



ASX ANNOUNCEMENT

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Date: 20 February 2017

Half Yearly Report - 31 December 2016

Please see the **attached** documents:

- 1 Condensed Half Year Financial Report; and
- 2 Media statement.

ENDS

For more information please contact:

Bill Armagnacq
Company Secretary
(07) 4694 9609

Shelley Sorrenson
Assistant Company Secretary
(07) 4694 9630

Condensed Half-Year Financial Report

31 December 2016



Heritage
Bank



Heritage Bank Limited

ABN 32 087 652 024, AFSL 240984, Australian Credit Licence 240984.

Condensed Half-Year Financial Report

31 December 2016

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Auditors
Ernst & Young

Registered Office
Heritage Bank Limited
6th Floor
400 Ruthven Street
Toowoomba Qld 4350

Postal Address
P.O. Box 190
Toowoomba Qld 4350
Telephone (07) 4690 9000

Internet Address
www.heritage.com.au

Information contained in this report should be read in conjunction with the June 2016 Financial Report

Heritage Bank Limited • Condensed Half-Year Financial Report 31 December 2016

Directors' Report

Your directors submit their report of the consolidated entity (the "Group"), being Heritage Bank Limited ("Heritage") and its controlled entities, for the half-year ended 31 December 2016.

Directors

The names of the directors of the Group in office during the half-year and until the date of this report are set out below:

Mr Kerry J. Betros (Chairman)

Dr Dennis P. Campbell (Deputy Chairman)

Mrs Vivienne A. Quinn

Ms Susan M. Campbell

Mr Brendan P. Baulch

Mr Stephen Davis

Mr David W. Thorpe

Review and result of operations

The operating profit of the Group for the half-year after income tax was \$20.888 million (2015 - \$17.814 million).

The Group reported total consolidated assets in the period to 31 December 2016 of \$8.818 billion (June 2016 - \$8.441 billion).

Events subsequent to reporting date

No matters or circumstances have arisen since the end of the half-year to the date of this report which significantly affected or may significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in subsequent financial periods.

Rounding

The amounts contained in this report and in the financial statements have been rounded to the nearest thousand dollars (where rounding is applicable) in accordance with ASIC Corporations Instrument 2016/191.

Auditor's independence declaration

In relation to the Auditor's Independence, the Directors have sought and received a report that there has been no breaches of the Auditor Independence requirement of the *Corporations Act 2001*. The report is shown on page 16.

Signed in accordance with a resolution of the directors:



KERRY J. BETROS
Chairman



DENNIS P. CAMPBELL
Deputy Chairman

TOOWOOMBA
16 February 2017

Statement of Profit or Loss

FOR THE HALF-YEAR ENDED 31 DECEMBER 2016

	Note	CONSOLIDATED	
		December 2016 \$'000	December 2015 \$'000
Net interest income			
Interest revenue	4.1	175,550	179,545
Interest expense	4.1	(100,008)	(106,448)
Net interest income		75,542	73,097
Other operating income	4.1	23,213	17,258
Total net operating income		98,755	90,355
Expenses			
Impairment losses on loans and receivables		(1,442)	(774)
Marketing expense		(2,954)	(3,308)
Occupancy expense		(6,335)	(6,070)
Employee benefits expense	4.2	(36,918)	(35,720)
Administrative expense		(14,266)	(12,420)
Depreciation		(2,850)	(2,692)
Amortisation		(1,062)	(972)
Communication		(2,533)	(2,457)
Fees and commissions		(475)	(616)
Total operating expenses		(68,835)	(65,029)
Profit before income tax		29,920	25,326
Income tax expense		(9,032)	(7,512)
Profit after tax		20,888	17,814

Statement of Comprehensive Income

FOR THE HALF-YEAR ENDED 31 DECEMBER 2016

	Note	CONSOLIDATED	
		December 2016 \$'000	December 2015 \$'000
Profit after tax		20,888	17,814
Other comprehensive income			
<i>Items that may be reclassified subsequently to profit or loss</i>			
Gain on cash flow hedge taken to members' funds		3,114	2,581
Income tax on other comprehensive income	4.3	(934)	(774)
		2,180	1,807
<i>Items that will not be reclassified subsequently to profit or loss</i>			
Actuarial (loss)/gain on defined benefit plan		-	(415)
Other comprehensive income, net of tax		2,180	1,392
Total comprehensive income for the period		23,068	19,206

Statement of Financial Position

AS AT 31 DECEMBER 2016

	Note	CONSOLIDATED	
		December 2016 \$'000	June 2016 \$'000
Assets			
Cash and cash equivalents	5	96,132	103,743
Receivables due from other financial institutions		200,773	194,374
Held to maturity financial assets		1,073,127	1,003,978
Other receivables		32,934	30,514
Loans and receivables		7,364,163	7,064,232
Available for sale financial investments		479	478
Derivatives		4,054	297
Deferred tax assets		7,853	9,318
Property, plant and equipment		28,159	25,758
Other assets		3,548	2,350
Intangibles		6,667	5,685
Total Assets		8,817,889	8,440,727
Liabilities			
Deposits		6,671,226	6,132,792
Other financial liabilities		284,290	350,846
Borrowings		1,276,412	1,397,144
Derivatives		1,509	11,848
Current tax liabilities		1,697	2,122
Other payables		52,339	36,882
Provisions		15,134	16,911
Deferred tax liabilities		412	403
Subordinated debt		49,697	49,674
Total Liabilities		8,352,716	7,998,622
Net Assets		465,173	442,105
Members' Funds			
Retained profits		463,759	442,871
Reserves		1,414	(766)
Total Members' Funds		465,173	442,105

Information contained in this report should be read in conjunction with the June 2016 Financial Report

Heritage Bank Limited • Condensed Half-Year Financial Report 31 December 2016

Statement of Changes in Members' Funds

FOR THE HALF-YEAR ENDED 31 DECEMBER 2016

	CONSOLIDATED			
	Retained profits	Asset revaluation reserve	Cash flow hedge reserve	Total members' funds
	\$'000	\$'000	\$'000	\$'000
Balance at 1 July 2016	442,871	2,445	(3,211)	442,105
Profit for the period	20,888	-	-	20,888
Other comprehensive income, net of tax				
Net gain taken to members' funds	-	-	2,180	2,180
Total comprehensive income	20,888	-	2,180	23,068
Balance at 31 December 2016	463,759	2,445	(1,031)	465,173
Balance at 1 July 2015	407,079	2,445	(5,673)	403,851
Profit for the period	17,814	-	-	17,814
Other comprehensive income, net of tax				
Actuarial loss on defined benefit plan	(415)	-	-	(415)
Net gain taken to members' funds	-	-	1,807	1,807
Total comprehensive income	17,399	-	1,807	19,206
Balance at 31 December 2015	424,478	2,445	(3,866)	423,057

Statement of Cash Flows

FOR THE HALF-YEAR ENDED 31 DECEMBER 2016

	Note	CONSOLIDATED	
		December 2016 \$'000	December 2015 \$'000
Cash flows from operating activities			
Interest received		181,041	186,359
Borrowing costs and interest paid		(97,966)	(113,270)
Other non-interest income received		17,450	19,153
Payments to suppliers and employees		(74,284)	(68,968)
Income tax paid		(8,666)	(8,048)
Proceeds from sale of financial planning and wealth operations		4,810	-
Net (increase) / decrease in loans and receivables and other receivables		(290,774)	10,576
Net increase / (decrease) in deposits and borrowings		351,493	(232,323)
Net cash flows from / (used in) operating activities		83,104	(206,521)
Cash flows from investing activities			
Net (increase) / decrease in investment securities and receivables due from other financial institutions		(84,951)	202,852
Proceeds from sale of property, plant and equipment		160	158
Acquisition of property, plant and equipment		(5,924)	(2,629)
Net cash flows (used in) / from investing activities		(90,715)	200,381
Net decrease in cash held		(7,611)	(6,140)
Cash at beginning of the period		103,743	196,911
Cash and cash equivalents at the end of the period	5	96,132	190,771

Notes to the half-year Financial Statements

1. Corporate information

The condensed consolidated financial statements of Heritage Bank Limited and the Consolidated Structured Entities (CSEs) for the six months ended 31 December 2016 was authorised for issue in accordance with a resolution of the directors on 16 February 2017.

Heritage Bank Limited is a for-profit entity. The parent entity, Heritage Bank Limited ("Heritage") is a mutual bank that is incorporated and domiciled in Australia. The nature of operations and principal activities of the Group is the provision of financial products and services to members.

2. Summary of significant accounting policies

The condensed consolidated financial statements do not include notes of the type normally included in an annual financial report and therefore cannot be expected to provide as full an understanding of the financial performance, financial position and financing and investing activities of the consolidated entity as the full financial report.

(a) Basis of preparation

The condensed consolidated financial statements for the six months ended 31 December 2016 have been prepared in accordance with AASB 134 Interim Financial Reporting.

The condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and

should be read in conjunction with the Group's annual financial statements as at 30 June 2016.

(b) Significant accounting policies

The accounting policies adopted are consistent with those used in the annual financial statements for the year ended 30 June 2016.

(c) Basis of consolidation

The Group refers to Heritage and the CSEs. The CSEs are made up of six trust vehicles that have been established for the purpose of securitising Heritage's loans.

3. Segment information

The Group operated predominantly in the finance industry within Australia. The operations comprise the provision of financial products and services to customers.

Notes to the half-year Financial Statements (continued)

4 Income and expenses

		CONSOLIDATED	
		December 2016 \$'000	December 2015 \$'000
4.1 Income			
Net interest income			
Interest revenue			
Deposits and investment securities		16,311	19,548
Loans and receivables		164,813	165,404
Add: Loan application fees		744	694
Less: Commission and agent direct costs		(6,069)	(5,844)
Less: Securitisation establishment costs		(249)	(257)
		175,550	179,545
Interest expense			
Deposits		80,763	83,700
Subordinated debt		1,399	1,469
Securitisation liabilities		13,212	16,726
Interest rate swaps		4,634	4,553
		100,008	106,448
Total net interest income		75,542	73,097
Other operating income			
Fees and commissions		17,714	16,577
Disposal of financial planning and wealth operations	(a)	4,537	-
Net gain/ (loss) on derivatives held at fair value		65	(172)
Impairment losses on loans recovered		291	182
Other		606	671
Total other operating income		23,213	17,258

- (a) On 11 December 2016 the sale of the financial planning and wealth operations was completed. The disposal is consistent with the Group's intention to focus on its core banking activities.

Information contained in this report should be read in conjunction with the June 2016 Financial Report

Heritage Bank Limited • Condensed Half-Year Financial Report 31 December 2016

Notes to the half-year Financial Statements (continued)

4 Income and expenses (continued)

		CONSOLIDATED	
		December 2016 \$'000	December 2015 \$'000
4.2 Expenses			
Employee benefits expense			
Salaries, wages and allowances		28,615	27,330
Net defined benefit fund expense		-	254
Contribution to accumulation fund		2,635	2,652
Other employee costs		5,668	5,484
Total employee benefits expense		36,918	35,720
4.3 Income tax amounts charged directly to equity			
Deferred income tax related to items charged directly to equity			
Cash flow hedges		(934)	(774)
Income tax expense on items of other comprehensive income		(934)	(774)
5 Cash and cash equivalents			
For the purpose of the half-year Statement of Cash Flows, cash and cash equivalents comprise the following:			
Cash at bank and on hand		48,100	65,739
Deposits at call		48,032	125,032
		96,132	190,771

Recognition and measurement

Cash and cash equivalents include cash on hand and deposits held with banks that have an original maturity of three months or less. Cash at bank earns interest at variable rates based on daily bank and short term deposit rates. Interest is recognised in the Statement of Profit or Loss using the effective interest method.

Notes to the half-year Financial Statements (continued)

6. Other notes

6.1 Fair value of financial instruments

Consolidated December 2016	Carrying amount	Fair value			
	\$'000	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value					
Foreign currency swaps	4,054	-	4,054	-	4,054
	4,054	-	4,054	-	4,054
Financial assets not measured at fair value					
Held to maturity financial assets	1,073,127	-	1,073,680	-	1,073,680
Loans and receivables	7,364,163	-	-	7,377,427	7,377,427
	8,437,290	-	1,073,680	7,377,427	8,451,107
Financial liabilities measured at fair value					
Interest rate swaps	1,472	-	1,472	-	1,472
Foreign currency swaps	37	-	37	-	37
	1,509	-	1,509	-	1,509
Financial liabilities not measured at fair value					
Term debt	428,242	-	431,861	-	431,861
Securitisation liabilities	848,170	-	851,317	-	851,317
Subordinated debt	49,697	-	50,073	-	50,073
	1,326,109	-	1,333,251	-	1,333,251

Notes to the half-year Financial Statements (continued)

6. Other notes (continued)

6.1 Fair value of financial instruments (continued)

Consolidated	Carrying amount	Fair value			
	\$'000	Level 1	Level 2	Level 3	Total
June 2016					
Financial assets measured at fair value					
Foreign currency swaps	297	-	297	-	297
	297	-	297	-	297
Financial assets not measured at fair value					
Held to maturity financial assets	1,003,978	-	1,002,337	-	1,002,337
Loans and receivables	7,064,232	-	-	7,079,775	7,079,775
	8,068,210	-	1,002,337	7,079,775	8,082,112
Financial liabilities measured at fair value					
Interest rate swaps	4,586	-	4,586	-	4,586
Foreign currency swaps	7,262	-	7,262	-	7,262
	11,848	-	11,848	-	11,848
Financial liabilities not measured at fair value					
Term debt	428,262	-	432,944	-	432,944
Securitisation liabilities	968,882	-	972,216	-	972,216
Subordinated debt	49,674	-	50,206	-	50,206
	1,446,818	-	1,455,366	-	1,455,366

Notes to the half-year Financial Statements (continued)

6. Other notes (continued)

6.1 Fair value of financial instruments (continued)

The following assets and liabilities have not been included in the table as their carrying amount is a reasonable approximation of fair value:

- Cash and cash equivalents
- Receivables due from other financial institutions
- Other receivables and other assets
- Other payables
- Deposits
- Bank borrowings

Recognition and measurement

The Group measures fair value using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

Level 1 – the fair value is calculated using quoted prices in active markets.

Level 2 – the fair value is estimated using inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).

Level 3 – the fair value is estimated using inputs for the asset or liability that are not based on observable market data.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. The following methods and assumptions are used to determine the net fair values of financial assets and liabilities.

Transfer between levels are deemed to have occurred at the beginning of the reporting period in which instruments are transferred. There were no transfers between levels during the half-year for the Group.

Valuation techniques used to determine fair values

Interest rate and foreign currency swaps

The Group enters into swaps with various counterparties who have investment grade credit ratings. The fair value is calculated as the present value of the estimated future interest cash flows based on observable yield curves. Other inputs include the credit quality of counterparties and foreign exchange spot and forward rates.

Held to maturity financial assets

The fair value for the held to maturity financial assets is based on the current quoted market price. For those assets where there is no quoted price the fair value is calculated as the present value of the estimated future interest cash flows based on observable yield curves.

Loans and receivables

The fair value is determined by adjusting the fixed rate loan portfolio for current market rates as at reporting date. For variable rate loans, the carrying amount is a reasonable estimate of the net fair value. The net fair value for fixed rate loans was calculated utilising discounted cash flow models based on the maturity of the loans. The discount rates applied were based on the current benchmark rate offered for the average remaining term of the portfolio as at 31 December 2016. Where observable market transactions are not available to estimate the fair value of loans, the fair value is estimated using valuation models such as discounted cash flow techniques. A counterparty default risk has also been assessed in determining the fair value.

Notes to the half-year Financial Statements (continued)

6. Other notes (continued)

6.1 Fair value of financial instruments (continued)

Recognition and measurement (continued)

Term debt, subordinated debt and securitisation liabilities

The fair value is determined by a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

Use of judgements and estimates

Where the fair values of financial assets and financial liabilities recorded in the Statement of Financial Position cannot be derived from active markets, they are determined using a variety of valuation models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available these assets are valued using valuation techniques based on non-observable data.

6.2 Commitments and contingencies

	CONSOLIDATED	
	December 2016 \$'000	June 2016 \$'000
Contingent liabilities		
Credit related commitments		
Approved but undrawn loans and credit limits	569,030	530,993

Recognition and measurement

In the normal course of business the Group enters into various types of contracts that give rise to contingent or future obligations. These contracts generally relate to the financial needs of customers. The Group uses the same credit policies and assessment criteria in making commitments and conditional obligations for off-balance sheet risks as it does for on-balance sheet loan assets. The Group holds collateral supporting these commitments where it is deemed necessary.

6.3. Significant events to reporting date

There are no significant events since the end of the half-year which will affect the operating results or state of affairs of the Group in subsequent years.

Directors' Declaration

In accordance with a resolution of the directors of Heritage Bank Limited, we state that:

In the opinion of the directors:

- (a) the condensed financial statements and notes of Heritage Bank Limited are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of Heritage Bank Limited's financial position as at 31 December 2016 and of its performance for the half-year ended on that date; and
 - (ii) complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001; and
- (b) there are reasonable grounds to believe that Heritage Bank Limited will be able to pay its debts as and when they become due and payable.

On behalf of the Board



KERRY J. BETROS
Chairman



DENNIS P. CAMPBELL
Deputy Chairman

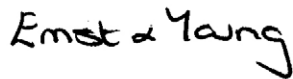
TOOWOOMBA
16 February 2017

Auditor's independence declaration to the directors of Heritage Bank Limited

As lead auditor for the review of Heritage Bank Limited for the half-year ended 31 December 2016, I declare to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
- b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Heritage Bank Limited and the entities it controlled during the financial period.



Ernst & Young



Paula McLuskie
Partner
16 February 2017

To the members of Heritage Bank Limited

Report on the condensed half-year financial report

We have reviewed the accompanying half-year financial report of Heritage Bank Limited, which comprises the statement of financial position as at 31 December 2016, the statement of profit or loss, the statement of comprehensive income, statement of changes in members funds and statement of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the half-year end or from time to time during the half-year.

Directors' responsibility for the half-year financial report

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Heritage Bank Limited and the entities it controlled during the half-year, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

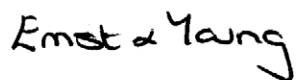
Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Heritage Bank Limited is not in accordance with the *Corporations Act 2001*, including:

- a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and of its performance for the half-year ended on that date; and
- b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.



Ernst & Young



Paula McLuskie
Partner
Brisbane
16 February 2017

20 February 2017

Heritage Bank reports record half-year profit growth

Heritage Bank has maintained excellent growth momentum in the first half of 2016/17, posting a record half-year profit and a strong lift in lending, CEO Peter Lock announced today.

Heritage's pre-tax profit for the six months to December 2016 was \$29.92 million, up 18.1% on the corresponding period the previous year. Profit after tax was \$20.89 million, an increase of 17.3%.

Loan approvals in this period totalled \$1.13 billion, an increase of 39.4% on the \$810.50 million achieved in the same period in 2015. As a result, Heritage's total loan portfolio grew by \$299 million, to reach \$7.362 billion.

Retail deposits grew by \$537.76 million in this period, up 385% on the \$110.89 million in the same period the previous year.

Mr Lock said Heritage's strong performance had come despite systemic constraints on the mutual sector that the Federal Government now had the blueprint to overcome.

"Mutual institutions like Heritage give customers great value but we're not competing on a level playing field with the big banks," Mr Lock said

"The Senate Inquiry into Cooperatives, Mutuals and Member-Owned Firms delivered a report in March last year outlining how to improve our competitiveness. The blueprint to fix the systemic barriers is there – all the Federal Government has to do is implement those reforms and give us a fairer chance to deliver better banking services to customers."

Mr Lock said even with these barriers, Heritage had maintained the strong growth momentum that had been generated at the end of 2015/16, and was delivering on its strategic goal to grow the business.

"Our results are very strong, and reflect our success in achieving the strategic goal of expanding our business. It's extremely pleasing that we have had such strong growth in our lending volumes, given the competitiveness of the marketplace. That growth has come both through our branch network in Queensland and through our broker partners nationwide.

"We will continue pursuing growth around the country as we set out to more firmly entrench the Heritage brand as an important player in Australia's home loan market."

The improved profit result was aided by proceeds from the sale of Heritage's financial planning business to Bridges Financial Services in December, but underlying profit remained ahead of the same period the previous year.

He said the profit result reflected both the flow-through from the growing loan portfolio and also Heritage's success in attracting retail deposits.

"Heritage offers extremely competitive term deposit rates, as we do with home loans as well, and our ability to attract retail deposits has had a positive impact on our margins. Growing our business helps us to continue our ongoing investment in improving the customer experience, particularly in enhancing our digital capabilities."

Loan portfolio growth helped lift total consolidated assets by 4.5% in this period to \$8.82 billion. The total capital adequacy ratio decreased minimally from 13.95% at 30 June 2016 to 13.78% at 31 December. The liquidity ratio also decreased slightly from 15.94% to 15.77% in the same period.

Chairman Mr Kerry Betros said Heritage had a clear strategy that was driving the business forward.

"We are focused on growing our lending volumes and our presence nationally, on the basis of delivering a great customer experience every time. We must make the banking experience simpler and give people better access to the modern banking channels that they expect.

"We are placing a high priority on improving our digital banking capabilities, while retaining the people first culture and personal service that our customers value so highly.

"We're also committed to living up to our vision of being passionate about helping people, by maintaining our high levels of community support. Our seven Community Branches have collectively put more than \$40 million back into their local communities in their history, and we support more than 120 community events and organisations in our footprint each year. We've also actively raised hundreds of thousands of dollars for charities through our annual Golf Day and support for other charitable activities.

"Heritage is a great bank, that's committed to the community, and well positioned to further drive our strategy of national growth."

Mortgage Loan arrears greater than 30 days sat at 0.42% of the total mortgage portfolio balance, further illustrating the quality of Heritage's loan book.

ENDS

For more information please contact:

Andrew Fox, Corporate Communications Manager, 0419 714 204; fox.a@heritage.com.au

For further Heritage information go to www.heritage.com.au