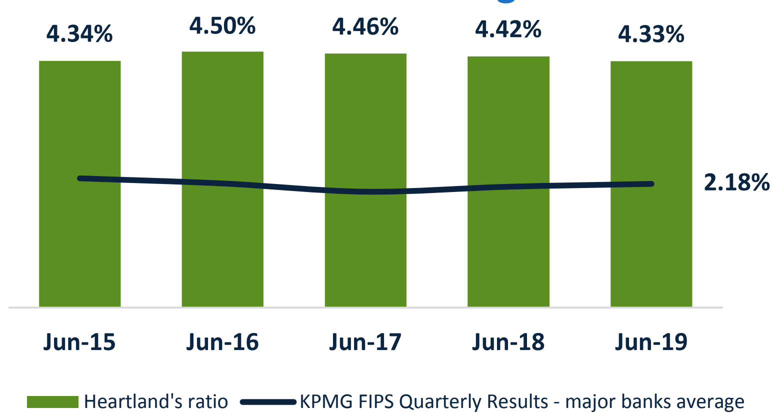
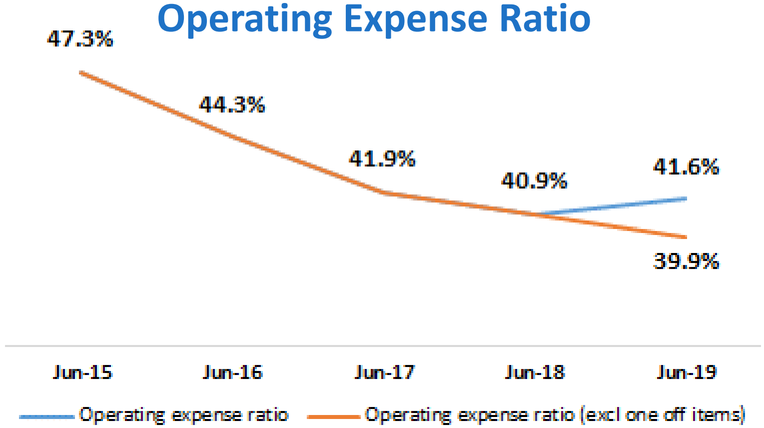
# Key Performance Measures

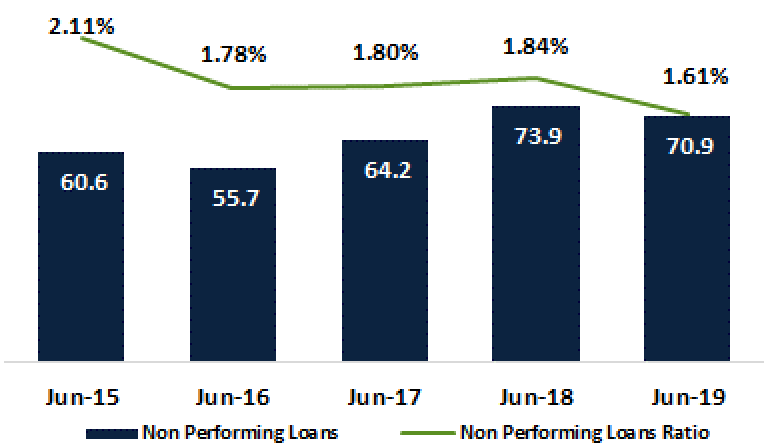
## Net Interest Margin



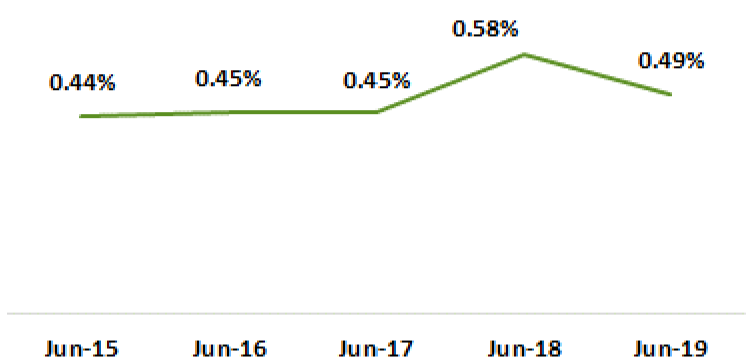

## Operating Expense Ratio




## Non Performing Loans Ratio




## Impairment Expense Ratio[1]




1. Impairment expense ratio is calculated as impaired asset expense / average gross finance receivables

# IFRS9

### Impairment

- New accounting standard IFRS9 came into effect on 1 July 2018.
- Requires impairments to be provided for on an expected loss basis at the date of loan origination, not just those loans that are past due or impaired.
- Excluding the impact of IFRS9 adoption, the impairment expense ratio was 0.42%[(1)].
- The initial adoption of IFRS9 also resulted in opening adjustments to provisions for impairments of $25.3 million and retained earnings of $17.9 million, after allowance for a deferred tax benefit.

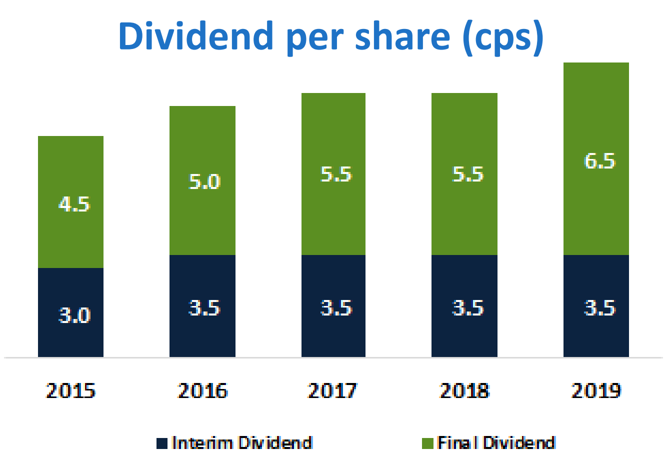
### Fair Value

- IFRS9 also introduced a change in the way Reverse Mortgages are valued.
- Under IFRS they are classified as 'fair value through profit or loss'.
- Currently, it has been determined that fair value equals current carrying value. However, should consistent evidence of a market value emerge, this may result in a revaluation.

1. Impairment expense ratio is calculated as impaired asset expense / average gross finance receivables

# Shareholder Return

- Return on equity 11.1% (11.7% excluding one-off costs and 12.2% for H2 FY2019).
- Earnings per share 13.0cps (14.4cps for H2 FY2019).
- Final dividend declared 6.5cps, up 1.0cps on FY2018 and takes total dividends for FY2019 to 10.0cps (11% growth).
- The dividend reflects consistent performance from the Bank, and an inaugural contribution to the dividend from Australian business following growth in assets and profitability, and enhanced capital efficiency.
- Dividend yield of 8.6%[1].




1. FY2019 total fully imputed dividends divided by share price as at 14 August 2019 of $1.62.

# Divisional summary

# NZ Reverse Mortgages

- Receivables increased 11.4% to $561.2m.
- Net Operating Income increased 13.3% to $20.9m.
- Increased brand awareness and digital distribution through marketing activity.

**NZ Reverse Mortgages**

As at 30 June 2019

**$561.2m**

**11.4% growth**

From FY2018

# Business

- Total Receivables increased 3.5% to $1,118.2m.
- Net Operating Income increased 5.0% to $55.9m.
- Core Business Intermediated Receivables increased 31.4% to $425.4m.
- Non-Core Business Relationship lending reduced $107.0m as part of a managed reduction in low margin risk concentration.

**Business**

As at 30 June 2019

**$1,118.2m**

**3.5% growth excl. FX**

From FY2018

# Motor

- Receivables increased 13.3% to $1,088.6m.
- Net Operating Income increased 8.0% to $57.1m.
- Continued focus on broadening intermediary relationships.
- New and used vehicle sales reduced in H2 FY2019 by 6% and 8% respectively.
- New distributor relationships.

**Motor**

As at 30 June 2019

**$1,088.6m**

**13.3% growth**

From FY2018

# Rural

- Total Receivables decreased 0.6% to $656.4m.
- Net Operating Income decreased 1.9% to $31.7m.
- Livestock Receivables increased 18.8% in the year to $121.6m.
- Non-Core Rural Relationship Receivables decreased 4.2% to $534.8m as part of a managed reduction in low margin risk concentration.

**Rural**

As at 30 June 2019

**$656.4m**

**0.6% decrease**

From FY2018

# Harmoney and other personal lending

- NZ Harmoney Receivables increased 40.0% to $149.7m.
- AU Harmoney Receivables increased 52.0% to $39.8m (excl. FX).
- Other Personal Lending reduced 24.1% to $16.8m.
- Net Operating Income increased 6.8% to $18.9m.

**Harmoney and other personal lending**
As at 30 June 2019

**$206.3m**

**32.9% growth excl. FX**

From FY2018

# Deposits


- Deposits increased 9.4% to $3,153.7m.
- Heartland Mobile App downloads increased by 72% from January 2019.
- Awarded Canstar's Bank of the Year – Savings Awards (second year running).
- Awarded Canstar's 5-Star Rating for Outstanding Value Savings Account for the Direct Call Account (fourth year running).
- Launched new product, YouChoose – a savings account with an arranged overdraft.

# Strategic update

# New Zealand Banking

- Delivering best or only products to depositors and borrowers through continued growth in niche markets:
  - **Reverse Mortgages** – supporting people to live a more comfortable retirement by releasing equity from their homes.
  - **Motor Finance** – helping New Zealanders to purchase safer, more reliable cars.
  - **SME Lending** – supporting small businesses to grow with fast secured or unsecured finance – so they don't necessarily have to own a home or other big asset to receive a loan.
  - **Business** – re-positioned to intermediated channels targeting manufacturers and distributors of plant and equipment.
  - **Livestock Finance** – helping farmers to purchase and trade livestock without having to mortgage their farm.
  - **Deposits** – providing New Zealanders with competitive on call and term deposit rates to reach their savings goals.
  - **Non-Core** – continued reduction in low margin, risk concentrations in Business and Rural.

# Australia

- Heartland is the leading originator of reverse mortgages in Australia.
- Market share grew to 24.0%[1], and is expected to continue to grow.
- Receivables increased 24.0% to $757.6m.
- Net Operating Income increased 10.7% to $22.7m.
- TVC launched to build awareness, and website refreshed to deliver a better user experience and customer journey under a refreshed brand.
- Continued diversification of funding with a focus on matching asset duration, increasing leverage and improving capital efficiency:
  - Established A$ medium-term note programme, A$50m issued.
  - New A$250m committed reverse mortgage funding facility.
  - Additional funding in progress with a potential new funder.
  - Long term reverse mortgage-backed structure being developed.
- O4B pilot in Australia.

**Australian Reverse Mortgages**

As at 30 June 2019

**$757.6m**

**24.0% growth excl. FX and transfers**

From FY2018

1. Based on APRA ADI Property Exposure statistics, plus Heartland Seniors Finance, as at 31 March 2019.

# Digital

## Vision

- A Financial Technology group with a bank licence, not a conventional bank.

## Digital Strategy

- High-quality customer outcomes depend on providing superior customer experiences through delivery of simple and fast access to products and services.

## Key Objectives

- Ensure our products are available to customers online or via an app, providing simple frictionless and fast on-boarding and processing.
- Achieve low cost reach to the broadest target market, through online and smartphone access and highly automated processes.

## Major Achievements

- Heartland Mobile App installed more than 5,900 times (72% increase since January 2019).
- YouChoose launched, an online offering providing both debit and credit capabilities.
- Online EFTPOS allowing customers greater flexibility to shop online without an EFTPOS or Debit Card.
- O4B webpage visits increased by 163%[1], and the number of online applications increased by 160%[2].
- Domain Authority increased 16%[3].

1. Google Analytics, 30 June 2019.
2. Proprietary data collection platform, 30 June 2019.
3. https//moz.com.

# Open for Business

- Receivables increased 48.2% to $133.3m.
- Net Operating Income increased 85.3% to $9.6m.
- Investment in awareness and processing capacity required for next phase of growth.

**Open for Business**

As at 30 June 2019

**$133.3m**

**48.2% growth excl. FX**

From FY2018

# Regulatory update

**FMA and RBNZ review of conduct and culture in New Zealand retail banks[1]**

- The review found no conduct and culture issues of material concern but urged banks to strengthen management of conduct risks.
- On 29 March 2019, Heartland submitted a workplan addressing the findings.
- The findings are consistent with Heartland's constant internal focus on positive customer outcomes and the values of Mahi Tika.

**RBNZ capital review**

- In December 2018, the RBNZ released a consultation paper seeking public feedback on the minimum amount of regulatory capital required for locally incorporated banks.
- A final decision is expected to be made by the RBNZ in November 2019.

1. "Bank Conduct and Culture – Findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks" report, dated November 2018 and published by the FMA and RBNZ.

# Capital

- Focus remains on improved return on equity through capital efficiency while ensuring Heartland Bank's capital needs are supported.
- Heartland Bank would require approximately $60m of additional regulatory capital[(1)] ($12m p.a. over the 5 year transition period) were the proposed RBNZ capital changes implemented in current form.
- This transition, along with growth could be supported from:
  - Retained earnings;
  - Contribution from managed reduction in relationship lending;
  - Available Group leverage; and/or
  - Improvement in Australian capital efficiency.

1. Based on Heartland Bank's risk weighted exposures, and regulatory capital as at 30 June 2019.

# Strategic Outlook

- High-quality customer outcomes.
- Continued stability and growth in Core Banking activities.
- Growth in Australia.
- Continued shift to fast and simple on-boarding and processing under a ‘Digital’ strategy.
- Capital efficiency and improved return on equity.

# FY2020 Outlook

- Continued asset growth in core lending, particularly reverse mortgages in New Zealand and Australia, and O4B.
- Managed reduction of low margin Business and Rural Relationship lending to reduce concentration risk.
- Increased costs associated with investment in:
  - Awareness for O4B and reverse mortgages in both Australia and New Zealand.
  - Capacity and processing volume to meet growing demand and opportunities in core strategic areas.
  - Finance and Compliance reflecting increased regulatory complexity and heightened and demands.
- Many of these costs are accelerated or one-off and will generate asset growth and income in ensuing years.
- Accordingly, we expect the cost to income ratio increase to 41.9%, before reverting to its current trajectory.
- Heartland expects net profit after tax for the year ending 30 June 2020 to be in the range of $77 million to $80 million.

# Appendices

# Appendix – Financial Position

| Summary Balance Sheet | 30 Jun 2019 ($m) | 30 Jun 2018 ($m) | Movement ($m) | Growth (%) |
|---|---|---|---|---|
| Gross finance receivables | 4,406.5 | 4,017.4 | 389.1 | 9.7% |
| Provisions for impairment and fair value adjustment | (58.4) | (32.5) | (25.9) | 79.8% |
| Net finance receivables | 4,348.1 | 3,984.9 | 363.1 | 9.1% |
| Other assets | 578.4 | 511.9 | 66.4 | 13.0% |
| **TOTAL ASSETS** | **4,926.4** | **4,496.8** | **429.6** | **9.6%** |
| Retail deposits | 3,153.7 | 2,881.8 | 271.9 | 9.4% |
| Other borrowings | 1,056.7 | 914.3 | 142.4 | 15.6% |
| Other liabilities | 40.4 | 36.6 | 3.8 | 10.3% |
| **Equity** | 675.7 | 664.2 | 11.5 | 1.7% |
| **TOTAL EQUITY & LIABILITIES** | **4,926.4** | **4,496.8** | **429.6** | **9.6%** |

- Receivables increased 10.5%, excluding the impact of FX, resulting in reported growth of 9.7%.
- Retail deposits increased 9.4% to $3,153.7m.

# Appendix – Impact of one-off items

- One-off items include post-tax impact of:
  - Corporate restructure and ASX listing costs of $1.8m.
  - Adverse impact of foreign currency movements of $0.9m.
  - Tier 2 break fees of $0.8m.

| | Reported | Impact | Excl. Impact |
|---|---|---|---|
| Net profit after tax | $73.6m | $3.5m | $77.1m |
| Net interest margin | 4.33% | 0.02% | 4.35% |
| Cost to income ratio | 41.6% | (1.7%) | 39.9% |
| Return on equity | 11.1% | 0.6% | 11.7% |
| Earnings per share | 13.0cps | 0.7cps | 13.7cps |

# Appendix – H1 FY2019 v H2 FY2019

| | H1 FY2019 | H2 FY2019 | FY 2019 |
|---|---|---|---|
| Net operating income | $102.1m | $103.7m | $205.8m |
| Operating expenses | $43.4m | $42.2m | $85.6m |
| Impaired asset expense | $13.3m | $7.4m | $20.7m |
| Tax expense | $12.4m | $15.5m | $27.9m |
| **Net profit after tax** | **$33.1m** | **$40.5m** | **$73.6m** |
| | | | |
| Net interest margin | 4.36% | 4.30% | 4.33% |
| Cost to income ratio | 42.5% | 40.7% | 41.6% |
| **Return on equity** | **10.3%** | **12.2%** | **11.1%** |
| Earnings per share | 11.7cps | 14.4cps | 13.0cps |

# Thank you

HEARTLAND GROUP

# Financial Statements

For the 12 months ended 30 June 2019

# Contents

# GENERAL INFORMATION

These financial statements are issued by Heartland Group Holdings Limited and its subsidiaries (the **Group**) for the year ended 30 June 2019.

Heartland Group Holdings Limited (**HGH**) is incorporated in New Zealand and registered under the Companies Act 1993. The shares in HGH are listed on the NZX Main Board and the Australian Securities Exchange under a Foreign Exempt Listing.

On 31 October 2018 HGH acquired Heartland Bank Limited (**HBL**) and subsidiaries (**HBL Group**) pursuant to a corporate restructure approved by the shareholders of HBL. Under this restructure all the shares of HBL were exchanged for shares in HGH. At the same time, the Australian group of companies owned by HBL were transferred to HGH. HGH was incorporated solely for the purpose of undertaking this transaction.

As common control remained after the restructure, the financial statements presented for the year ended 30 June 2019 are for the Group as if it had operated for the entire period. Comparative figures shown are for the consolidated HBL Group.

**Name and address for service**

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

**Details of incorporation**

HGH was incorporated under the Companies Act 1993 on 19 July 2018.

# DIRECTORS

All Directors of the HGH Group reside in New Zealand with the exception of Ellen Comerford who resides in Australia. Communications to the Directors can be sent to Heartland Group Holdings Limited, 35 Teed Street, Newmarket, Auckland. At the time of the signing of these Financial Statements the Directors of the Group and their details were:

**Chairman - Board of Directors**
**Name:** Geoffrey Thomas Ricketts CNZM
**Qualifications:** LLB(Hons), LLD (honoris causa), CFInstD
**Type of Director:** Independent Non-Executive Director
**Occupation:** Company Director
**External Directorships:**
Asteron Life Limited, Janmac Capital Limited, Maisemore Enterprises Limited, MCF2 Message4U Limited, MCF 2 Nexus Limited, MCF 7 Limited, MCF 8 Limited, MCF 9 Limited, MCF 10 Limited, MCF2 (Fund 1) Limited, MCF2A General Partner Limited, MCF2 GP Limited, MCF3 GP Limited, MCF3B General Partner Limited, MCF3A General Partner Limited, MCF2 FFF-GK Limited, MC Medical Properties Limited, Mercury Capital No.1 Fund Limited, Mercury Capital No. 1 Trustee Limited, Mercury Pharmacy Holdings Limited, Mercury Medical Holdings Limited, New Zealand Catholic Education Office Limited, NZCEO Finance Limited, O & E Group Services Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, Oceania North Limited, Oceania Securities Limited, Quartet Equities Limited, Suncorp Group Holdings (NZ) Ltd, Suncorp Group New Zealand Limited, Suncorp Group Services NZ Limited, The Centre for Independent Studies Limited, The Todd Corporation Limited, Todd Management Services Limited, Todd Offshore Limited, Vero Insurance New Zealand Limited, Vero Liability Insurance Limited.

**Name:** Jeffrey Kenneth Greenslade
**Qualifications:** LLB
**Type of Director:** Non-Independent Executive Director
**Occupation:** Chief Executive Officer
**External Directorships:**
Nil

**Name:** Ellen Frances Comerford

**Type of Director:** Independent Non-Executive Director

**Qualifications:** BEc

**Occupation:** Chief Financial Officer of Hollard Insurance Company Pty Ltd

**External Directorships:**

Comerford Gohl Holdings Pty Limited, Hollard Holdings Australia Pty Limited, The Hollard Insurance Company Pty Limited.

**Name:** Sir Christoper Robert Mace KNZM

**Type of Director:** Independent Non-Executive Director

**Qualifications:** CMInstD

**Occupation:** Company Director

**External Directorships:**

Akitu Equities Limited, Akitu Capital Limited, Akitu Group Company No 1 Limited, Akitu Group Company No 2 Limited, Akitu Group Company No 3 Limited, Akitu Health Services Limited, Akitu Investments Limited, Akitu Investments No 2 Limited, Goldburn Resources Limited, Helicopter Enterprises Limited, Janik Equities Limited, Janmac Capital Limited, J N S Capital Limited, Mace Capital Limited, Mace Construction Limited, Mace Developments Limited, Mace Enterprises Limited, Mace Investments Limited, Maisemore Enterprises Limited, Nuffield Forestry Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, O & E Group Services Limited, Paroa Bay Station Limited, PPT Trustee (NZ) Limited, Quartet Equities Limited, St. Just Enterprises Limited, Te Puia Tapapa GP Limited.

**Name:** Gregory Raymond Tomlinson

**Type of Director:** Independent Non-Executive Director

**Qualifications:** AME

**Occupation:** Company Director

**External Directorships:**

Alta Cable Holdings Limited, Argenta Limited, Chippies Vineyard Limited, Forte Health Group Limited, Forte Health Limited, Impact Capital Management Limited, Impact Capital Limited, Indevin Group Limited, Little Ngakuta Trust Company Limited, Mountbatten Trustee Limited, Nearco Stud Limited, Ngakuta Trust Company Limited, Oceania Healthcare Limited, Pelorus Finance Limited, St Leonards Limited, The Icehouse Limited, Tomlinson Group NZ Limited, Tomlinson Holdings Limited, Tomlinson Group Investments Limited, Tomlinson Ventures Limited.

## AUDITOR

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland

## OTHER MATERIAL MATTERS

There are no material matters relating to the business or affairs of the Group that are not contained elsewhere in these Consolidated Financial statements which would, if disclosed in these Consolidated Financial Statements, materially affect the decision of a person to subscribe for debt securities of which the Group is the issuer.

# DIRECTORS STATEMENTS

The Consolidated Financial Statements are dated 15 August 2019 and have been signed by all the Directors.

G T Ricketts (Chair)

E F Comerford

J K Greenslade

Sir C R Mace

G R Tomlinson

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

**For the year ended 30 June 2019**

| $000's | NOTE | June 2019 | June 2018 |
|---|---|---|---|
| Interest income | 3 | 334,330 | 309,284 |
| Interest expense | 3 | 136,747 | 125,483 |
| **Net interest income** | | **197,583** | **183,801** |
| Operating lease income | 4 | 5,262 | 5,675 |
| Operating lease expenses | 4 | 3,427 | 4,005 |
| **Net operating lease income** | | **1,835** | **1,670** |
| Lending and credit fee income | | 3,117 | 2,351 |
| Other income | 5 | 3,307 | 8,972 |
| **Net operating income** | | **205,842** | **196,794** |
| Operating expenses | 6 | 85,589 | 80,433 |
| **Profit before impaired asset expense and income tax** | | **120,253** | **116,361** |
| Fair value movement on investment property | 11 | 1,936 | - |
| Impaired asset expense | 7 | 20,676 | 22,067 |
| **Profit before income tax** | | **101,513** | **94,294** |
| Income tax expense | 8 | 27,896 | 26,781 |
| **Profit for the year** | | **73,617** | **67,513** |
| **Other comprehensive income** | | | |
| Items that are or may be reclassified subsequently to profit or loss: | | | |
| Effective portion of changes in fair value of derivative financial instruments, net of income tax | | (4,762) | 72 |
| Movement in fair value reserve, net of income tax | | 2,968 | 981 |
| Movement in foreign currency translation reserve | | (5,281) | 2,315 |
| **Items that will not be reclassified to profit or loss:** | | | |
| Movement in defined benefit reserve, net of income tax | | (86) | 340 |
| **Other comprehensive income for the year, net of income tax** | | **(7,161)** | **3,708** |
| **Total comprehensive income for the year** | | **66,456** | **71,221** |
| **Earnings per share** | | | |
| Basic earnings per share | 9 | 13c | 13c |
| Diluted earnings per share | 9 | 13c | 13c |

Total comprehensive income for the year is attributable to the owners of the Group.

The notes on pages 12 to 53 are an integral part of this consolidated financial statement.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

**For the year ended 30 June 2019**

| | | June 2019 | | | | June 2018 | | | |
|---|---|---|---|---|---|---|---|---|---|
| **$000's** | **Note** | **Share Capital** | **Reserves** | **Retained Earnings** | **Total Equity** | **Share Capital** | **Reserves** | **Retained Earnings** | **Total Equity** |
| **Balance at beginning of year** | | **542,315** | **4,585** | **117,260** | **664,160** | **470,516** | **1,437** | **97,642** | **569,595** |
| NZ IFRS 9 adjustment | 1 | - | - | (19,283) | (19,283) | - | - | - | - |
| **Restated balance at beginning of year** | | **542,315** | **4,585** | **97,977** | **644,877** | **470,516** | **1,437** | **97,642** | **569,595** |
| **Total comprehensive income for the year** | | | | | | | | | |
| Profit for the year | | - | - | 73,617 | 73,617 | - | - | 67,513 | 67,513 |
| Other comprehensive income/(loss) net of income tax | | - | (7,161) | - | (7,161) | - | 3,708 | - | 3,708 |
| **Total comprehensive income for the year** | | **-** | **(7,161)** | **73,617** | **66,456** | **-** | **3,708** | **67,513** | **71,221** |
| **Contributions by and distributions to owners** | | | | | | | | | |
| Dividends paid | 16 | - | - | (50,599) | (50,599) | - | - | (47,895) | (47,895) |
| Dividend reinvestment plan | 16 | 14,333 | - | - | 14,333 | 12,745 | - | - | 12,745 |
| Issue of share capital | | - | - | - | - | 59,225 | - | - | 59,225 |
| Transaction costs associated with capital raising | | (18) | - | - | (18) | (910) | - | - | (910) |
| Share based payments | | - | 619 | - | 619 | - | 666 | - | 666 |
| Shares vested | | 2,340 | (2,340) | - | - | 739 | (1,226) | - | (487) |
| **Total transactions with owners** | | **16,655** | **(1,721)** | **(50,599)** | **(35,665)** | **71,799** | **(560)** | **(47,895)** | **23,344** |
| **Balance at the end of the year** | | **558,970** | **(4,297)** | **120,995** | **675,668** | **542,315** | **4,585** | **117,260** | **664,160** |

The notes on pages 12 to 53 are an integral part of this consolidated financial statement.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

**As at 30 June 2019**

| $000's | NOTE | June 2019 | June 2018 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | | 80,584 | 49,588 |
| Investments | 10 | 354,928 | 340,546 |
| Investment properties | 11 | 11,132 | 9,196 |
| Derivative financial instruments | 12 | 12,675 | 923 |
| Finance receivables | 13 | 3,029,231 | 3,984,941 |
| Finance receivables - reverse mortgages | 13 | 1,318,819 | - |
| Operating lease vehicles | 14 | 15,516 | 17,524 |
| Other assets | 17 | 21,309 | 14,411 |
| Intangible assets | 17 | 72,679 | 74,401 |
| Deferred tax asset | 8 | 9,531 | 5,319 |
| **Total assets** | | **4,926,404** | **4,496,849** |
| | | | |
| **Liabilities** | | | |
| Retail deposits | 15 | 3,153,681 | 2,881,805 |
| Other borrowings | 15 | 1,056,653 | 914,253 |
| Tax liabilities | | 7,532 | 11,459 |
| Derivative financial instruments | 12 | 10,372 | 2,562 |
| Trade and other payables | 17 | 22,498 | 22,610 |
| **Total liabilities** | | **4,250,736** | **3,832,689** |
| | | | |
| **Equity** | | | |
| Share capital | 16 | 558,970 | 542,315 |
| Retained earnings and other reserves | | 116,698 | 121,845 |
| **Total equity** | | **675,668** | **664,160** |
| | | | |
| **Total equity and liabilities** | | **4,926,404** | **4,496,849** |
| | | | |
| Total interest earning and discount bearing assets | | 4,773,180 | 4,361,937 |
| Total interest and discount bearing liabilities | | 4,208,879 | 3,790,067 |

The notes on pages 12 to 53 are an integral part of this consolidated financial statement.

# CONSOLIDATED STATEMENT OF CASH FLOWS

**For the year ended 30 June 2019**

| $000's | Note | June 2019 | June 2018 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | 304,991 | 280,471 |
| Operating lease income received | | 4,761 | 4,941 |
| Lending, credit fees and other income received | | 4,587 | 10,398 |
| **Operating inflows** | | **314,339** | **295,810** |
| Payments to suppliers and employees | | 89,607 | 73,672 |
| Interest paid | | 135,404 | 123,783 |
| Taxation paid | | 25,895 | 23,818 |
| **Operating outflows** | | **250,906** | **221,273** |
| **Net cash flows from operating activities before changes in operating assets and liabilities** | | **63,433** | **74,537** |
| Proceeds from sale of operating lease vehicles | | 4,641 | 5,577 |
| Purchase of operating lease vehicles | | (5,495) | (7,163) |
| Net movement in finance receivables | | (384,367) | (431,863) |
| Net movement in deposits | | 271,876 | 307,733 |
| **Net cash flows applied to operating activities** | | **(49,912)** | **(51,179)** |
| **Cash flows from investing activities** | | | |
| Net proceeds from sale of investment properties | | - | 3,185 |
| Proceeds from equity investments | | - | 300 |
| **Total cash provided from investing activities** | | **-** | **3,485** |
| Purchase of property plant equipment and intangible assets | | 4,513 | 8,837 |
| Net increase in investments | | 11,468 | 23,107 |
| Purchase of investment properties | | - | 7,472 |
| **Total cash applied to investing activities** | | **15,981** | **39,416** |
| **Net cash flows applied to investing activities** | | **(15,981)** | **(35,931)** |
| **Cash flows from financing activities** | | | |
| Net increase/(decrease) in wholesale funding | | 31,000 | (93,507) |
| Proceeds from issue of Unsubordinated Notes | | 125,000 | 150,000 |
| Increase in share capital | | - | 58,315 |
| **Total cash provided from financing activities** | | **156,000** | **114,808** |
| Dividends paid | 16 | 36,265 | 35,150 |
| Repayment of subordinated notes | 15 | 22,846 | - |
| **Total cash applied to financing activities** | | **59,111** | **35,150** |
| **Net cash flows from financing activities** | | **96,889** | **79,658** |
| **Net increase/(decrease) increase in cash held** | | **30,996** | **(7,452)** |
| Opening cash and cash equivalents | | 49,588 | 57,040 |
| **Closing cash and cash equivalents** | | **80,584** | **49,588** |

The notes on pages 12 to 53 are an integral part of this consolidated financial statement.

# CONSOLIDATED STATEMENT OF CASH FLOWS

**For the year ended 30 June 2019**

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

| $000's | Note | June 2019 | June 2018 |
|---|---|---|---|
| **Profit for the year** | | **73,617** | **67,513** |
| | | | |
| Add / (less) non-cash items: | | | |
| Depreciation and amortisation expense | | 5,760 | 4,638 |
| Depreciation on lease vehicles | | 3,363 | 3,771 |
| Capitalised net interest income | | (29,417) | (26,373) |
| Impaired asset expense | 7 | 20,676 | 22,067 |
| Investment property fair value movement | | (1,936) | - |
| **Total non-cash items** | | **(1,554)** | **4,103** |
| | | | |
| Add / (less) movements in operating assets and liabilities: | | | |
| Finance receivables | | (384,367) | (431,863) |
| Operating lease vehicles | | (1,354) | (2,257) |
| Other assets | | (8,260) | (635) |
| Current tax | | (3,927) | 1,603 |
| Derivative financial instruments | | (8,701) | (1,638) |
| Deferred tax | | 3,759 | 2,533 |
| Deposits | | 271,876 | 307,733 |
| Other liabilities | | 8,999 | 1,729 |
| **Total movements in operating assets and liabilities** | | **(121,975)** | **(122,795)** |
| | | | |
| **Net cash flows applied to operating activities** | | **(49,912)** | **(51,179)** |

The notes on pages 12 to 53 are an integral part of this consolidated financial statement.

# NOTES TO THE FINANCIAL STATEMENTS

**For the year ended 30 June 2019**

## 1 Financial statements preparation

**Reporting entity**
The financial statements presented are the consolidated financial statements comprising Heartland Group Holdings Limited (**HGH**) and its subsidiaries (**the Group**). Refer note 25 – Significant subsidiaries for further details.

On 31 October 2018 HGH acquired Heartland Bank Limited (**HBL**) pursuant to a corporate restructure approved by the shareholders of HBL. Under this restructure all the shares of HBL were exchanged for shares in HGH. At the same time, the Australian group of companies owned by HBL were transferred to HGH. HGH was incorporated solely for the purpose of undertaking this transaction. HGH is a Financial Markets Conduct (**FMC**) reporting entity for the purposes of the Financial Markets Conduct Act 2013.

As common control remained after the restructure, the financial statements presented for the year ended 30 June 2019 are for the Group as if it had operated for the entire period. Comparative figures shown are for the consolidated HBL Group.

As at 30 June 2019, the Group is a company incorporated in New Zealand under the Companies Act 1993.

**Basis of preparation**
The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**) and the NZX Main Board Listing Rules and the ASX Listing Rules. The financial statements comply with New Zealand equivalents to International Financial Reporting Standards (**NZ IFRS**) and other applicable Financial Reporting Standards as appropriate for profit-oriented entities. The financial statements also comply with International Financial Reporting Standards (**IFRS**) as issued by the International Accounting Standards Board.

The financial statements are presented in New Zealand dollars which is the Group's currency. Unless otherwise indicated, amounts are rounded to the nearest thousand.

The financial statements have been prepared on the basis of historical cost, except for certain financial instruments and investment property, which are measured at their fair values as identified in the accounting policies set out in the accompanying notes.

The financial statements have been prepared on a going concern basis after considering the Group's funding and liquidity position.

The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements.

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

**Principles of consolidation**
The consolidated financial statements of the Group incorporate the assets, liabilities and results of all controlled entities. Controlled entities are all entities in which the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Intercompany transactions, balances and any unrealised income and expense (except for foreign currency transaction gains or losses) between controlled entities are eliminated.

Assets and liabilities with transactional currency that is not the New Zealand dollar, are translated at the exchange rates ruling at balance date. Revenue and expense items are translated at the spot rate at the transaction date or a rate approximating that rate. Exchange differences are taken to the Consolidated Statement of Comprehensive Income.

**Changes in accounting policy**
The Group adopted NZ IFRS 9 - Financial instruments (**NZ IFRS 9**) and NZ IFRS 15 - Revenue from contracts with customers (**NZ IFRS 15**) from 1 July 2018. There have been no changes in previously reported financials.

***NZ IFRS 9 Financial instruments***
In accordance with the transition provisions of NZ IFRS 9 the classification and measurement requirements of this standard have been applied retrospectively by adjusting affected opening balances at the date of initial application with no restatement of comparative periods.

The following changes have been made to accounting policies as result of the application of NZ IFRS 9.

## 1 Financial Statements preparation (continued)

***Impairment of finance receivables***

At each reporting date, the Group applies a three stage approach to measuring expected credit losses (**ECL**) to Finance receivables not carried at fair value. The ECL model assesses whether there has been a significant increase in credit risk since initial recognition

The ECL model is a forward looking model where impairment allowances are recognised before losses are actually incurred. On initial recognition, an impairment allowance is made, based on events that are possible in the next 12 months.

After initial recognition, the Group applies a three stage test to measuring ECL's. Assets may migrate through the following stages based on their change in credit quality.

Stage 1 - 12 months ECL (past due 30 days or less)

Where there has been no evidence of increased credit risk since initial recognition, and are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Stage 2 - Lifetime ECL not credit impaired (greater than 30 but less than 90 days past due)

Where there has been a significant increase in credit risk.

Stage 3 - Lifetime ECL credit impaired (90 days past due or more)

Objective evidence of impairment, so are considered to be in default or otherwise credit impaired.

In determining whether credit risk has increased all available information relevant to the assessment of economic conditions at the reporting date are taken into consideration. To do this the Group considers its historical loss experience and adjusts this for current observable data. In addition to this the Group uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. Future economic conditions consider macroeconomic factors such as unemployment, interest rate, gross domestic product, and inflation, and requires an evaluation of both the current and forecast direction of the economic cycle. The methodology and assumptions including any forecasts of future economic conditions are reviewed regularly as incorporating forward-looking information increases the level of judgement as to how changes in these macroeconomic factors will affect the ECL.

The calculation of expected credit loss is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

***Impairment of investments***

The requirements of NZ IFRS 9 also apply to the Groups Investments. The impact of which has been assessed as not material.

The table below shows the changes to classification and measurement of the Group's financial assets due to the adoption of NZ IFRS 9. There are no changes in the classification or measurement category of the Group's financial liabilities.

| **Financial Instruments** | **NZ IAS 39 Measurement category** | **NZ IFRS 9 Measurement category** | **NZ IAS 39 Carrying value June 2018** | **NZ IFRS 9 Carrying value 1 July 2018** |
|---|---|---|---:|---:|
| **Financial assets** | | | | |
| Bank bonds and floating rate notes | Available for sale (**AFS**) | Fair value through other comprehensive income (**FVOCI**) | 230,754 | 230,754 |
| Public sector securities and Corporate bonds | AFS | FVOCI | 57,818 | 57,818 |
| Local authority stock | AFS | FVOCI | 42,280 | 42,280 |
| Equity investments | Fair value through profit or loss (**FVTPL**) | FVOCI | 9,694 | 9,694 |
| Finance receivables - reverse mortgages | Amortised cost | FVTPL | 1,129,956 | 1,132,838 |
| Finance receivables | Amortised cost | Amortised cost | 2,854,985 | 2,824,819 |
| Trade receivables | Amortised cost | Amortised cost | 1,613 | 1,613 |

## 1 Financial Statements preparation (continued)

The table below is a reconciliation of the balance sheet detailing the changes from NZ IAS 39 to NZ IFRS 9.

| $000's | Audited 12 months to June 2018 | Impact of NZ IFRS 9 Restatement | Restated 1 July 2018 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 49,588 | - | 49,588 |
| Investments | 340,546 | - | 340,546 |
| Investment properties | 9,196 | - | 9,196 |
| Derivative financial instruments | 923 | - | 923 |
| Finance receivables | 3,984,941 | (27,284) | 3,957,657 |
| Operating lease vehicles | 17,524 | - | 17,524 |
| Other assets | 14,411 | - | 14,411 |
| Intangible assets | 74,401 | - | 74,401 |
| Deferred tax asset | 5,319 | 8,001 | 13,320 |
| **Total assets** | **4,496,849** | **(19,283)** | **4,477,566** |
| **Liabilities** | | | |
| Retail deposits | 2,881,805 | - | 2,881,805 |
| Other borrowings | 914,253 | - | 914,253 |
| Tax liabilities | 11,459 | - | 11,459 |
| Derivative financial instruments | 2,562 | | 2,562 |
| Trade and other payables | 22,610 | - | 22,610 |
| **Total liabilities** | **3,832,689** | **-** | **3,832,689** |
| **Equity** | | | |
| Share capital | 542,315 | - | 542,315 |
| Retained earnings and reserves | 121,845 | (19,283) | 102,562 |
| **Total equity** | **664,160** | **(19,283)** | **644,877** |
| **Total equity and liabilities** | **4,496,849** | **-** | **4,477,566** |

### *Impact of NZ IFRS 9 adjustment on adoption*

| | |
|---|---|
| Additional provision for impairment recognised at 1 July 2018 on: | |
| - Finance receivables | 28,085 |
| - Finance receivables - reverse mortgages | (2,824) |
| Provision for impairment at 1 July 2018 | 25,261 |
| Change in valuation basis - reverse mortgages | 2,023 |
| Income tax expense | (8,001) |
| **Net impact on retained earnings** | **19,283** |

***NZ IFRS 15 Revenue from contracts with customers***

The Group adopted NZ IFRS 15 on 1 July 2018. This standard provides a principles based approach for revenue recognition and introduces the concept of recognising revenue for performance obligations as they are satisfied.

The Group has adopted this standard retrospectively with the cumulative effect of initial application recognised as an adjustment to opening balances and has applied all practical expedients applicable. There have been no changes to previously reported financials.

## 1 Financial Statements preparation (continued)

**Accounting standards issued but not yet effective**

| Standard and description | Effective for annual years beginning on or after | Expected to be initially applied in year ending |
|---|---|---|
| **NZ IFRS 16 Leases:** contains guidance on identification, recognition, measurement, presentation and disclosure of leases by lessees and lessors. | 1 January 2019 | 30 June 2020 |
| **NZ IFRS 9 Financial instruments:** contains relaxed requirements for hedge effectiveness, and expanded disclosures. | 1 January 2019 | To be confirmed |
| **NZ IFRS 17 Insurance contracts:** establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts. | 1 January 2021 | 30 June 2022 |

***NZ IFRS 16 Leases***

NZ IFRS 16 *Leases* replaces NZ IAS 17 *Leases* and will be adopted by the Group from 1 July 2019. NZ IFRS 16 requires that a right of use asset and lease liability is recognised at lease commencement date. The value of the lease liability is the present value of all future payments arising from a lease contract. The right of use asset will be depreciated over the life of the lease. This could affect the timing on expenses of leased assets. This change will primarily affect leases relating to properties and car leases. Currently the Group accounts for these as operating leases.

The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. All practical expedients available to the Group around short term leases, and low value leases will be applied. Right-of-use assets will be measured on transition as if the new rules had always been applied, using the transition discount rate. The cumulative effect of adopting NZ IFRS 16 is estimated at $2 million and will be recognised as an adjustment to the opening balance of retained earnings at 1 July 2019, with no restatement of comparative information.

***NZ IFRS 9 Financial instruments***

NZ IFRS 9 introduces new hedge accounting requirements which more closely align accounting with risk management activities undertaken when hedging financial and non-financial risks. NZ IFRS 9 provides the Group with an accounting policy choice to continue to apply the NZ IAS 39 hedge accounting requirements until the International Accounting Standards Board's ongoing project on macro hedge accounting is completed. The Group's current expectation is that it will continue to apply the hedge accounting requirements of NZ IAS 39.

# 1 Financial Statements preparation (continued)

**Estimates and judgements**
The preparation of the Group's financial statements requires the use of estimates and judgement. This note provides an overview of the areas that involve a higher degree of judgement or complexity. Detailed information about each of these estimates and judgements is included in the relevant notes together with the basis of calculation for each affected item in the financial statements.

- Provisions for impairment - The effect of credit risk is quantified based on management's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings and historical loss data. Refer to Note 13 - Finance receivables for further details.

- Fair value of reverse mortgages – Fair value is quantified by the transaction price and management's subsequent best estimate of the risk profile of the reverse mortgage portfolio. Refer to Note 20 – Fair value for further details.

- Goodwill - Determining the fair value of assets and liabilities of acquired businesses requires the exercise of management judgement. The carrying value of goodwill is tested annually for impairment, refer to Note 17 - Other balance sheet items.

Assumptions made at each reporting date (e.g: the calculation of the provision for impairment and fair value adjustments) are based on best estimates as at that date. Although the Group has internal controls in place to ensure that estimates can be reliably measured, actual amounts may differ from these estimates. The estimates and judgements used in the preparation of the Group's financial statement are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity. Revisions to accounting estimates are recognised in the reporting period in which the estimates are revised and in any future periods affected.

**Financial assets and liabilities**

The Group initially recognises finance receivables and borrowings on the date that they are originated. All other financial assets and liabilities (including assets and liabilities designated at fair value through profit or loss) are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

The Group enters into transactions whereby it transfers assets recognised on its Statement of Financial Position, but retains either all risks or rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the Statement of Financial Position. Transfers of assets with the retention of all or substantially all risks and rewards include, for example, securitised assets and repurchase transactions.

**Offsetting financial instruments**
The Group offsets financial assets and financial liabilities and reports the net balance in the balance sheet where there is currently a legally enforceable right to set off and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

# PERFORMANCE

## 2 Segment reporting

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

*Operating segments*

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

| | |
|---|---|
| **Motor** | Providing motor vehicle finance. |
| **Reverse Mortgages** | Providing reverse mortgage lending within NZ. |
| **Other Personal** | Providing a comprehensive range of financial services – including term, transactional and savings based deposit accounts and personal loans. |
| **Business** | Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium 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. |
| **Australia** | Providing reverse mortgage lending and other financial services within Australia. |

Certain operating expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Other.

Internal structures have changed during the current year. Previously reported Household segment has been disaggregated to show Motor, Reverse Mortgages and Other Personal. Prior year numbers have been restated accordingly.

# 2 Segment reporting (continued)

| $000's | Motor | Reverse Mortgages | Other Personal | Business | Rural | Australia | Other | Total |
|---|---|---|---|---|---|---|---|---|
| **June 2019** | | | | | | | | |
| Net interest income | 54,753 | 20,673 | 16,345 | 54,334 | 30,865 | 21,148 | (535) | 197,583 |
| Net other income | 2,313 | 224 | 2,563 | 1,524 | 816 | 1,582 | (763) | 8,259 |
| **Net operating income** | **57,066** | **20,897** | **18,908** | **55,858** | **31,681** | **22,730** | **(1,298)** | **205,842** |
| Operating expenses | 2,543 | 2,279 | 5,602 | 9,163 | 3,263 | 5,115 | 57,624 | 85,589 |
| **Profit/(loss) before impaired asset expense and income tax** | **54,523** | **18,618** | **13,306** | **46,695** | **28,418** | **17,615** | **(58,922)** | **120,253** |
| Fair value movement on investment property | | | | 1,936 | | | | 1,936 |
| Impaired asset expense | 5,009 | 268 | 8,429 | 7,102 | (132) | - | - | 20,676 |
| **Profit/(loss) before income tax** | **49,514** | **18,350** | **4,877** | **41,529** | **28,550** | **17,615** | **(58,922)** | **101,513** |
| Income tax expense | - | - | - | - | - | 5,016 | 22,880 | 27,896 |
| **Profit/(loss) for the year** | **49,514** | **18,350** | **4,877** | **41,529** | **28,550** | **12,599** | **(81,802)** | **73,617** |
| **Total assets** | 1,074,446 | 561,211 | 215,253 | 1,096,253 | 643,278 | 758,268 | 577,695 | **4,926,404** |
| **Total liabilities** | - | - | - | - | - | 740,111 | 3,510,625 | **4,250,736** |

| $000's | Motor | Reverse Mortgages | Other Personal | Business | Rural | Australia | Other | Total |
|---|---|---|---|---|---|---|---|---|
| **June 2018 (restated)** | | | | | | | | |
| Net interest income | 50,328 | 18,189 | 12,421 | 51,189 | 32,122 | 20,215 | (663) | 183,801 |
| Net other income | 2,515 | 262 | 2,392 | 1,124 | 163 | 310 | 6,227 | 12,993 |
| **Net operating income** | **52,843** | **18,451** | **14,813** | **52,313** | **32,285** | **20,525** | **5,564** | **196,794** |
| Operating expenses | 2,914 | 1,670 | 6,552 | 8,130 | 4,351 | 4,142 | 52,674 | 80,433 |
| **Profit/(loss) before impaired asset expense and income tax** | **49,929** | **16,781** | **8,261** | **44,183** | **27,934** | **16,383** | **(47,110)** | **116,361** |
| Impaired asset expense | 7,779 | (362) | 5,741 | 6,275 | 2,400 | 234 | - | 22,067 |
| **Profit/(loss) before income tax** | **42,150** | **17,143** | **2,520** | **37,908** | **25,534** | **16,149** | **(47,110)** | **94,294** |
| Income tax expense | - | - | - | - | - | - | 26,781 | 26,781 |
| **Profit/(loss) for the year** | **42,150** | **17,143** | **2,520** | **37,908** | **25,534** | **16,149** | **(73,891)** | **67,513** |
| Total assets | 955,088 | 453,119 | 178,309 | 1,048,239 | 654,935 | 695,251 | 511,908 | **4,496,849** |
| **Total liabilities** | - | - | - | - | - | - | 3,832,689 | **3,832,689** |

## 3 Net interest income

*Policy*

Interest income and expense is recognised in profit or loss using the effective interest method. The effective interest rate is established on initial recognition of the financial assets and liabilities and is not revised subsequently. The calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the effective interest rate.

Interest on the effective portion of a derivative designated as a cash flow hedge is initially recognised in the hedging reserve. It is released to profit or loss at the same time as the hedged item or when the hedge relationship is subsequently deemed to be ineffective, should this occur.

| $000's | June 2019 | June 2018 |
|---|---|---|
| **Interest income** | | |
| Cash and cash equivalents | 717 | 842 |
| Investments | 10,864 | 9,515 |
| Finance receivables | 242,556 | 231,848 |
| Finance receivables - reverse mortgages | 80,193 | 67,079 |
| **Total interest income** | **334,330** | **309,284** |
| | | |
| **Interest expense** | | |
| Retail deposits | 97,119 | 90,880 |
| Other borrowings | 36,382 | 31,976 |
| Net interest expense on derivative financial instruments | 3,246 | 2,627 |
| **Total interest expense** | **136,747** | **125,483** |
| | | |
| **Net interest income** | **197,583** | **183,801** |

## 4 Net operating lease income

*Policy*

Leases' where the Group retains substantially all the risks and rewards of ownership of an asset are classified as operating leases. Rental income and expense from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term. Profits on the sale of operating lease assets are included as part of operating lease income. Current year depreciation and losses on the sale of operating lease assets are included as part of operating lease expenses. The leased assets are depreciated over their useful lives on a basis consistent with similar assets.

| $000's | June 2019 | June 2018 |
|---|---|---|
| **Operating lease income** | | |
| Lease income | 4,761 | 5,004 |
| Gain on disposal of lease assets | 501 | 671 |
| **Total operating lease income** | **5,262** | **5,675** |
| | | |
| **Operating lease expense** | | |
| Depreciation on lease assets | 3,363 | 3,771 |
| Direct lease costs | 64 | 234 |
| **Total operating lease expenses** | **3,427** | **4,005** |
| | | |
| **Net operating lease income** | **1,835** | **1,670** |

# 5 Other income

*Policy*

**Investment property**

Rental income from investment properties is recognised on a straight-line basis over the term of the relevant lease.

**Other income**

Other items of income are recognised at the fair value of the consideration received or receivable.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Rental income from investment properties | 662 | 739 |
| Insurance income | 2,436 | 2,238 |
| Gain on sale of investments | 173 | 156 |
| Other income[1] | 36 | 5,839 |
| **Total other income** | **3,307** | **8,972** |

[1] In June 2018 Other income includes

- A $0.6 million gain on the sale of the HBL's invoice finance business.
- A $4.8 million gain in relation to the sale of property pertaining to a loan previously written off for which the bank had entered into a profit share arrangement with third parties.

# 6 Operating expenses

*Policy*

Operating expenses are recognised as the underlying service is rendered or over a period in which an asset is consumed or once a liability is incurred.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Personnel expenses | 46,346 | 45,539 |
| Directors' fees | 1,099 | 972 |
| Superannuation | 1,081 | 921 |
| Audit and review of financial statements [1] | 614 | 433 |
| Other assurance services paid to auditor [2] | 52 | 36 |
| Other fees paid to auditor [3] | - | 171 |
| Depreciation - property, plant and equipment | 1,867 | 1,386 |
| Amortisation - intangible assets | 3,893 | 3,252 |
| Operating lease expense as a lessee | 1,807 | 2,033 |
| Legal and professional fees | 3,130 | 2,267 |
| Other operating expenses | 25,700 | 23,423 |
| **Total operating expenses** | **85,589** | **80,433** |

[1] Audit and review of financial statement includes fees paid for both audit of financial statement and review of interim financial statement.
[2] Other assurance services paid to the auditor comprise review of regulatory returns, trust deed reporting, registry audits and other agreed upon procedures engagements.
[3] Other fees paid to the auditor include professional fees in connection with regulatory advisory services and health and safety framework review.

# 7 Impaired asset expense

*Policy*

**Impairment of finance receivables**

At each reporting date, the Group applies a three stage approach to measuring expected credit losses (**ECL**) to Finance receivables not carried at fair value. The ECL model assesses whether there has been a significant increase in credit risk since initial recognition.

The ECL model is a forward looking model where impairment allowances are recognised before losses are actually incurred. On initial recognition, an impairment allowance is made, based on events that are possible in the next 12 months.

After initial recognition, the Group applies a three stage test to measuring ECL's. Assets may migrate through the following stages based on their change in credit quality.

Stage 1 - 12 months ECL (past due 30 days or less)

Where there has been no evidence of increased credit risk since initial recognition, and are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Stage 2 - Lifetime ECL not credit impaired (greater than 30 but less than 90 days past due)

Where there has been a significant increase in credit risk.

Stage 3 - Lifetime ECL credit impaired (90 days past due or more)

Objective evidence of impairment, so are considered to be in default or otherwise credit impaired.

In determining whether credit risk has increased all available information relevant to the assessment of economic conditions at the reporting date are taken into consideration. To do this the Group considers its historical loss experience and adjusts this for current observable data. In addition to this the Group uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. Future economic conditions consider macroeconomic factors such as unemployment, interest rate, gross domestic product, and inflation, and requires an evaluation of both the current and forecast direction of the economic cycle. The methodology and assumptions including any forecasts of future economic conditions are reviewed regularly as incorporating forward-looking information increases the level of judgement as to how changes in these macroeconomic factors will affect the ECL.

The calculation of expected credit loss is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

| $000's | June 2019 | June 2018 |
|---|---|---|
| **Non-securitised** | | |
| Individually impaired expense | 1,311 | 5,190 |
| Collectively impaired expense | 19,024 | 16,889 |
| **Total non-securitised impaired asset expense** | **20,335** | **22,079** |
| | | |
| **Securitised** | | |
| Collectively impaired expense | 341 | (12) |
| **Total securitised impaired asset expense** | 341 | (12) |
| | | |
| **Total** | | |
| Individually impaired expense | 1,311 | 5,190 |
| Collectively impaired expense | 19,365 | 16,877 |
| **Total impaired asset expense** | **20,676** | **22,067** |

# 8 Taxation

*Policy*

***Income tax***

Income tax expense for the year comprises current tax and movements in deferred tax balances. Income tax expense is recognised in Profit or loss except to the extent it relates to items recognised directly in other comprehensive income, in which case it is recognised in equity or other comprehensive income.

***Current tax***

Current tax is the expected tax receivable or payable on the taxable income for the year, using the tax rate enacted or substantively enacted at the reporting date, and any adjustment to the tax receivable or payable in respect of previous years. Current tax for current and prior years is recognised as a liability (or asset) to the extent that is unpaid (or refundable).

***Deferred tax***

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. As required by NZ IAS 12 *Income Taxes*, a deferred tax asset is recognised only to the extent that it is probable that a future taxable profit will be available.

***Goods and services tax (GST)***

Revenues, expenses and assets are recognised net of the amount of GST. As the Group is predominantly involved in providing financial services, only a proportion of GST paid on inputs is recoverable. The non-recoverable proportion of GST is treated as part of the cost of assets at the time of acquisition or is expensed.

***Income tax expense***

| $000's | June 2019 | June 2018 |
|---|---|---|
| *Income tax recognised in profit and loss* | | |
| *Current tax* | | |
| Current year | 25,181 | 24,861 |
| Adjustments for prior year | (1,989) | (332) |
| Tax other rates | 277 | - |
| *Deferred tax* | | |
| Current year | 3,306 | 1,898 |
| Tax other rates | 54 | - |
| Adjustments for prior year | 1,067 | 354 |
| **Total income tax expense recognised** | **27,896** | **26,781** |
| | | |
| *Income tax recognised in other comprehensive income* | | |
| *Current tax* | | |
| Derivatives at fair value reserve | (82) | (261) |
| | | |
| *Deferred tax* | | |
| Defined benefit plan | (34) | (132) |
| Fair value movements of cash flow hedges | (238) | (149) |
| **Total income tax expense recognised in other comprehensive income** | **(354)** | **(542)** |
| | | |
| *Reconciliation of effective tax rate* | | |
| Profit before income tax | 101,513 | 94,294 |
| Prima facie tax @ 28% | 28,424 | 26,402 |
| Higher tax rate for overseas jurisdiction | 331 | 299 |
| Plus tax effect of items not taxable/deductible | 63 | 58 |
| Adjustments for prior year | (922) | 22 |
| **Total income tax expense** | **27,896** | **26,781** |

# 8 Taxation (continued)

***Deferred tax assets comprise the following temporary differences:***

| **$000's** | **June 2019** | **June 2018** |
|---|---|---|
| Employee expenses | 1,286 | 1,240 |
| Provision for impairment | 14,574 | 8,427 |
| Investment properties | 4 | 546 |
| Intangibles and property, plant and equipment | (4,182) | (2,100) |
| Deferred acquisition costs | (1,321) | (1,476) |
| Operating lease vehicles | (800) | (850) |
| Other temporary differences | (30) | (468) |
| **Total deferred tax assets** | **9,531** | **5,319** |

| | | |
|---|---|---|
| **Opening balance of deferred tax assets** | **5,319** | **7,852** |
| Movement recognised in profit or loss | (4,537) | (2,252) |
| Movement recognised in other comprehensive income | (272) | (281) |
| Foreign exchange and other | 777 | - |
| Movement recognised in retained earnings | 8,244 | - |
| **Closing balance of deferred tax assets** | **9,531** | **5,319** |

***Imputation credit account***

| **$000's** | **June 19** | **June 18** |
|---|---|---|
| Imputation credit account | 9,116 | 6,717 |

# 9 Earnings per share

| | **June 2019** | | | **June 2018** | | |
|---|---|---|---|---|---|---|
| | **Earnings per share cents** | **Net profit after tax $000's** | **Weighted average no. of shares 000's** | **Earnings per share cents** | **Net profit after tax $000's** | **Weighted average no. of shares 000's** |
| Basic earnings | 13 | 73,617 | 563,364 | 13 | 67,513 | 538,594 |
| Diluted earnings | 13 | 73,617 | 563,364 | 13 | 67,513 | 538,594 |

# FINANCIAL POSITION

## 10 Investments

*Policy*
The Group holds investments in bank deposits, bank bonds and floating rate notes, local authority stock, public securities, corporate bonds and equity investments. The fair values are derived by reference to published price quotations in an active market or modelled using observable market rates. Investments are classified as being fair value through other comprehensive income.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Bank deposits, bank bonds and floating rate notes | 246,724 | 230,754 |
| Public sector securities and corporate bonds | 82,370 | 57,818 |
| Local authority stock | 13,399 | 42,280 |
| Equity investments | 12,435 | 9,694 |
| **Total investments** | **354,928** | **340,546** |

## 11 Investment properties

*Policy*
Investment properties are initially recorded at fair value, with subsequent changes in fair value recognised in Profit or loss. Fair values are determined by qualified independent valuers or other similar external evidence, adjusted for changes in market conditions and the time since last valuation.

Investment properties have been acquired through the enforcement of security over finance receivables and are held to earn rental income or for capital appreciation (or both).

| $000's | June 2019 | June 2018 |
|---|---|---|
| Opening balance | 9,196 | 4,909 |
| Acquisition | - | 7,472 |
| Fair value movement | 1,936 | - |
| Disposals | - | (3,185) |
| **Closing balance** | **11,132** | **9,196** |

A $1.9 million increase in the fair value of non-core legacy property assets has been recognised, reflecting Management's view on the current market value of this portfolio.

# 12 Derivative financial instruments

*Policy*
Derivative financial instruments are contracts whose value is derived from changes in one or more underlying financial instruments or indices. They include forward contracts, swaps, options and combinations of these instruments.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently measured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. Fair values include adjustment for counterparty credit risk. The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. A hedge instrument is a designated derivative, the changes in fair values or cash flows of which are expected to offset changes in the fair value of cash flows of a designated hedged item.

A hedged item is an asset, liability, firm commitment or highly probable forecast transaction that exposes the Group to risk of changes in fair value or cash flows, and that is designated as being hedged. The Group applies fair value hedge accounting to hedge movements in the value of fixed interest rate assets and liabilities subject to interest rate risk. The Group applies cash flow hedge accounting to hedge the variability in highly probable forecast future cash flows attributable to interest rate risk on variable rate assets and liabilities.

**Fair value hedge accounting**
The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments must involve a party external to the Group.

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective on offsetting changes in fair value of hedged items.

Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify for fair value hedge accounting are recorded in the Consolidated Statement of Comprehensive Income together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to carrying amount of a hedged item is amortised to the Consolidated Statement of Comprehensive Income on an effective yield basis over the remaining period to maturity of the hedged item. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the Consolidated Statement of Comprehensive Income.

**Cash flow hedge accounting**
The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments must involve a party external to the Group.

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective on offsetting changes in cash flows of hedged items.

A fair value gain or loss associated with the effective portion of a derivative designated as a cash flow hedge is recognised initially in the hedging reserve. The ineffective portion of a fair value gain or loss is recognised immediately in the Consolidated Statement of Comprehensive Income.

## 12 Derivative financial instruments (continued)

When a hedging derivative expires or is sold, the hedge no longer meets the criteria for hedge accounting, or the Group elects to revoke the hedge designation, the cumulative gain or loss on the hedging derivative remains in the cash flow hedging reserve until the forecast transaction occurs and affects income, at which point it is transferred to the corresponding income or expense line. If a forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging derivative previously reported in the cash flow hedging reserve is immediately transferred to the Consolidated Statement of Comprehensive Income.

| | June 2019 | | | June 2018 | | |
|---|---|---|---|---|---|---|
| **$000's** | **Notional principal** | **Fair value assets** | **Fair value liabilities** | **Notional principal** | **Fair value assets** | **Fair value liabilities** |
| **Held for risk management** | | | | | | |
| *Interest rate related contracts* | | | | | | |
| Swaps | 1,958,083 | 11,232 | 10,230 | 744,822 | 923 | 2,562 |
| *Foreign currency related contracts* | | | | | | |
| Forwards | 222,769 | 315 | 142 | - | - | - |
| Options | 177,255 | 1,128 | - | - | - | - |
| **Total derivative financial instruments** | 2,358,107 | 12,675 | 10,372 | 744,822 | 923 | 2,562 |

## 13 Finance receivables

### (a) Finance receivables held at amortised cost

*Policy*

Finance receivables are initially recognised at fair value plus incremental direct transaction costs and are subsequently measured at amortised cost using the effective interest method, less any impairment loss. .

Fees and direct costs relating to loan origination, financing and loan commitments are deferred and amortised to interest income over the life of the loan using the effective interest method. Lending fees not directly related to the origination of a loan are recognised over the period of service.

Past due but not impaired assets are any assets which have not been operated by the counterparty within their key terms but are not considered to be impaired by the Group.

Individually impaired assets are those loans for which the Group has evidence that it will incur a loss, and will be unable to collect all principal and interest due according to the contractual terms of the loan.

In determining whether credit risk has increased all available information relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date are taken into consideration.

The calculation of expected credit loss is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

# 13 Finance receivables (continued)

| $000's | June 2019 | June 2018 |
|---|---|---|
| *Non-securitised* | | |
| Neither at least 90 days past due nor impaired - at amortised cost | 3,016,844 | 3,863,764 |
| At least 90 days past due- at amortised cost | 44,466 | 27,893 |
| Individually impaired - at amortised cost | 26,412 | 45,186 |
| ***Gross finance receivables*** | **3,087,722** | **3,936,843** |
| Less provision for impairment | (58,491) | (29,367) |
| Less fair value adjustment for present value of future losses over expected life | - | (2,824) |
| **Total non-securitised finance receivables** | **3,029,231** | **3,904,652** |
| *Securitised* | | |
| Neither at least 90 days past due nor impaired - at amortised cost | - | 79,809 |
| At least 90 days past due- at amortised cost | - | 784 |
| Individually impaired - at amortised cost | - | - |
| ***Gross finance receivables*** | **-** | **80,593** |
| Less provision for impairment | - | (304) |
| **Total securitised finance receivables** | **-** | **80,289** |
| *Total* | | |
| Neither at least 90 days past due nor impaired - at amortised cost | 3,016,844 | 3,943,573 |
| At least 90 days past due - at amortised cost | 44,466 | 28,677 |
| Individually impaired - at amortised cost | 26,412 | 45,186 |
| ***Gross finance receivables*** | **3,087,722** | **4,017,436** |
| Less provision for impairment | (58,491) | (29,671) |
| Less fair value adjustment for present value of future losses over expected life | - | (2,824) |
| **Total finance receivables** | **3,029,231** | **3,984,941** |

# 13 Finance receivables (continued)

| $000's | 12 month ECL | Lifetime ECL Not credit impaired | Lifetime ECL Credit impaired | Collective provision June 2018 | Specific provision | Total |
|---|---|---|---|---|---|---|
| *Non-securitised* | | | | | | |
| Impairment allowance as at 30 June 2018 | - | - | - | 20,301 | 9,066 | 29,367 |
| Restated for adoption of NZ IFRS 9 | 31,784 | 1,365 | 14,945 | (20,301) | (169) | 27,624 |
| ***Restated impairment allowance as at 1 July 2018*** | 31,784 | 1,365 | 14,945 | - | 8,897 | 56,991 |
| Changes in loss allowance | | | | | | |
| Transfer to 12 month | 1,144 | (1,071) | (73) | - | - | - |
| Transfer to lifetime not credit impaired | (2,134) | 2,268 | (134) | - | - | - |
| Transfer to lifetime credit impaired | (29) | (1,399) | 1,428 | - | - | - |
| Transfer to specific provision | (1,443) | (36) | (1,169) | - | 2,648 | - |
| Effect of changes in foreign exchange rate | (52) | (3) | (1) | - | - | (56) |
| Impaired asset expense | 911 | 607 | 17,505 | - | 1,311 | 20,334 |
| Write offs | - | - | (15,720) | - | (4,993) | (20,713) |
| Transfer to/from securitised | 240 | 49 | 817 | - | - | 1,106 |
| Recovery of amounts written off | - | - | 829 | - | - | 829 |
| ***Closing impairment allowance*** | **30,421** | **1,780** | **18,427** | **-** | **7,863** | **58,491** |
| *Securitised* | | | | | | |
| Impairment allowance as at 30 June 2018 | - | - | - | 304 | - | 304 |
| Restated for adoption of NZ IFRS 9 | 400 | 20 | 345 | (304) | - | 461 |
| ***Restated impairment allowance as at 1 July 2018*** | 400 | 20 | 345 | - | - | 765 |
| Changes in loss allowance | | | | | | |
| Transfer to 12 month | 35 | (34) | (1) | - | - | - |
| Transfer to lifetime not credit impaired | (42) | 44 | (2) | - | - | - |
| Transfer to lifetime credit impaired | (1) | (17) | 18 | - | - | - |
| Transfer to specific provision | - | - | - | - | - | - |
| Effect of changes in foreign exchange rate | - | - | - | - | - | - |
| Impaired asset expense | (152) | 36 | 457 | - | - | 341 |
| Write offs | - | - | - | - | - | - |
| Transfer to/from non-securitised | (240) | (49) | (817) | - | - | (1,106) |
| Recovery of amounts written off | - | - | - | - | - | - |
| ***Closing impairment allowance*** | **-** | **-** | **-** | **-** | **-** | **-** |
| *Total* | | | | | | |
| Impairment allowance as at 30 June 2018 | - | - | - | 20,605 | 9,066 | 29,671 |
| Restated for adoption of NZ IFRS 9 | 32,184 | 1,385 | 15,290 | (20,605) | (169) | 28,085 |
| ***Restated impairment allowance as at 1 July 2018*** | 32,184 | 1,385 | 15,290 | - | 8,897 | 57,756 |
| Changes in loss allowance | | | | | | |
| Transfer to 12 month | 1,179 | (1,105) | (74) | - | - | - |
| Transfer to lifetime not credit impaired | (2,176) | 2,312 | (136) | - | - | - |
| Transfer to lifetime credit impaired | (30) | (1,416) | 1,446 | - | - | - |
| Transfer to specific provision | (1,443) | (36) | (1,169) | - | 2,648 | - |
| Effect of changes in foreign exchange rate | (52) | (3) | (1) | - | - | (56) |
| Impaired asset expense | 759 | 643 | 17,962 | - | 1,311 | 20,675 |
| Write offs | - | - | (15,720) | - | (4,993) | (20,713) |
| Transfers | - | - | - | - | - | - |
| Recovery of amounts written off | - | - | 829 | - | - | 829 |
| ***Closing impairment allowance*** | **30,421** | **1,780** | **18,427** | **-** | **7,863** | **58,491** |

# 13 Finance receivables (continued)

***Summary of impairment allowance***

| $000's | Non-securitised June 2019 | Total June 2019 |
|---|---|---|
| Collective allowance measured on a 12 month ECL | 30,421 | 30,421 |
| Collective allowance not credit impaired | 1,780 | 1,780 |
| Collective allowance credit impaired | 18,427 | 18,427 |
| Specific allowance | 7,863 | 7,863 |
| **Total impairment allowance** | **58,491** | **58,491** |

***Impact of changes in gross carrying amounts of ECL***

The following provides an explanation of how significant change in the gross carrying value of the finance receivables have contributed to the changes in the provision for impairment. The provision for impairment reflects ECL measured using the 3 stage approach under NZ IFRS 9 (refer Note 1 Financial statement preparation).

Overall the net increase in the total provision for impairment was $0.7 million which was primarily driven by an increase in stage 2 and 3 collective provisions offset by a reduction in stage 1 provisions and specific provisions.

Collective 12 month ECL provisions (stage 1) decreased $1.8m. Net growth in receivables of $339 million added $3.0m to stage 1 provisions. This was offset by a reduction in provisions of $2.1m as a result of changes to expected loss rates in the Motor book following changes to and investment in collection processes. Stage 1 provisions were further reduced on $289m loans moving from stage 2 to stage 3 or specifically provided, offset by $134m of loans moving from stage 2 and 3 or specifically provided.

Collective lifetime not credit impaired provisions (stage 2) increased $0.4m. $282 million of receivables transferred to stage 2 due to deterioration in credit quality and $8m transferred from stage 3 due to improvement in asset quality. These were offset by $209m which was repaid or transferred to stage 1 due to improvement in credit quality and $90m transferred to stage 3 or specifically provided due to deterioration in credit quality.

Collective lifetime credit impaired provisions (stage 3) increased $3.1m driven primarily by a net increase in receivables of $17 million. This was due to a net increase transferred to stage 3 of $57m offset by $40m of loans that were repaid or written off in the period.

The reduction in specific provisions of $1.0 million was primarily the result of provisions on $24m of loans transferred from collectively provided off set by the release of provisions on $14m of loans that were repaid or written off in the period.

## (b) Finance receivables held at fair value

*Policy*

Finance receivables – reverse mortgages are initially recognised, and subsequently measured, at fair value through profit or loss

Advances relating to reverse equity mortgages are recognised in the financial statements at fair value through profit or loss, therefore carrying amount equals fair value. Note 20 (a) Fair Value of the financial statements discloses further information regarding the Group's valuation policy

Note 22 Credit Risk Exposure of the financial statements discloses further information regarding how reverse mortgages operate

## 13 Finance receivables (continued)

| $000's | June 2019 | June 2018 |
|---|---|---|
| Finance receivables - reverse mortgages | 1,318,819 | - |
| **Total Finance receivables - reverse mortgages at fair value** | **1,318,819** | **-** |

***Credit risk adjustments on financial assets designated at fair value through Profit or loss***

There were no credit risk adjustments on individual financial assets.

Credit risk adjustments on financial assets designated at fair value through Profit or loss are presented in the following table.

| $000's | Non-securitised June 2019 | Total June 2019 |
|---|---|---|
| Opening balance as at 30 June 2018 | 2,824 | 2,824 |
| Restated for adoption of NZ IFRS 9 | (2,824) | (2,824) |
| Restated opening balance as at 1 July 2018 | - | - |
| **Closing balance as at 30 June 2019** | **-** | **-** |

## 14 Operating lease vehicles

*Policy*

Operating lease vehicles are stated at cost less accumulated depreciation.

Operating lease vehicles are depreciated on a straight line basis over their expected life after allowing for any residual values. The estimated lives of these vehicles vary up to five years. Vehicles held for sale are not depreciated but are tested for impairment.

| $000's | June 2019 | June 2018 |
|---|---|---|
| *Cost* | | |
| Opening balance | 24,703 | 28,137 |
| Acquisitions | 5,495 | 7,163 |
| Disposals | (8,575) | (10,597) |
| **Closing balance** | **21,623** | **24,703** |
| *Accumulated depreciation* | | |
| Opening balance | 7,179 | 9,099 |
| Depreciation charge | 3,363 | 3,771 |
| Disposals | (4,435) | (5,691) |
| **Closing balance** | **6,107** | **7,179** |
| Opening NBV | 17,524 | 19,038 |
| **Closing NBV** | **15,516** | **17,524** |

The future minimum lease payments receivable under non-cancellable operating leases not later than one year is $3.952 million (2018: $4.380 million), within one to five years is $3.137 million (2018: $3.897 million) and over five years is nil (2018: nil).

## 15 Borrowings

*Policy*
Borrowings and deposits are initially recognised at fair value including incremental direct transaction costs. They are subsequently measured at amortised cost using the effective interest method.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Deposits | 3,153,681 | 2,881,805 |
| **Total borrowings relating to deposits** | **3,153,681** | **2,881,805** |
| | | |
| Subordinated bonds | - | 3,378 |
| Subordinated notes | - | 22,172 |
| Unsubordinated notes | 337,680 | 151,853 |
| Bank borrowings | 25,002 | 35,004 |
| Certificate of deposit | 34,836 | 39,832 |
| Securitised borrowing | 659,135 | 662,014 |
| **Total borrowings other** | **1,056,653** | **914,253** |

Deposits and unsubordinated notes rank equally and are unsecured.

The subordinated notes (settled early on 31 October 2018) and subordinated bonds ranked below all other general liabilities of the Group.

The Group from time to time issues unsubordinated notes. At 30 June 2019 the Group had the following unsubordinated notes outstanding:

- Issuer HBL

  - $125 million five year unsubordinated notes issued 12 April 2019, interest payable six monthly, maturing 12 April 2024.
  - $150 million five year unsubordinated notes issued 21 September 2017, interest payable six monthly, maturing 21 September 2022.

- Issuer Heartland Australia Group Pty Limited

  - AU $50 million two year unsubordinated notes issued 8 March 2019, interest payable quarterly, maturing 8 March 2021.

The Group from time to time securitises loans. At 30 June 2019 the Group had the following securitised borrowings outstanding:

- Heartland Auto Receivables Warehouse Trust 2018 - 1 securitisation facility $150 million, undrawn. Securitised borrowings held by investors are secured over the securitised assets of the Heartland Auto Receivables Warehouse Trust 2018-1.
- Heartland ABCP Trust 1 (**ABCP Trust**) securitisation facility nil (2018: $100 million, drawn $47 million). Heartland ABCP Trust 1 was dissolved 29 August 2018.
- Senior Warehouse Trust securitisation facility AU $650 million (2018: AU $600 million). Drawn AU $631 million (2018: AU $562 million). The bank facility is secured over the assets of Australian Seniors Finance Pty Limited (**ASF**) group (comprising ASF, the ASF Settlement Trust and the Seniors Warehouse Trust). The bank facility has a maturity date of 30 September 2022.

HGH has a $50 million undrawn bank facility at 30 June 2019 (2018: nil).

## 16 Share capital and dividends

*Policy*
Ordinary shares are classified as equity, incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effect.

| 000's | Number of shares June 2019 | Number of shares June 2018 |
|---|---|---|
| ***Issued shares*** | | |
| Opening balance | 560,588 | 516,236 |
| Shares issued during the year | - | 37,224 |
| Dividend reinvestment plan | 9,191 | 7,128 |
| Cancelled shares | (441) | - |
| **Closing balance** | **569,338** | **560,588** |
| Less treasury shares | - | (2,299) |
| **Net closing balance** | **569,338** | **558,289** |

The table above shows shares in HBL up until 31 October 2018 when HGH acquired HBL, and shares in HGH from that date. At 31 October 2018 HBL had issued 565,430 shares, all of which were exchanged for shares in HGH on a one for one basis.

Under dividend reinvestment plans, 5,282,619 new shares were issued at $1.6250 per share on 21 September 2018 and 3,907,858 at $1.4709 per share on 1 April 2019, (June 2018: 4,163,008 new shares at $1.8004 per share on 21 September 2017 and 2,965,048 new shares at $1.7707 per share on 3 April 2018).

***Dividends paid***

| | June 2019 | | | June 2018 | | |
|---|---|---|---|---|---|---|
| | Date declared | Cents per share | $000's | Date declared | Cents per share | $000's |
| Final dividend | 15 August 2018 | 5.5 | 30,808 | 14 August 2017 | 5.5 | 28,393 |
| Interim dividend | 19 February 2019 | 3.5 | 19,791 | 20 February 2018 | 3.5 | 19,502 |
| **Total dividends paid** | | | **50,599** | | | **47,895** |

## 17 Other balance sheet items

*Policy*
Property, plant and equipment are stated at cost less accumulated depreciation and impairment (if any). Depreciation is calculated on a straight line basis to write off the net cost or other revalued amount of each asset over its expected life to its estimated residual value.

| $000's | June 2019 | June 2018 |
|---|---|---|
| ***Other Assets*** | | |
| Trade receivables | 3,277 | 1,613 |
| GST receivable | 3,837 | 1,553 |
| Prepayments | 4,734 | 2,261 |
| Property, plant and equipment | 9,461 | 8,984 |
| **Total other assets** | **21,309** | **14,411** |

*Policy*
***Intangible assets***
*Intangible assets with finite useful lives*
Software acquired or internally developed by the Group is stated at cost less accumulated amortisation and any accumulated impairments losses. Subsequent expenditure on software assets is capitalised only when it increases the future economic value of that asset. Amortisation of software is on a straight line basis, at rates which will write off the cost over the assets' estimated useful lives. The expected useful life of the software has been determined to be ten years. All other expenditure is expensed immediately as incurred.
*Goodwill*
Goodwill arising on acquisition represents the excess of cost of the acquisition over the Group's interest in the fair value of the identifiable net assets of a controlled entity. Goodwill that has an indefinite useful life is not subject to amortisation and is tested for impairment annually. Goodwill is carried at cost less accumulated impairment losses.

## 17 Other balance sheet items (continued)

| $000's | June 2019 | June 2018 |
|---|---|---|
| *Computer software* | | |
| Cost | 37,965 | 36,215 |
| Accumulated depreciation | 10,429 | 6,957 |
| **Net carrying value of computer software** | **27,536** | **29,258** |
| | | |
| Goodwill | 45,143 | 45,143 |
| **Total intangible assets** | **72,679** | **74,401** |

Goodwill was tested for impairment on 31 May 2019. In assessing impairment, an internal valuation model was developed to indicate the value of the business. This value is compared to the net assets of the Group. There was no indication of impairment and no impairment losses have been recognised against the carrying amount of goodwill for the year ended 30 June 2019 (30 June 2018: nil).

For the purposes of impairment testing, goodwill is allocated to cash generation units (CGU's). A CGU is the smallest identifiable group of assets that generate independent cash inflows. The Group has assessed that goodwill should be allocated to HBL and ASF as the smallest identifiable CGU.

*Policy*

***Employee benefits***

Annual leave entitlements are accrued at amounts expected to be paid. Long service leave is accrued by calculating the probable future value of the entitlements and discounting back to present value. Obligations to defined contribution superannuation schemes are recognised as an expense when the contribution is paid.

| $000's | June 2019 | June 2018 |
|---|---|---|
| *Trade and other payables* | | |
| Trade payables | 11,787 | 10,406 |
| Insurance liability | 5,699 | 6,333 |
| Employee benefits | 5,012 | 5,871 |
| **Total trade and other payables** | **22,498** | **22,610** |

## 18 Other Reserves

| $000's | Employee benefits reserve | Foreign currency translation reserve (FCTR) | Fair value reserve | Defined benefit reserve | Cash flow hedge reserve | Total |
|---|---|---|---|---|---|---|
| **June 2019** | | | | | | |
| Balance as at 1 July 2018 | 2,559 | 1,260 | 1,590 | 257 | (1,081) | 4,585 |
| Other comprehensive income net of tax | | (5,281) | 2,968 | (86) | (4,762) | (7,161) |
| Share based payments | 619 | | | | | 619 |
| Shares vested | (2,340) | | | | | (2,340) |
| **Balance as at 30 June 2019** | **838** | **(4,021)** | **4,558** | **171** | **(5,843)** | **(4,297)** |
| **June 2018** | | | | | | |
| Balance as at 1 July 2017 | 3,119 | (1,055) | 609 | (83) | (1,153) | 1,437 |
| Other comprehensive income net of tax | - | 2,315 | 981 | 340 | 72 | 3,708 |
| Share based payments | 666 | - | - | - | - | 666 |
| Shares vested | (1,226) | - | - | - | - | (1,226) |
| **Balance as at 30 June 2018** | **2,559** | **1,260** | **1,590** | **257** | **(1,081)** | **4,585** |

## 19 Related party transactions and balances

***Transactions with key management personnel***

Key management personnel (**KMP**), being directors of the Group, the Chief Executive Officer (**CEO**) and those executive staff reporting directly to the CEO. Transactions with immediate family members of KMP are also disclosed below.

Loans made to KMP are made in the ordinary course of business on normal commercial terms and conditions no more favourable than those given to other employees or customers, including the term of the loan, security required and the interest rate.

All other transactions with KMP and transactions with related entities of KMP are made on terms equivalent to those that prevail in arm's length transactions.

| $000's | June 2019 | June 2018 |
|---|---|---|
| ***Transactions with key personnel*** | | |
| Interest income | - | 5 |
| Interest expense | (76) | (128) |
| ***Key personnel compensation*** | | |
| Short-term employee benefits | (4,633) | (6,194) |
| Share-based payment expense | (703) | (640) |
| **Total transactions with key personnel** | **(5,412)** | **(6,957)** |
| ***Due(to)/from key personnel*** | | |
| Borrowings - deposits | (3,019) | (2,412) |
| **Total due(to)/from key personnel** | **(3,019)** | **(2,412)** |

# 20 Fair value

*Policy*
Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

On initial recognition, the transaction price generally represents the fair value of the financial instrument, unless there is observable information from an active market that provides a more appropriate 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 Group determines fair value using other valuation techniques.

The Group measures fair values using the 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 Group recognises transfers between levels of the fair value hierarchy as at the end of the reporting period during which the change has occurred.

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

The following assets and liabilities of the Bank are measured at fair value on a recurring basis in the Consolidated Statement of Financial Position.

**Investments**
Investments in public sector securities and corporate bonds are classified as being fair value through other comprehensive income with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using unobservable 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 flow analysis.

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

**Finance receivables – reverse mortgages**
Reverse mortgage loans are classified at fair value through profit or loss.

On initial recognition the Group considers the transaction price to represent the fair value of the loan.

For subsequent measurement the Group has considered if the fair value can be determined by reference to a relevant active market or observable inputs, but has concluded relevant support is not currently available. In the absence of such market evidence the Group has used valuation techniques including actuarial assessments to consider the fair value.

When the Group enters into a reverse mortgage loan the Group has set expectations regarding the loan's current and future risk profile and expectation of performance. This expectation references a wide range of assumptions including:

- mortality and move to care;
- voluntary exits;
- house price changes;
- no negative equity guarantee; and
- interest rate margin.

## 20 Fair Value (continued)

At balance date the Group does not consider any of the above expectations to have moved outside of the original expectation range. Therefore the Group has continued to estimate the fair value of the portfolio at transaction price. There has been no fair value movement recognised in profit or loss during the period. Given the nature of the loan terms and the current market conditions the fair value as recorded is not sensitive to changes in house prices or interest rates.

The Group will continue to reassess the existence of a relevant active market and movements in expectations on an on-going basis.

There have been no losses on reverse mortgage loans during the current year (2018: Nil).

**Derivative financial instruments**
Interest rate and foreign currency related contracts are recognised in the financial statements at fair value. Fair values are determined from observable market prices as at the reporting date, discounted cash flow models or option pricing models as appropriate. (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 Statement of Financial Position.

| $000's | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| *June 2019* | | | | |
| Investments | 255,875 | 86,618 | 12,435 | 354,928 |
| Derivative financial instruments | - | 12,675 | - | 12,675 |
| Finance receivables - reverse mortgage | - | - | 1,318,819 | 1,318,819 |
| **Total assets measured at fair value** | **255,875** | **99,293** | **1,331,254** | **1,686,422** |
| Derivative financial instruments | - | 10,372 | - | 10,372 |
| **Total liabilities measured at fair value** | **-** | **10,372** | **-** | **10,372** |
| *June 2018* | | | | |
| Investments | 140,282 | 190,570 | 9,694 | 340,546 |
| Derivative financial instruments | - | 923 | - | 923 |
| Finance receivables - reverse mortgage | - | 454 | - | 454 |
| **Total assets measured at fair value** | **140,282** | **191,947** | **9,694** | **341,923** |
| Derivative liabilities held for risk management | - | 2,562 | - | 2,562 |
| **Total liabilities measured at fair value** | **-** | **2,562** | **-** | **2,562** |

The movement in Level 3 assets measured at fair value are below:

| $000's | Finance receivables - reverse mortgages | Investments | Total |
|---|---|---|---|
| *June 2019* | | | |
| As at 1 July 2018 | 1,129,956 | 9,694 | 1,139,650 |
| Adjustment for NZ IFRS 9 | 2,882 | - | 2,882 |
| New loans | 284,819 | - | 284,819 |
| Repayments | (104,644) | - | (104,644) |
| Capitalised Interest | 29,417 | - | 29,417 |
| Purchase of investments | - | 2,741 | 2,741 |
| Other | (23,611) | - | (23,611) |
| **As at 30 June 2019** | **1,318,819** | **12,435** | **1,331,254** |

## 20 Fair Value (continued)

***(b) Financial instruments measured not at fair value***

The following assets and liabilities of the Group are not measured at fair value in the Consolidated Statement of Financial Position.

**Cash and cash equivalents and other financial assets and liabilities**
Cash and cash equivalents and other financial assets and liabilities are considered equivalent to their carrying value due to their short term nature.

**Finance receivables**
The fair value of the Group's financial receivables is calculated using a valuation technique which assumes the Group's current weighted average lending rates for loans of a similar nature and term.

The current weighted average lending rate used to fair value finance receivables with a fixed interest rate was 8.88% (2018: 8.12%). Finance receivables with a floating interest rate are deemed to be at current market rates. The current amount of credit provisioning has been deducted from the fair value calculation of finance receivables as a proxy for future losses.

**Borrowings**

The fair value of deposits, bank borrowings and other borrowings is the present value of future cash flows and is based on the current market interest rates payable by the Group for the debt of similar maturities. The current market rate used to fair value borrowings is 2.59% (2018: 3.09%).

**Other financial assets and financial liabilities**
Financial instruments such as short-term trade receivables and payables are considered equivalent to their carrying value due to their short term nature.

The following table sets financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy.

| $000's | Level 1 | Level 2 | Level 3 | Total Fair Value | Total Carrying Value |
|---|---|---|---|---|---|
| ***June 2019*** | | | | | |
| Cash and cash equivalents | 80,584 | - | - | 80,584 | 80,584 |
| Finance receivables | - | 3,017,327 | - | 3,017,327 | 3,029,231 |
| Other financial assets | - | - | 3,277 | 3,277 | 3,277 |
| **Total financial assets** | **80,584** | **3,017,327** | **3,277** | **3,101,188** | **3,113,092** |
| Retail deposits | - | 3,160,426 | - | 3,160,426 | 3,153,681 |
| Other borrowings | - | 1,056,653 | - | 1,056,653 | 1,056,653 |
| Other financial liabilities | - | - | 22,498 | 22,498 | 22,498 |
| **Total financial liabilities** | **-** | **4,217,079** | **22,498** | **4,239,577** | **4,232,832** |
| ***June 2018*** | | | | | |
| Cash and cash equivalents | 49,588 | - | - | 49,588 | 49,588 |
| Finance receivables | - | 3,972,072 | - | 3,972,072 | 3,984,487 |
| Other financial assets | - | - | 1,613 | 1,613 | 1,613 |
| **Total financial assets** | **49,588** | **3,972,072** | **1,613** | **4,023,273** | **4,035,688** |
| Retail deposits | - | 2,877,885 | - | 2,877,885 | 2,881,805 |
| Other borrowings | - | 914,253 | - | 914,253 | 914,253 |
| Other financial liabilities | - | - | 22,610 | 22,610 | 22,610 |
| **Total financial liabilities** | **-** | **3,792,138** | **22,610** | **3,814,748** | **3,818,668** |

## 20 Fair Value (continued)

### *(c) Classification of financial instruments*

The following table summarise the categories of financial instruments and the carrying and fair value of all financial instruments of the Group.

| $000's | FVOCI | FVTPL | Amortised cost | Total carrying Value | Total fair value |
|---|---|---|---|---|---|
| *June 2019* | | | | | |
| Cash and cash equivalents | - | - | 80,584 | 80,584 | 80,584 |
| Investments | 354,928 | - | - | 354,928 | 354,928 |
| Finance receivables | - | - | 3,029,231 | 3,029,231 | 3,017,327 |
| Finance receivables - reverse mortgages | - | 1,318,819 | - | 1,318,819 | 1,318,819 |
| Derivative financial instruments | 2,758 | 9,917 | - | 12,675 | 12,675 |
| Other financial assets | - | - | 3,277 | 3,277 | 3,277 |
| **Total financial assets** | **357,686** | **1,328,736** | **3,113,092** | **4,799,514** | **4,787,610** |
| | | | | | |
| Retail deposits | - | - | 3,153,681 | 3,153,681 | 3,160,426 |
| Other borrowings | - | - | 1,056,653 | 1,056,653 | 1,056,653 |
| Derivative financial instruments | 9,159 | 1,213 | - | 10,372 | 10,372 |
| Other financial liabilities | - | - | 22,498 | 22,498 | 22,498 |
| **Total financial liabilities** | **9,159** | **1,213** | **4,232,832** | **4,243,204** | **4,249,949** |
| | | | | | |
| *June 2018* | | | | | |
| Cash and cash equivalents | - | - | 49,588 | 49,588 | 49,588 |
| Investments | 330,852 | 9,694 | - | 340,546 | 340,546 |
| Finance receivables | - | - | 3,984,487 | 3,984,487 | 3,972,072 |
| Finance receivables - reverse mortgages | - | - | 454 | 454 | 454 |
| Derivative financial instruments | 923 | - | - | 923 | 923 |
| Other financial assets | - | - | 1,613 | 1,613 | 1,613 |
| **Total financial assets** | **331,775** | **9,694** | **4,036,142** | **4,377,611** | **4,365,196** |
| | | | | | |
| Retail deposits | - | - | 2,881,805 | 2,881,805 | 2,877,885 |
| Other borrowings | - | - | 914,253 | 914,253 | 914,253 |
| Derivative financial instruments | 2,562 | - | - | 2,562 | 2,562 |
| Other financial liabilities | - | - | 22,610 | 22,610 | 22,610 |
| **Total financial liabilities** | **2,562** | **-** | **3,818,668** | **3,821,230** | **3,817,310** |

# RISK MANAGEMENT

## 21 Enterprise risk management program

The board of directors (the Board) sets and monitors the Group's risk appetite across the primary risk domains of, credit, capital, liquidity, market (including interest rate), operational and compliance and general business risk. Management are, in turn, responsible for ensuring appropriate structures, policies, procedures and information systems are in place to actively manage these risk domains, as outlined within the Enterprise Risk Management Framework (**ERMF**). Collectively, these processes are known as the Group's Enterprise Risk Management Programme (**RMP**).

*Role of the Board and the Board Risk Committee*

The Board, through its Board Risk Committee (**BRC**) is responsible for oversight and governance of the development of the RMP, the role of the BRC is to assist the Board to formulate its risk appetite, and to monitor the effectiveness of the RMP. The BRC has the following specific responsibilities;

- To advise the Board on the formulation of the Boards Risk Appetite Statement at least annually.
- To review reports from management concerning the RMP in the context of the Risk Appetite Statement in order to assure the Board of the programme's effectiveness.
- To review reports from management concerning changes anticipated in the economic, business and regulatory environment (including consideration of emerging trends) and other factors considered relevant to the risk appetite statement, in order to monitor them and advise the Board of any new risks or opportunities that could have significant financial, regulatory or reputational impact.
- To review reports from management concerning the Bank's internal compliance policies in order to advise the Board of their effectiveness and recommend their approval or variation (or, where the BRC has been delegated authority to itself approve or vary them).
- To review the lending standards developed by the Chief Risk Officer of HBL (**CRO**) at least annually.

The BRC consists of at least three non-executive directors. A member of the BRC sits on the Audit Committee. In addition the CEO, CRO and Chief Financial Officer of HBL (**CFO**) (or their nominee, subject to the Chair's prior approval) attend the BRC meetings, and the directors who are not members of the BRC are entitled to attend meetings and to receive copies of the BRC papers.

*Audit Committee and Internal Audit*

The Group has an internal audit function, the objective of which is to provide independent, objective assurance over the internal control environment. In certain circumstances, Internal Audit will provide risk and control advice to management provided the work does not impede the independence of the Internal Audit function. The function assists the Group in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

Internal Audit is allowed full, free and unfettered access to any and all the organisations records, personnel and physical properties deemed necessary to accomplish its activities.

A regular cycle of review has been implemented to cover all areas of the business, focused on assessment, management and control of risks. The audit plan ensures a cyclical review process of various business units and operational areas, as well as identified areas of higher identified risk. The audit methodology is designed to meet the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors.

Each audit has specific audit procedures tailored to the area of business that is being reviewed. The audit procedures are updated during each audit to reflect any process changes. Audit work papers are completed to evidence the testing preformed in accordance with audit procedures.

Audit reports are addressed to the manager of the relevant area that is being audited in addition to other relevant stakeholders within the Group. Management comments are obtained from the process owner(s) and are included in the report.

## 21 Enterprise risk management program (continued)

The Head of Internal Audit has a direct reporting line to the Chairman of the Audit Committee whilst administratively reporting to the CFO. Internal audit has accountability to the Audit Committee of the Group. A schedule of all outstanding internal control issues is maintained and presented to the Audit Committee to assist the Audit Committee to track the resolution of previously identified issues. Any issues raised that are categorised as high risk are specifically reviewed by internal audit during a follow up review once the issue is considered closed by management. The follow up review is performed with a view to formally close out the issue.

The Audit Committee focuses on financial reporting and the application of accounting policies as part of the internal control and risk assessment framework. The Audit Committee monitors the identification, evaluation and management of all significant risks through the Group. This work is supported by internal audit, which provides an independent assessment of the design, adequacy and effectiveness of internal controls. The Audit Committee receives regular reports from internal audit.

Charters for both the BRC and Audit Committee ensure suitable cross representation to allow effective communication pertaining to identified issues with oversight by the Board.

***Asset and Liability Committee (ALCO)***

The ALCO comprises the CEO (Chair), CEO HBL, Chief Digital Officer HGH, CFO , CRO , Chief Sales and Distribution Officer HBL, Head of Corporate Finance HGH, Deputy CFO – Finance HBL, Deputy CFO – Treasury HBL, Treasurer HBL. The ALCO generally meets monthly, and provides reports to the BRC. ALCO's specific responsibilities include decision making and oversight of risk matters in relation to:

- Market risk (including non-traded interest rate risk and the investment of capital)
- Liquidity risk (including funding)
- Foreign exchange rate risk
- Balance sheet structure
- Capital management

***Executive Risk Committee (ERC)***

The ERC comprises of the CEO (Chair), CEO of HBL, CRO, General Counsel HGH, CFO of HBL and Head of Internal Audit. The ERC has responsibility for overseeing risk aspects not considered by ALCO, including that the internal control environment is managed so that residual risk is consistent with the Group's risk appetite. The ERC generally meets monthly, and provides minutes to the BRC. ERC’s specific responsibilities include decision making and oversight of operational and compliance risk, and credit risk.

The Group’s exposure to operational and compliance risk is governed by a risk appetite statement approved by the Board and is used to guide management activities by the ERC. This statement sets out the nature of risk which may be taken and aggregate risk limits, and the ERC monitors adherence to this.

***Operational and compliance risk***

Operational and compliance Risk is the risk arising from day to day operational activities in the execution of the Group’s strategy which may result in direct or indirect loss. Operational and compliance risk losses can occur as a result of fraud, human error, missing or inadequately designed processes, failed systems, damage to physical assets, improper behaviour or from external events. The losses range from direct financial losses, to reputational damage, adverse customer outcomes, unfavourable media attention, injury to or loss of staff or clients or as a breach of laws or banking regulations. Where appropriate, risks are mitigated by insurance.

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational and compliance risk, the Group operates a “three lines of defence” model which outlines principles for the roles, responsibilities and accountabilities for operational and compliance risk management:

- The first line of defence is the business line management of the identification, management and mitigation of the risks associated with the products and processes of the business. This accountability includes regular testing and attestation of the adequacy and effectiveness of controls and compliance with the Group’s policies.
- The second line of defence is the Risk and Compliance function, responsible for the design and ownership of the operational risk management framework. It incorporates key processes including risk and control self-assessment , incident, issue and complaints management, independent evaluation of the adequacy and effectiveness of the internal control framework and the attestation process
- The third line of defence is Internal Audit which is responsible for independently assessing how effectively the Group is managing its risk according to stated risk appetite.

**Market risk**
Market risk is the possibility of experiencing losses or gains due to factors affecting the overall performance of financial markets in which the Group is exposed. The primary market risk exposures for the Group are interest rate risk and foreign exchange risk. The risk being that market interest rates or foreign exchange rates will change and adversely impact on the Group's earnings due to either adverse moves in foreign exchange market rates or in the case of interest rate risks mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

**Interest rate risk**
Interest rate risk is principally generated through interest rate risk in the customer loans and deposits (the bank book). This risk arises from three key sources:

- Mismatches between the repricing dates of interest bearing assets and liabilities;
- Banking products repricing differently to changes in wholesale market rates (basis risk); and
- The investment of capital in interest bearing assets.

Refer Note 24 - Interest rate risk for further details regarding interest rate risk.

**Foreign exchange risk**
Foreign exchange risk is the risk that the Group's earnings and shareholder equity position are adversely impacted from changes in foreign exchange rates. The Group has exposure to foreign exchange translation risks through its Australian subsidiaries (which have a functional currency of AUD), in the forms of profit translation risk and balance sheet translation risk.

Profit translation risk is the risk that deviations in exchange rates have a significant impact on the reported profit. Balance sheet translation risk is the risk that whilst the foreign currency value of the net investment in a subsidiary may not have changed, when translated back to the New Zealand dollars (**NZD**), the NZD value has changed materially due to movements in the exchange rates. Foreign exchange revaluation gains and losses are booked to the foreign currency translation reserve. Foreign exchange rate movements in any given year may have an impact on other comprehensive income. The Group manages this risk by setting and approving the foreign exchange rate for the upcoming financial year and entering into hedging contracts to manage the foreign exchange translation risks.

**Counterparty credit risk**
The Group has on-going credit exposures associated with:

- Cash and cash equivalents;
- Finance receivables
- Holding of investment securities; and
- Payments owed to the Group from risk management instruments.

Counterparty credit risk is managed against limits set in the market risk policy, including credit exposure on the derivative contracts, bilateral set-off arrangements, cash and cash equivalents and investment securities.

# 22 Credit risk exposure

Credit risk is the risk that a borrower will default on any type of debt by failing to make payments which it is obligated to make. 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 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 commercial judgement as described below.

To manage this risk the ERC oversees the formal credit risk management strategy. The ERC reviews the Group’s credit risk exposures typically on a monthly basis. The credit risk management strategies aim to ensure that:

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

The BRC also oversees the Group’s credit risk exposures to monitor overall risk metrics having regard to risk appetite set by the Board.

The Group has adopted a detailed credit risk framework. The framework is supported further by lending standards that provide criteria for finance products within each business sector.

The BRC has authority from the Board for approval of all credit exposures. Lending authority has been provided to the Group’s Credit Committees, and to the business units under a detailed delegated lending authority framework. Application of credit discretions in the business operation are monitored through a defined review and hindsight structure as outlined in the credit risk oversight policy. Delegated lending authorities are provided to individual officers with due cognisance of their experience and ability. Larger and higher risk exposures require approval of senior management, the credit committees and ultimately through to the BRC.

The Group employs a process of hind sighting loans to ensure that credit policies and the quality of credit processes are maintained.

**Reverse mortgage loans and negative equity risk**
Reverse mortgage loans are a form of mortgage lending targeted toward the seniors market. These loans differ to conventional mortgages in that they typically are not repaid until the borrower ceases to reside in the property. Further, interest is not required to be paid, it is capitalised with the loan balance and is repayable on termination of the loan. As such, there are no incoming cash flows and therefore no default risk to manage during the term of the loan. Credit risk becomes 'negative equity' risk through the promise by the Group to customers that they can reside in their property for 'as long as they wish' and repayment of their loan is limited to the net sale proceeds of their property.

The Group’s exposure to negative equity risk is managed by the Credit Risk Oversight Policy in conjunction with associated lending standards specific for this product. In addition to usual criteria regarding the type, and location, of security property that the Group will accept for reverse mortgage lending, a key aspect of the Group’s policy is that a borrower’s age on origination of the reverse mortgage loan will dictate the loan-to-value ratio of the reserve mortgage on origination.  Both New Zealand and Australia reverse mortgage operations are similarly aligned. The policy is managed and reviewed periodically to ensure appropriate consistency across locations.

**Maximum exposure to credit risk at the equivalent reporting dates**
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 Statement of Financial Position.

| **$000's** | **June 2019** | **June 2018** |
|---|---:|---:|
| Cash and cash equivalents | 80,584 | 49,588 |
| Investments | 342,493 | 330,852 |
| Finance receivables | 3,029,231 | 3,984,941 |
| Finance receivables reverse mortgages | 1,318,819 | - |
| Derivative financial instruments | 12,675 | 923 |
| Other financial assets | 3,277 | 1,613 |
| **Total on balance sheet credit exposures** | **4,787,079** | **4,367,917** |

## 22 Credit risk exposure (continued)

### Concentration of credit risk by geographic region

| $000's | June 2019 | June 2018 |
|---|---|---|
| New Zealand | | |
| Auckland | 1,130,673 | 1,085,421 |
| Wellington | 246,028 | 250,933 |
| Rest of North Island | 1,214,744 | 1,123,324 |
| Canterbury | 505,990 | 484,685 |
| Rest of South Island | 587,723 | 598,933 |
| Australia | | |
| Queensland | 175,914 | 154,145 |
| New South Wales | 427,437 | 322,705 |
| Victoria | 206,551 | 162,214 |
| Western Australia | 45,557 | 35,672 |
| South Australia | 31,888 | 25,356 |
| Rest of Australia | 18,914 | 13,951 |
| Rest of the World [1] | 254,151 | 143,073 |
| | 4,845,570 | 4,400,412 |
| Provision for impairment | (58,491) | (29,671) |
| Less fair value adjustment | - | (2,824) |
| **Total on balance sheet credit exposures** | **4,787,079** | **4,367,917** |

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

### Concentration of credit risk by industry sector

| $000's | June 2019 | June 2018 |
|---|---|---|
| Agriculture | 741,947 | 741,666 |
| Forestry and fishing | 80,642 | 87,955 |
| Mining | 13,697 | 19,222 |
| Manufacturing | 69,709 | 71,391 |
| Finance and insurance | 440,194 | 338,164 |
| Wholesale trade | 40,875 | 33,195 |
| Retail trade | 237,427 | 205,380 |
| Households | 2,430,084 | 2,105,437 |
| Property and business services | 406,781 | 402,169 |
| Transport and storage | 237,553 | 211,005 |
| Other | 146,661 | 184,828 |
| | 4,845,570 | 4,400,412 |
| Provision for impairment | (58,491) | (29,671) |
| Less fair value adjustment | - | (2,824) |
| **Total on balance sheet credit exposures** | **4,787,079** | **4,367,917** |

### Commitments to extend credit

| $000's | June 2019 | June 2018 |
|---|---|---|
| Undrawn facilities available to customers | 102,285 | 180,940 |
| Conditional commitments to fund at a future date | 89,317 | 94,239 |

As at 30 June 2019 there was nil of undrawn lending commitments available to counterparties for whom drawn balances was classified as individually impaired (2018: $0.196 million).

# 22 Credit risk exposure (continued)

**Credit risk grading**

The Group's Finance receivables are monitored either by account behaviour (**Behavioural portfolio**) or a regular assessment of their credit risk grade based on an objective review of defined risk characteristics (**Judgemental portfolio**).

Finance receivables reverse mortgages have no arrears characteristics and are assessed on origination against a pre-determined criteria.

The Judgemental portfolio consists mainly of business and rural lending where an on-going and detailed working relationship with the customer has been developed while the Behavioural portfolio consists of consumer, retail and smaller business receivables.

Judgemental loans are individually risk graded based on loan status, financial information, security and debt servicing ability. Exposures in the Judgemental portfolio are credit risk graded by an internal risk grading mechanism where grade 1 is the strongest risk. Grade and grade 9 is the weakest risk grade where a loss is probable. Behavioural loans are managed based on their arrears status.

Upon adoption of NZ IFRS 9 all loans past due but not impaired have been categorised into three impairments stages (Note 1 financial statements preparation) which are in most cases based on arrears status. If a Judgemental loan is risk graded 6 or above it will be classified as stage 2 as a minimum and carry a provision based on lifetime expected credit losses.

The arrears profile is driving the behavioural portfolio categorisation for the credit risk grading.

| $000's | 12 months ECL | Lifetime ECL Not credit impaired | Lifetime ECL Credit impaired | Specifically provided | Fair value | June 2019 Total | June 2018 |
|---|---|---|---|---|---|---|---|
| **Judgemental portfolio** | | | | | | | |
| Grade 1 - Very strong | 7 | - | - | - | - | 7 | 29 |
| Grade 2 - Strong | 8,685 | - | - | - | - | 8,685 | 10,172 |
| Grade 3 - Sound | 86,109 | - | 71 | - | - | 86,180 | 72,447 |
| Grade 4 - Adequate | 478,682 | 3,707 | 5,478 | - | - | 487,867 | 352,411 |
| Grade 5 - Acceptable | 851,307 | 4,835 | 4,854 | - | - | 860,996 | 687,174 |
| Grade 6 - Monitor | - | 142,122 | 5,031 | - | - | 147,153 | 145,706 |
| Grade 7 - Substandard | - | 22,913 | 3,450 | - | - | 26,363 | 22,961 |
| Grade 8 - Doubtful | 566 | - | - | 15,391 | - | 15,957 | 28,607 |
| Grade 9 - At risk of loss | - | - | - | 11,021 | - | 11,021 | 10,580 |
| **Total judgemental portfolio** | **1,425,356** | **173,577** | **18,884** | **26,412** | **-** | **1,644,229** | **1,330,087** |
| Total behavioural portfolio | 1,372,029 | 33,305 | 38,159 | - | 1,318,819 | 2,762,312 | 2,687,349 |
| **Gross finance receivables** | **2,797,385** | **206,882** | **57,043** | **26,412** | **1,318,819** | **4,406,541** | **4,017,436** |
| Provision for impairment | (30,421) | (1,780) | (18,427) | (7,863) | - | (58,491) | (29,671) |
| FV adjustment for PV of future losses | - | - | - | - | - | - | (2,824) |
| **Total finance receivables** | **2,766,964** | **205,102** | **38,616** | **18,549** | **1,318,819** | **4,348,050** | **3,984,941** |

# 23 Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations as they fall due. The timing mismatch of cash flows and the related liquidity risk in all banking operations and is closely monitored by the Group.

Measurement of liquidity risk is designed to ensure that the Group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis.

The Group's exposure to liquidity risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of the risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the Group in terms of a mix of assets and liabilities given its expectations of future cash flows, liquidity constraints and capital adequacy. The Group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

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

| **$000's** | **June 2019** | **June 2018** |
|---|---|---|
| Cash and cash equivalents | 80,584 | 49,588 |
| Investments | 342,493 | 330,852 |
| Undrawn committed bank facilities | 219,631 | 52,500 |
| **Total liquidity** | **642,708** | **432,940** |

**Contractual liquidity profile of financial assets and liabilities**
The following tables present the Group's financial assets and liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the tables represent undiscounted future principal and interest cash flows. As a result, the amounts in the tables below may differ to the amounts reported on the Consolidated Statement of Financial Position.

The contractual cash flows presented below may differ significantly from the actual cash flows. This occurs as a result of future actions by the Group and its counterparties, such as early repayment 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 Group.

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

## 23 Liquidity risk (continued)

**Contractual liquidity profile of financial assets and liabilities (continued)**

| $000's | On demand | 0-6 months | 6-12 months | 1-2 years | 2-5 years | 5+ years | Total |
|---|---|---|---|---|---|---|---|
| ***June 2019*** | | | | | | | |
| ***Financial Assets*** | | | | | | | |
| Cash and cash equivalents | 80,584 | - | - | - | - | - | 80,584 |
| Investments | - | 44,979 | 94,307 | 56,129 | 152,870 | 8,330 | 356,615 |
| Finance receivables | - | 931,670 | 513,162 | 799,266 | 1,168,678 | 327,719 | 3,740,495 |
| Finance receivables - reverse mortgages | - | 27,559 | 38,654 | 48,524 | 212,268 | 5,194,951 | 5,521,956 |
| Derivative financial instruments | - | 12,675 | - | - | - | - | 12,675 |
| Other financial assets | - | 3,277 | - | - | - | - | 3,277 |
| **Total financial assets** | **80,584** | **1,020,160** | **646,123** | **903,919** | **1,533,816** | **5,531,000** | **9,715,602** |
| ***Financial Liabilities*** | | | | | | | |
| Retail deposits | 895,290 | 1,415,994 | 605,804 | 224,545 | 73,034 | 1,680 | 3,216,348 |
| Other borrowings | - | 75,198 | 15,032 | 81,915 | 977,044 | - | 1,149,189 |
| Derivative financial liabilities | - | 10,372 | - | - | - | - | 10,372 |
| Other financial liabilities | - | 30,030 | - | - | - | - | 30,030 |
| **Total financial liabilities** | **895,290** | **1,531,594** | **620,836** | **306,460** | **1,050,078** | **1,680** | **4,405,939** |
| **Net financial (liabilities)/assets** | **(814,706)** | **(511,434)** | **25,287** | **597,459** | **483,738** | **5,529,320** | **5,309,664** |
| Undrawn facilities available to customers | 102,285 | - | - | - | - | - | 102,285 |
| Undrawn committed bank facilities | 219,631 | - | - | - | - | - | 219,631 |
| ***June 2018*** | | | | | | | |
| ***Financial Assets*** | | | | | | | |
| Cash and cash equivalents | 49,588 | - | - | - | - | - | 49,588 |
| Investments | - | 53,474 | 85,376 | 134,654 | 71,592 | 9,694 | 354,790 |
| Finance receivables | - | 554,170 | 384,245 | 1,204,534 | 1,356,798 | 5,029,371 | 8,529,118 |
| Finance receivables -reverse mortgages | | 11 | 11 | 18 | 76 | 2,066 | 2,182 |
| Derivative financial instruments | - | 923 | - | - | - | - | 923 |
| Other financial assets | - | 1,613 | - | - | - | - | 1,613 |
| **Total financial assets** | **49,588** | **610,191** | **469,632** | **1,339,206** | **1,428,466** | **5,041,131** | **8,938,214** |
| ***Financial Liabilities*** | | | | | | | |
| Retail deposits | 924,072 | 1,219,540 | 559,208 | 159,765 | 62,361 | - | 2,924,946 |
| Other borrowings | - | 101,527 | 13,523 | 627,070 | 189,333 | - | 931,453 |
| Derivative financial instruments | - | 1,639 | - | - | - | - | 1,639 |
| Other financial liabilities | - | 22,610 | - | - | - | - | 22,610 |
| **Total financial liabilities** | **924,072** | **1,345,316** | **572,731** | **786,835** | **251,694** | **-** | **3,880,648** |
| **Net financial (liabilities)/assets** | **(874,484)** | **(735,125)** | **(103,099)** | **552,371** | **1,176,772** | **5,041,131** | **5,057,566** |
| Undrawn facilities available to customers | 180,940 | - | - | - | - | - | 180,940 |
| Undrawn committed bank facilities | 52,500 | - | - | - | - | - | 52,500 |

# 24 Interest rate risk

The Group's market risk is derived primarily of exposure to interest rate risk, predominately from raising funds through the retail and wholesale deposit market, the debt capital markets and committed and uncommitted bank funding, securitisation of receivables, and offering loan finance products to the commercial and consumer market in New Zealand and Australia.

Interest rate risk is the risk that the value of assets or liabilities will change because of changes in interest rates or that market interest rates may change and thus alter the margin between interest-earning assets and interest-bearing liabilities. Interest rate risk for the Group refers to the risk of loss due to holding assets and liabilities that may mature or re-price in different periods.

The Group's exposure to market risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the Groups in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints and capital adequacy.

To manage this market risk, the Group measures sensitivity to interest rate changes by frequently testing its position against various interest rate change scenarios to assess potential risk exposure. The Group also manage interest rate risk by:

- Monitoring maturity profiles and seeking to match the re-pricing of assets and liabilities (physical hedging),
- Monitoring interest rates daily and regularly (at least monthly) reviewing interest rate exposure; and
- Entering into forward rate agreements and interest rate swaps and options to hedge against movements in interest rates.

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

| $000's | 0-3 months | 3-6 months | 6-12 months | 1-2 years | 2+ years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| *June 2019* | | | | | | | |
| *Financial assets* | | | | | | | |
| Cash and cash equivalents | 80,578 | - | - | - | - | 6 | 80,584 |
| Investments | 24,097 | 15,368 | 91,248 | 62,048 | 149,732 | 12,435 | 354,928 |
| Due from related parties | - | - | - | - | - | - | - |
| Finance receivables | 1,551,851 | 206,801 | 337,236 | 537,300 | 386,870 | 9,173 | 3,029,231 |
| Finance receivables - reverse mortgages | 1,318,819 | - | - | - | - | - | 1,318,819 |
| Derivative financial instruments | 11,232 | | | | | | 11,232 |
| Other financial assets | - | - | - | - | - | 3,277 | 3,277 |
| **Total financial assets** | **2,986,577** | **222,169** | **428,484** | **599,348** | **536,602** | **24,891** | **4,798,071** |
| *Financial liabilities* | | | | | | | |
| Retail deposits | 1,614,124 | 519,676 | 729,734 | 212,575 | 65,887 | 11,685 | 3,153,681 |
| Other borrowings | 771,219 | - | - | - | 285,434 | - | 1,056,653 |
| Derivative financial instruments | 10,230 | - | - | - | - | - | 10,230 |
| Other financial liabilites | - | - | - | - | - | 30,031 | 30,031 |
| **Total financial liabilites** | **2,395,573** | **519,676** | **729,734** | **212,575** | **351,321** | **41,716** | **4,250,595** |
| Effect of derivatives held for risk | (36,789) | 162,749 | 38,975 | (313,184) | 148,249 | - | - |
| **Net financial (liabilities)/assets** | **554,215** | **(134,758)** | **(262,275)** | **73,589** | **333,530** | **(16,825)** | **547,476** |

## 24 Interest rate risk (continued)

**Contractual repricing analysis (continued)**

| $000's | 0-3 months | 3-6 months | 6-12 months | 1-2 years | 2+ years | Non-interest bearing | Total |
|---|---|---|---|---|---|---|---|
| *June 2018* | | | | | | | |
| *Financial Assets* | | | | | | | |
| Cash and cash equivalents | 49,580 | - | - | - | - | 8 | 49,588 |
| Investments | 44,483 | 22,935 | 82,149 | 111,355 | 69,930 | 9,694 | 340,546 |
| Finance receivables | 2,687,543 | 165,901 | 284,847 | 418,800 | 423,037 | 4,359 | 3,984,487 |
| Finance receivables - reverse mortagages | 454 | - | - | - | - | - | 454 |
| Derivative financial instruments | 923 | - | - | - | - | - | 923 |
| Other financial assets | - | - | - | - | - | 1,613 | 1,613 |
| **Total financial assets** | **2,782,983** | **188,836** | **366,996** | **530,155** | **492,967** | **15,674** | **4,377,611** |
| *Financial Liabilities* | | | | | | | |
| Retail deposits | 1,663,258 | 482,447 | 543,746 | 150,230 | 33,571 | 8,553 | 2,881,805 |
| Other borrowings | 736,850 | 3,378 | - | - | 174,025 | - | 914,253 |
| Derivative financial instruments | 2,562 | - | - | - | - | - | 2,562 |
| Other financial liabilites | - | - | - | - | - | 22,610 | 22,610 |
| **Total financial liabilites** | **2,402,670** | **485,825** | **543,746** | **150,230** | **207,596** | **31,163** | **3,821,230** |
| Effect of derivatives held for risk | 361,760 | (44,735) | (75,365) | (242,090) | 430 | - | - |
| **Net financial (liabilities)/assets** | **742,073** | **(341,724)** | **(252,115)** | **137,835** | **285,801** | **(15,489)** | **556,381** |

The tables above illustrate the periods in which the cash flows from interest rate swaps are expected to occur and affect Profit or loss.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Groups' financial assets and liabilities to various standard and nonstandard interest rate scenarios. Standard scenarios which are considered on a monthly basis include a 100 basis point parallel fall or rise in the yield curve. There is a no material impact on Profit or loss in terms of a fair value change from movement in market interest rates. Furthermore there is no material cash flow impact on the Consolidated Statement of Cash flows from a 100 basis point change in interest rates.

# OTHER DISCLOSURES

## 25 Significant subsidiaries

| Significant subsidiaries | Country of incorporation and place of business | Nature of business | Proportion of ownership and voting power held June 2019 | June 2018 |
|---|---|---|---|---|
| Heartland Bank Limited | New Zealand | Bank | 100% | 100% |
| VPS Properties Limited | New Zealand | Investment property holding company | 100% | 100% |
| MARAC Insurance Limited | New Zealand | Insurance services | 100% | 100% |
| Heartland Australia Group Pty Limited | Australia | Financial services | 100% | 100% |
| Australian Seniors Finance Pty Limited | Australia | Management services | 100% | 100% |

## 26 Structured entities

A structured entity is one which has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities are created to accomplish a narrow and well defined objective such as the securitisation or hold of particular assets, or the execution of a specific borrowing or lending transaction. Structured entities are consolidated where the substance of the relationship is that the Group controls the structured entity.

**(a) Heartland Cash and Term PIE (Heartland PIE Fund)**
The Group controls the operations of the Heartland PIE Fund which is a portfolio investment entity that invests in the Group's deposits. Investments of Heartland PIE Fund are represented as follows.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Deposits | 146,094 | 115,095 |

**(b) Seniors Warehouse Trust (SW Trust) and ASF Settlement Trust (ASF Trust)**
SW Trust and ASF Trust form part of the ASF reverse mortgage business and were both 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 reverse mortgage loans held by the Trusts were set aside for the benefit of the investors in the SW Trust and ASF Trust.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Cash and cash equivalents | 35,356 | 12,207 |
| Finance receivables - reverse mortgages | 759,749 | 676,837 |
| Other Borrowings | (711,471) | (614,510) |

## 26 Structured entities (continued)

**(c) Heartland ABCP Trust 1 (ABCP Trust)**
At 30 June 2018 the Group had securitised a pool of receivables comprising commercial and motor vehicle loans to ABCP Trust.

The Group continued to recognise the securitised assets and associated borrowings in the Consolidated Statement of Financial Position. Although the Group recognised those interests in the ABCP Trust, the loans sold to the Trust were set aside for the benefit of investors in the ABCP Trust.

On 29 August 2018 the assets of the ABCP Trust were purchased by HBL and the ABCP Trust dissolved.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Cash and cash equivalents | - | 3,625 |
| Finance receivables - securitised | - | 80,289 |
| Borrowings - securitised | - | (47,504) |
| Derivative financial liabilities - securitised | - | (496) |

**(d) Heartland Auto Receivables Warehouse Trust (Auto Warehouse)**
On 29 August 2018 the Group established the Auto Warehouse in order to securitise commercial and motor loan receivables as a source of funding.

The Group continues to recognise the securitised assets and associated borrowings in the Consolidated Statement of Financial Position. Although the Group recognises those interests in Auto Warehouse, the loans sold to the Trust are set aside for the benefit of investors in Auto Warehouse and other depositors and lenders to the Group have no recourse to those assets.

| $000's | June 2019 | June 2018 |
|---|---|---|
| Cash and cash equivalents | 555 | - |
| Other liabilities | (559) | - |

## 27 Staff share ownership arrangements

The Group operates a number of share-based compensation plans that are equity settled. The fair value determined at the grant date is expensed on a straight line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the employee benefits reserve.

**(a) Share-based compensation plan details**

***Heartland LTI net share settled plan (LTI plan)***
The LTI plan was allotted under three tranches (referred to as the 2013, 2014 and 2015 tranches). Under the LTI plan participants were granted an option to acquire shares in the Group. The number of shares granted upon exercise of the options is based on the difference between the market price of the shares on the exercise date and the reference price.

The options are subject to the participants' continued employment with the Group for the service period of 3 years which begins on 1 July 2014 for the 2015 plan. Participants in the 2015 tranche were able to exercise their options between September 2017 and 1 July 2019.

***2015 Special grant (LTI SG)***
Participants of the LTI SG were able to exercise options in the period beginning on the date the market price of the Group shares was equal to $1.50 and ending on 1 July 2017. Market price was calculated based on the VWAP of a Heartland share for the 10 business days immediately before (but excluding) the exercise date for those options.

## 27 Staff share ownership arrangements (continued)

The options were subject to the participants' continued employment with the Group for the service period of 3 years which began on 1 July 2014. Following exercise a lock up period until 1 July 2020 applies during which participants are restricted from disposing of shares.

The reference price was the amount by which the market price of the Group shares, at the time of exercise, exceeded $1.00 (based on a volume weighted average price of Heartland shares for the prior 20 business days), plus the aggregate amount of cash dividends (cents per the Group share) paid by the Group in the period from 1 April 2015 until and including the date the options were exercised. However, for the purpose of calculating the settlement amount, the market price of the Group shares was capped at $1.50 and any increase above this amount was disregarded.

***Senior executive scheme (SES)***

The SES was established in June 2016 as a replacement of the LTI plan and LTI SG for certain affected participants only (senior executives). Under the SES, senior executives forfeited their options under the 2014 and 2015 tranches of the LTI plan and the LTI SG and purchased the Group shares with proceeds from a settlement amount paid to them by the Group. The shares were unable to be sold or otherwise disposed of by the senior executive until 30 June 2019.

The SES has been treated as a modification of the senior executive entitlements under the 2014 and 2015 tranches of the LTI Plan and the LTI SG. The incremental fair value granted is $0.49 million based on the value of shares acquired under the SES less the fair value of the benefits forfeited under the 2014 and 2015 tranches of the LTI Plan and the LTI SG.

***Heartland performance rights plant (PR plan)***

The PR plan was established to enhance the alignment of participants' interests with those of the Group's shareholders. Under the PR plan participants are issued performance rights which will entitle them to receive shares in the Group.

**PR Plan 2016 tranche (PR plan 2016)**

The number of performance rights offered is determined by the participant's LTI value over the VWAP of the Group's ordinary shares on the NZX Main Board for the 10 business days immediately before (and including) the issue date. The issue date is 31 August 2016. Performance rights do not entitle participants to dividends or voting rights.

The performance rights are issued subject to the participants' continued employment with the Group until the measurement date and the Group achieving its total shareholder return (TSR) target. The measurement date is defined as 10 business days following the date on which the Group announces its full year results for the financial year ended 2019. The TSR target has been set at an annual rate of 11%, compounding and is determined primarily by share price movements and cash dividends. Performance rights will vest on the measurement date where these criteria have been met.

**PR Plan 2017 tranche (PR plan 2017)**

The number of performance rights offered is determined by the participant's LTI value over the VWAP of the Groups ordinary shares on the NZX Main Board for the 20 business days immediately before (and excluding) the issue date. The issue date is 12 September 2017. Performance rights do not entitle participants to dividends or voting rights.

The performance rights are issued subject to the participants' continued employment with the Group until the measurement date and the Group achieving its share price and/or market capitalisation targets. The targets are dynamic and may be adjusted by the Board from time to time in order to account for unanticipated capital changes during the performance period. The measurement date is 10 business days following the date on which the Group announces its full year results for the financial year ended 2021.

Performance rights will vest on the measurement date to the extent these criteria have been met, but subject to caps and also to retesting on a later measurement date if the criteria are not met on the initial measurement date.

**PR Plan 2018 tranche (PR plan 2018)**

The number of performance rights offered is determined by the participant's LTI value over the VWAP of the Groups ordinary shares on the NZX Main Board for the 20 business days immediately before (and excluding) the issue date. The issue date is 13 September 2018. Performance rights do not entitle participants to dividends or voting rights.

The performance rights are issued subject to the participants' continued employment with the Group until the measurement date and the Group achieving its share price and/or market capitalisation targets. The targets are dynamic and may be adjusted by the Board from time to time in order to account for unanticipated capital changes during the performance period. The measurement date is 10 business days following the date on which the Group announces its full year results for the financial year ended 2021.

Performance rights will vest on the measurement date to the extent these criteria have been met, but subject to caps and also to retesting on a later measurement date if the criteria are not met on the initial measurement date.

## 27 Staff share ownership arrangements (continued)

| | PR Plan Number of rights | SES Number of shares | LTI Plan Number of options |
|---|---|---|---|
| 1 July 2018 | 3,180,298 | 1,858,676 | - |
| Granted | - | (1,858,676) | - |
| Issued | 293,759 | - | - |
| Forfeited | (352,717) | - | - |
| **30 June 2019** | **3,121,340** | **-** | **-** |
| | | | |
| 1 July 2017 | 888,300 | 1,858,676 | 7,492,753 |
| Granted | 2,291,998 | - | - |
| Exercises | - | - | (7,300,488) |
| Forfeited | - | - | (192,265) |
| **30 June 2018** | **3,180,298** | **1,858,676** | **-** |

The fair value of performance rights granted during the period is $0.072 million (2018: $1.06 million). This fair value was derived using the Monte Carlo model. The key inputs used in the model are:

- Volatility 18% -22% (calculated based on the historical movement in the group's shares)
- Risk free rate 2.08% pa
- Initial measurement date 10 September 2021
- VWAP on issue Date $1.72
- Share price at valuation $1.67

The weighted average share price exercised in 2018 was $1.83.

**(b) Effect of share-based payment transactions**

| **$000's** | **June 2019** | **June 2018** |
|---|---|---|
| Award of shares | | |
| SES | 327 | 328 |
| LTI plan | - | (34) |
| PR plan | 341 | 372 |
| **Total expense recognised** | **668** | **666** |

As at 30 June 2019 $0.590 million of the share scheme awards remain unvested and not expensed (2018: $1.02 million). This expense will be recognised over the vesting period of the awards.

**(c) Number of options/rights outstanding at 30 June 2019**

| **$000's** | **Rights outstanding** | **Remaining years** |
|---|---|---|
| PR plan 2016 | 823 | - |
| PR plan 2017 | 2,039 | 2 |
| PR plan 2018 | 259 | 2 |
| **Total** | **3,121** | |

# 28 Concentrations of funding

### (a) Concentrations of funding by industry

| $000's | June 2019 | June 2018 |
|---|---|---|
| Agriculture | 68,559 | 69,245 |
| Forestery and Fishing | 25,360 | 23,403 |
| Mining | 61 | 38 |
| Manufacturing | 11,233 | 10,691 |
| Finance and Insurance | 1,148,119 | 979,871 |
| Wholesale Trade | 11,520 | 9,967 |
| Retail Trade | 18,048 | 14,102 |
| Households | 2,340,764 | 2,260,330 |
| Property and business services | 88,744 | 110,385 |
| Transport and storage | 4,416 | 4,853 |
| Other | 155,830 | 139,148 |
| | 3,872,654 | 3,622,033 |
| Subordinated notes | - | 22,172 |
| Unsubordinated notes | 337,680 | 151,853 |
| **Total borrowings** | **4,210,334** | **3,796,058** |

### (b) Concentrations of funding by geographical area

| $000's | June 2019 | June 2018 |
|---|---|---|
| Auckland | 1,094,639 | 969,518 |
| Wellington | 303,595 | 270,096 |
| Rest of North Island | 773,960 | 686,208 |
| Canterbury | 969,778 | 885,005 |
| Rest of South Island | 261,276 | 245,830 |
| Overseas [1] | 807,086 | 739,401 |
| **Total borrowings** | **4,210,334** | **3,796,058** |

[1] Included in overseas funding are facilities totalling (AU $650 million) (2018: AU $600 million), Refer to note 15 – Borrowings for more information.

# 29 Contingent liabilities and commitments

Contingent liabilities are possible obligations, whose existence will be confirmed only by uncertain future events, or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised, but are disclosed, unless they are remote. Where some loss is probable, provisions have been made.

Contingent liabilities and credit related commitments arising in respect of the Group's operations were:

| $000's | June 2019 | June 2018 |
|---|---|---|
| Letters of credit, guarantee commitments and performance bonds | 6,757 | 6,847 |
| **Total contingent liabilities** | **6,757** | **6,847** |
| | | |
| Undrawn facilities available to customers | 102,285 | 180,940 |
| Conditional commitments to fund at future dates | 89,317 | 94,239 |
| **Total commitments** | **191,602** | **275,179** |

# 30 Events after the reporting date

The Group declared a fully imputed dividend of 6.5cents per share on 15 August 2019, to be paid to shareholders on 6 September 2019.
A funding facility of AU $250 million for Seniors Warehouse Trust No. 2 was secured on 2 July 2019 being the date of establishment of that Trust.

# Independent Auditor's Report

To the shareholders of Heartland Group Holdings Limited

**Report on the audit of the consolidated financial statements**

## Opinion

In our opinion, the accompanying consolidated financial statements of Heartland Group Holdings Limited (the "Company") and its subsidiaries (the "Group") on pages 7 to 53:

i. present fairly in all material respects the Group's financial position as at 30 June 2019 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

We have audited the accompanying consolidated financial statements which comprise:

— the consolidated statement of financial position as at 30 June 2019;

— the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended; and

— notes, including a summary of significant accounting policies and other explanatory information.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ("ISAs (NZ)"). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Group in accordance with Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISAs (NZ) are further described in the auditor's responsibilities for the audit of the consolidated financial statements section of our report.

Our firm has also provided other services to the Company and Group in relation to review of the Group's consolidated interim financial statements, review of regulatory returns, trust deed reporting, registry audits and other agreed upon procedures engagements. Subject to certain restrictions, partners and employees of our firm may also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in, the Group.

## Emphasis of matter

We draw attention to the financial statements preparation note of the consolidated financial statements which explains the corporate restructure on 31 October 2018 when the Group acquired Heartland Bank Limited. As common control remained after the restructure, the consolidated financial statements have been prepared as if the Group had operated for the entire period. Comparative figures shown are for the consolidated Heartland Bank Limited. Our opinion is not qualified in respect of this matter.

## Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the consolidated financial statements as a whole. The materiality for the consolidated financial statements as a whole was set at $5,070,000 determined with reference to a benchmark of the Group's profit before tax. We chose the benchmark because, in our view, this is a key measure of the Group's performance.

We agreed with the Audit Committee that we would report misstatements identified during our audit, to them, above $250,000, as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

## Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements in the current period. We summarise below those matters and our key audit procedures to address those matters in order that the shareholders as a body may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the consolidated financial statements as a whole and we do not express discrete opinions on separate elements of the consolidated financial statements.

| The key audit matter | How the matter was addressed in our audit |
|---|---|
| **Provision for impairment of finance receivables**<br>*Refer to notes 13 and 22 to the consolidated financial statements* | |
| The provision for impairment of finance receivables is a key audit matter owing to their financial significance and the high degree of complexity and judgement applied by management in determining the value.<br><br>NZ IFRS 9 *Financial Instruments* was adopted for the first time on 1 July 2018. This added effort to our audit due to the complexity of the accounting standard and its expected pervasive impact on the industry.<br><br>The provision for individually impaired assets is based on the application of management judgement, with the assessment of expected future cash flows being inherently uncertain. The provision for individually impaired assets for 'rural' and other 'corporate' loans is of particular audit focus, owing to its financial significance and inherent uncertainties of expected future cash flows, which may include estimated timing and proceeds from the future sale of assets securing the debt, in addition to repayments from borrowers.<br><br>Based on the assigned risk grading or arrears status, an estimate of ECL will be applied to | Together with KPMG credit risk specialists we assessed the Group's adoption of NZ IFRS 9, individual provisions and collective provisions. Our procedures included:<br><br>— Assessing the Group's governance and oversight, including the continuous reassessment of overall provisioning;<br>— Assessing the Group's significant accounting policies and expected credit loss ("ECL") modelling methodology against the requirements of the standards and underlying accounting records;<br>— Assessing the disclosures in the consolidated financial statements against the requirements of NZ IFRS;<br>— Testing key controls over arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and model validations;<br>— Evaluating credit assessments for a sample of 'rural' and other 'corporate' loans that are either individually above $10 million or on management's credit watchlist. This included inspection of the latest correspondence with the borrower, assessment of the provision estimates prepared by credit risk officers, and consideration of the resolution strategy; including challenging assumptions based on our experience and industry knowledge, and assessing collateral values by comparing them to valuations performed by independent valuers;<br>— Assessing individually significant loans in arrears not specifically |

| The key audit matter | How the matter was addressed in our audit |
|---|---|
| determine the collective provision based on historical data, adjusted for forward looking information.<br><br>Additionally management apply judgement in the determination of provision overlays to adjust for future market conditions.<br><br>The level of judgement involved in determining the provision for collectively impaired assets requires us to challenge the appropriateness of management's assumptions. | provided for, to determine whether they were being appropriately monitored and incorporated into the provision for collectively impaired assets;<br><br>— Testing key inputs used in the ECL calculation for significant portfolios. This included testing data reconciliation controls between the ECL models and source systems;<br><br>— Challenging the key assumptions in the models such as probability of default, loss given default and forward-looking assumptions for a sample of models. We compared modelled estimates against actual losses incurred by the Group and forward-looking assumptions against external economic information; and<br><br>— Assessing management's judgement in the application of overlays by applying sensitivities to assumptions underlying the overlays, and evaluating current economic and climatic conditions linked to the overlays, not captured in the Group's models.<br><br>The estimates and assumptions used to determine the provision for impairment of finance receivables are reasonable, with no evidence of management bias or influence identified from our procedures.<br><br>We did not identify any material issues or exceptions from our procedures. |
| **Valuation of finance receivables - reverse mortgages**<br>*Refer to notes 13 and 20 to the consolidated financial statements.* | |
| The Group's reverse mortgage portfolio is held at fair value.<br><br>The fair value calculation is based on the application of management judgement. In assessing the fair value the Group continuously considers evidence of a relevant active market. In the absence of such a market, in the current period, the Group considered changes since the original lending and an independent actuarial assessment of future cash flows.<br><br>The inherent uncertainties include estimated future mortality and move to care rates, voluntary exits, house price changes and interest rate margin. | Together with KPMG valuation specialists, our procedures over the fair value loan portfolios included:<br><br>— Testing key controls over the accuracy of historic data impacting the fair value assessment;<br><br>— Assessing evidence of a relevant active market or observable inputs; and<br><br>— Challenging the key assumptions used by the Group in determining the portfolio's fair value.<br><br>The estimates and assumptions used to determine the valuation of finance receivables are reasonable, with no evidence of management bias or influence identified from our procedures.<br><br>We did not identify any material issues or exceptions from our procedures. |
| **Operation of IT systems and controls** | |
| The Group is heavily dependent on complex IT systems for the processing and recording of significant volumes of transactions and other core banking activity.<br><br>For significant financial statement balances, such as finance receivables and deposits, our | Our audit procedures, amongst others, included:<br><br>— Gaining an understanding of business processes, key controls, and IT systems relevant to significant financial statement balances, including technology services provided by a third party; |

| The key audit matter | How the matter was addressed in our audit |
|---|---|
| audit involves an assessment of the design of the Group's internal control environment relevant to the preparation of these consolidated financial statements. There are some areas of the audit where we seek to test and place reliance on IT systems, automated controls and reporting.<br><br>The effective operation of these controls is dependent upon the Group's general IT control environment, which incorporates controls relevant to IT system changes and development, IT operations, developer and user access controls. | — Assessing the effectiveness of the IT control environment, including core banking IT systems, key automated controls and reporting; and<br>— Evaluating general IT controls relevant to IT system changes and development, IT operations, developer and user access controls.<br><br>In performing our work, we identified design and operating effectiveness control observations that impacted the level of reliance we could place on IT systems, automated controls and reports.<br><br>In response, we performed additional compensating control tests and substantive audit procedures:<br>— We carried out substantive testing on IT systems and controls to assess:<br>(i) the accuracy of automated controls and IT system calculated transactions and balances, such as interest income and expense;<br>(ii) the reliability of automated reporting, such as IT system generated arrears reporting; and<br>(iii) the operation of technology dependent manual controls;<br>— We performed additional control testing on compensating controls, including management and governance review controls; and<br>— We completed further substantive audit procedures over significant financial statement balances, where required to support our audit.<br><br>We did not identify any material issues or exceptions from those additional procedures. |

## Other information

The Directors, on behalf of the Group, are responsible for the other information included in the entity's Annual Report. Other information may include the Annual Review and information included in the Financial Report. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

The Annual Report is expected to be made available to us after the date of this Independent Auditor's Report. Our responsibility is to read the Annual Report when it becomes available and consider whether the other information it contains is materially inconsistent with the consolidated financial statements, or our knowledge obtained in the audit, or otherwise appears misstated. If so, we are required to report such matters to the Directors.

## Use of this independent auditor's report

This independent auditor's report is made solely to the shareholders as a body. Our audit 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 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 audit work, this independent auditor's report, or any of the opinions we have formed.

## Responsibilities of the Directors for the consolidated financial statements

The Directors, on behalf of the Company, are responsible for:

- the preparation and fair presentation of the consolidated financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;
- implementing necessary internal control to enable the preparation of a consolidated set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

## Auditor's responsibilities for the audit of the consolidated financial statements

Our objective is:

- to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- to issue an independent auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ will always detect a material misstatement when it exists.

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 these consolidated financial statements.

A further description of our responsibilities for the audit of these consolidated financial statements is located at the External Reporting Board (XRB) website at:

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

This description forms part of our independent auditor's report.

The engagement partner on the audit resulting in this independent auditor's report is Graeme Edwards.

For and on behalf of

KPMG

KPMG
Auckland

15 August 2019

HEARTLAND GROUP

# Results announcement

## (for Equity Security issuer/Equity and Debt Security issuer)

Updated as at 8 May 2019

| Results for announcement to the market | | |
|---|---|---|
| Name of issuer | Heartland Group Holdings Limited | |
| Reporting Period | 12 months to 30 June 2019 | |
| Previous Reporting Period | 12 months to 30 June 2018 | |
| Currency | NZD | |
| | **Amount (000s)** | **Percentage change** |
| Revenue from continuing operations | $205,842 | 4.60% |
| Total Revenue | $205,842 | 4.60% |
| Net profit/(loss) from continuing operations | $73,617 | 9.04% |
| Total net profit/(loss) | $73,617 | 9.04% |
| **Interim/Final Dividend** | | |
| Amount per Quoted Equity Security | $0.065 | |
| Imputed amount per Quoted Equity Security | $0.025 | |
| Record Date | 23 August 2019 | |
| Dividend Payment Date | 6 September 2019 | |
| | **Current period** | **Prior comparable period** |
| Net tangible assets per Quoted Equity Security | $1.04 | $1.05 |
| A brief explanation of any of the figures above necessary to enable the figures to be understood | Please refer to the audited financial statements that accompany this announcement for a further explanation of these figures. | |
| **Authority for this announcement** | | |
| Name of person authorised to make this announcement | Michael Drumm | |
| Contact person for this announcement | Michael Drumm | |
| Contact phone number | 09 927 9136 | |
| Contact email address | michael.drumm@heartland.co.nz | |
| Date of release through MAP | 15/08/2019 | |

Audited financial statements accompany this announcement.

HEARTLAND GROUP

# Distribution Notice

Updated as at 8 May 2019

| **Section 1: Issuer information** | | | | |
|---|---|---|---|---|
| Name of issuer | Heartland Group Holdings Limited | | | |
| Financial product name/description | Ordinary Shares | | | |
| NZX ticker code | HGH | | | |
| ISIN (If unknown, check on NZX website) | NZHGHE0007S9 | | | |
| Type of distribution (Please mark with an X in the relevant box/es) | Full Year | X | Quarterly | |
| | Half Year | | Special | |
| | DRP applies | X | | |
| Record date | 23/08/2019 | | | |
| Ex-Date (one business day before the Record Date) | 22/08/2019 | | | |
| Payment date (and allotment date for DRP) | 06/09/2019 | | | |
| Total monies associated with the distribution | $37,006,952 | | | |
| Source of distribution (for example, retained earnings) | Retained earnings | | | |
| Currency | NZD | | | |
| **Section 2: Distribution amounts per financial product** | | | | |
| Gross distribution | $0.090 | | | |
| Total cash distribution | $0.065 | | | |
| Excluded amount (applicable to listed PIEs) | $NIL | | | |
| Supplementary distribution amount | $0.011 | | | |
| **Section 3: Imputation credits and Resident Withholding Tax** | | | | |
| Is the distribution imputed | Fully imputed – YES | | | |
| | ~~Partial imputation~~ | | | |
| | ~~No imputation~~ | | | |
| If fully or partially imputed, please state imputation rate as % applied | 28% | | | |
| Imputation tax credits per financial product | $0.025 | | | |
| Resident Withholding Tax per financial product | $0.005 | | | |

| Section 4: Distribution re-investment plan (if applicable) | | |
|---|---|---|
| DRP % discount (if any) | 2.0% | |
| Start date and end date for determining market price for DRP | 26/08/2019 | 30/08/2019 |
| Date strike price to be announced (if not available at this time) | 02/09/2019 | |
| Specify source of financial products to be issued under DRP programme (new issue or to be bought on market) | New issue | |
| DRP strike price per financial product | $ | |
| Last date to submit a participation notice for this distribution in accordance with DRP participation terms | 26/08/2019, 5:00pm (NZT) | |
| **Section 5: Authority for this announcement** | | |
| Name of person authorised to make this announcement | Michael Drumm | |
| Contact person for this announcement | Michael Drumm | |
| Contact phone number | 09 927 9136 | |
| Contact email address | michael.drumm@heartland.co.nz | |
| Date of release through MAP | 15/08/2019 | |

*NZX/ASX Release*

# ASX Listing Rule 1.15.3 Statement

15 August 2019

Heartland Group Holdings Limited (**ASX/NZX: HGH**) (an ASX Foreign Exempt Listing) confirms, for the purposes of ASX Listing Rule 1.15.3, that it has complied with and continues to comply with the Listing Rules of NZX Limited, which is its overseas home exchange.

**- Ends -**

For further information, please contact:

Michael Drumm
General Counsel
Heartland Group Holdings Limited
DDI 09 927 9136