



NZX/ASX Release

Heartland publishes Annual Report and Notice of Meeting

30 September 2019

Heartland Group Holdings Limited (**Heartland**) (NZX/ASX: HGH) has today published its Annual Report for the year ended 30 June 2019 and the Notice of Meeting for its 2019 Annual Meeting.

Annual Report

Heartland is pleased to release its Annual Report for the year ended 30 June 2019. Heartland's Annual Report is made up of the Annual Review and Financial Report. These are being sent to shareholders today, copies of which are attached.

Notice of Meeting

Heartland's Annual Meeting will be held on Tuesday 12 November 2019 at Chateau on the Park (DoubleTree by Hilton), Riccarton, Christchurch commencing at 10am.

The Notice of Meeting and Voting/Proxy Form are being sent to shareholders today, copies of which are attached.

-ENDS-

For further information, please contact:

Michael Drumm
General Counsel
Heartland Group Holdings Limited
09 927 9136

Notice of 2019 Annual Meeting

ANNUAL MEETING 2019

**Heartland Group Holdings Limited invites you,
our shareholders, to join us at our annual meeting.**

The meeting will take place on Tuesday 12
November 2019 commencing at 10am (NZ time).
It will be held in Christchurch at Chateau on the
Park (DoubleTree by Hilton).

Dear Shareholders,

On behalf of the board, I am pleased to invite you to the 2019 annual meeting of Heartland Group Holdings Limited (**Heartland Group**) which is to be held on 12 November 2019 at 10am (New Zealand time) at Chateau on the Park (DoubleTree by Hilton) in Christchurch.

At this year's annual meeting, we will be updating you on Heartland Group's performance for the 2019 financial year and discussing Heartland Group's strategy and plans for future growth.

Jeff Greenslade and I will be retiring and standing for re-election at the annual meeting. Shareholders will be asked to vote on our re-elections as directors. The board unanimously supports our re-election. You can read about my background and Jeff's background in the explanatory notes to this notice of meeting.

If you are unable to attend the annual meeting, I encourage you to cast a postal vote or appoint a proxy to attend and vote at the annual meeting on your behalf. Your personalised voting form accompanies this letter.

For those shareholders who are attending the annual meeting, please bring the enclosed voting form with you to assist with your registration.

You are invited to join the board and senior management for light refreshments at the conclusion of the meeting. I look forward to seeing you there.

Yours sincerely



Geoffrey Ricketts
Chair of the board

Agenda for the Annual Meeting

- A. Chair's Welcome and Address**
- B. Chief Executive Officer's Review**
- C. Shareholder Discussion**
- D. Business**

To consider, and if thought fit, to pass the following resolutions:

Resolution 1: Re-election of Jeff Greenslade

That Jeff Greenslade, who retires by rotation and is eligible for re-election, be re-elected as a director of Heartland Group.

Resolution 1 is an ordinary resolution, requiring approval by a majority (being more than 50%) of the votes of those shareholders entitled to vote and voting.

Resolution 2: Re-election of Geoffrey Ricketts

That Geoffrey Ricketts, who retires by rotation and is eligible for re-election, be re-elected as a director of Heartland Group.

Resolution 2 is an ordinary resolution, requiring approval by a majority (being more than 50%) of the votes of those shareholders entitled to vote and voting.


Resolution 3: Auditor's remuneration

That the board be authorised to fix the remuneration of Heartland Group's auditor, KPMG, for the financial year ending 30 June 2020.

Resolution 3 is an ordinary resolution, requiring approval by a majority (being more than 50%) of the votes of those shareholders entitled to vote and voting.

A brief description of each resolution is included in the explanatory notes. The board unanimously supports each resolution.

On behalf of the board,



Geoffrey Ricketts
Chair of the board

30 September 2019

Explanatory Notes – Resolutions 1 and 2:

Re-election of Jeff Greenslade & Geoffrey Ricketts

Heartland Group's constitution and the NZX Listing Rules require each director to retire by rotation at least every three years. Although the Heartland Group directors do not need to rotate this year (given they were only appointed last year), the board considers it is prudent to start the rotation this year so that, going forward, two directors will rotate each year. Accordingly, this year Jeff Greenslade and Geoffrey Ricketts are standing for re-election.

Biographies for Jeff Greenslade and Geoffrey Ricketts are set out on the next page, together with a list of their current directorships.

Explanatory Notes – Resolution 3:

Auditor's Remuneration

KPMG will be automatically reappointed as Heartland Group's auditor under section 207T of the Companies Act 1993. It is proposed that the board be authorised to fix KPMG's remuneration for the year ending 30 June 2020 in accordance with section 207S of the Companies Act 1993.

Jeff Greenslade

LLB



Heartland Group Executive Director and Chief Executive Officer

Term of office

Appointed 31 October 2018

Board committees

Member of the Heartland Group Corporate Finance Committee.

Jeff joined the Heartland Group as Chief Executive Officer of MARAC Finance Limited (MARAC) in 2009 and successfully guided the merger of Southern Cross Building Society, CBS Canterbury and MARAC to become Heartland in 2011.

Together with the board, Jeff has set the strategy for Heartland focusing on delivery of best or only products to markets that are under-served by the other banks using low cost intermediated, direct and digital channels.

Jeff is a member of Champions for Change, an organisation facilitating the exchange of ideas with peers of appropriate ways to improve diversity and inclusion.

Current directorships

Heartland Group Holdings Limited, Heartland Bank Limited, Heartland PIE Fund Limited.

Geoffrey Ricketts

CNZM, LLB (Hons), LLD (honoris causa), CFInstD



Heartland Group Chair and Independent Non-Executive Director

Term of office

Appointed 31 October 2018

Board committees

Chair of the Heartland Group Corporate Governance, People, Remuneration and Nominations Committee, Chair of the Heartland Group Corporate Finance Committee, member of the Heartland Group and Heartland Bank Audit Committees and member of the Heartland Group Risk Committee.

Geoff is a company director and investor with wide experience in the New Zealand and Australian business environments. He holds a number of directorships, including Chair of Todd Corporation Limited, Chair of Suncorp Group (NZ) Limited and Vero Insurance New Zealand Limited. Geoff chairs The University of Auckland Foundation and is a strong supporter of community and philanthropic activities, particularly in relation to the arts and education in New Zealand.

Current directorships

Heartland Group Holdings Limited, Heartland Bank Limited, Quartet Equities Limited, Oceania and Eastern Holdings Limited (and associated companies), Suncorp Group Holdings (NZ) Limited (and associated companies), Vero Insurance New Zealand Limited (and associated companies), Asteron Life Limited, JANMAC Capital Limited, Mercury Pharmacy Holdings Limited (and associated companies), The Todd Corporation Limited (and associated companies), Maisemore Enterprises Limited, NZCEO Finance Limited, New Zealand Catholic Education Office Limited, The Centre for Independent Studies Limited.

Procedural Notes

Voting

Voting at the meeting will be decided by a poll. Each shareholder will be entitled to one vote for every share held as at 5pm (New Zealand time) on 8 November 2019.

Your right to vote may be exercised by:

- attending the meeting and voting in person;
- submitting a postal vote; or
- appointing a proxy (or representative) to attend the meeting and vote in your place (**Proxy**).

If you are attending the meeting, please bring the enclosed voting form that will act as your admission card to the meeting.

How to submit a postal vote or appoint a proxy

If you are not able to attend the annual meeting, but wish to submit a postal vote or appoint a Proxy to attend the meeting and vote on your behalf, you can:

- lodge your postal vote or appoint a Proxy online at <https://investorcentre.linkmarketservices.co.nz/voting/HGH>. You will be required to enter your CSN/Holder Number and Authorisation Code (**FIN**). If you do not have a FIN number, please contact Link Market Services at 09 375 5998 or enquiries@linkmarketservices.co.nz; or
- complete and return your voting form in accordance with the instructions on the voting form.

Your completed voting form must be received by Link Market Services, or your postal vote or your Proxy appointment lodged online, by no later than 10am (New Zealand time) on 8 November 2019.

If you wish, you may appoint the Chair of the meeting as your proxy. To do so, please write “Chair of the meeting” in the relevant section. The Chair will vote according to your instructions. If the Chair is not instructed how to vote, the Chair will vote as he or she thinks fit.

Shareholder questions prior to the annual meeting

Shareholders present at the annual meeting will have the opportunity to ask questions during the meeting. If you cannot attend the annual meeting but would like to ask a question, you can submit a question by emailing shareholders@heartland.co.nz. Shareholder questions will need to be submitted by 5 November 2019. Questions should relate to matters being addressed at the annual meeting.



↖ Airport

FENDALTON RD

Avon River

Ōtākaro

Christchurch Girls' High School

Hagley Park North

HARPER AVE

MATAI ST EAST

CHATEAU ON THE PARK

DARVEL ST

KILMARNOCK ST

DEANS AVE

Venue and Parking Information

The meeting is being held in the Great Hall at Chateau on the Park (DoubleTree by Hilton), **189 Deans Avenue, Riccarton, Christchurch**. Free parking is available via Darvel Street, Deans Avenue and Kilmarnock Street entrances. The Great Hall is located on the right from the hotel foyer via the South Gallery.

← University

CBD →

AYR ST

RICCARTON RD

RICCARTON AVE

HEARTLAND GROUP HOLDINGS LIMITED

2019 ANNUAL MEETING

Chateau on the Park (DoubleTree by Hilton) Christchurch.
10.00am Tuesday 12 November 2019



HOW TO LODGE YOUR POSTAL VOTE/PROXY APPOINTMENT:

Online: <https://investorcentre.linkmarketservices.co.nz/voting/HGH>

Email: meetings@linkmarketservices.co.nz

Mail: Use the enclosed reply paid envelope or send to:
Link Market Services Limited
PO Box 91976, Auckland 1142, New Zealand

Deliver: Link Market Services Limited
Level 11, Deloitte Centre, 80 Queen Street, Auckland 1010

Fax: +64 9 375 5990

Scan this QR Code with your
smartphone and vote online

ADMISSION CARD

If you are attending the meeting, keep this form intact and bring it to the meeting for registration purposes.

If you are not attending the meeting, but wish to make a postal vote or appoint a proxy, you can do so online or by completing and returning this form to Link Market Services Limited. It must be received by no later than 10am on Friday, 8 November 2019.

SIGNING THIS FORM

If your shares are held by:

- (a) an individual, this form must be signed by the individual (or his or her duly authorised attorney);
- (b) a company, this form must be signed by a duly authorised signatory of the company (including a director);
- (c) a trust, this form should be signed as above by at least one trustee in accordance with the relevant trust deed (in accordance with (a) or (b) above, as applicable if the trustee is an individual or a company);
- (d) a partnership, this form should be signed by at least one partner in accordance with the rules governing the partnership (in accordance with (a) or (b) above, as applicable if the partner is an individual or a company); or
- (e) joint shareholders, this form should be signed by at least one joint shareholder (or as otherwise required by the arrangements between the joint shareholders) in accordance with the relevant method for that joint shareholder set out above.

If this form is completed by an attorney or representative, a copy of the power of attorney or letter of appointment of representative (unless previously provided), must accompany this form together with a completed certificate of non-revocation of authority.

POSTAL VOTING

If you are entitled to vote at the meeting, you may cast a postal vote by ticking the Postal Vote box, completing the Resolutions section and signing and returning this form. Alternatively, you can cast your postal vote online.

If you return a postal vote without indicating how you wish to vote on a resolution, you will be deemed to have abstained from voting on that resolution. If you lodge a postal vote and also appoint a proxy, your postal vote will take priority over your proxy appointment.

APPOINTING A PROXY

If you are entitled to vote at the meeting, you may appoint a proxy by completing the Appointment of Proxy and Resolutions sections and signing and returning this form. Alternatively, you can appoint a proxy online. If you return this form without appointing a proxy, it will be treated as a postal vote.

A Proxy does not have to be a Heartland Group Holdings Limited shareholder. If your Proxy does not attend the meeting, your vote will not be counted (unless you have cast a postal vote before the meeting).

If you appoint a proxy to vote on your behalf and tick the "Proxy's Discretion" box for a resolution, or do not direct your proxy how to vote on a resolution, your proxy will vote as he/she sees fit on that resolution. If you wish, you may appoint the Chair of the meeting as your proxy. To do so, please write "Chair of the meeting" in the Appointment of Proxy section. The Chair will vote according to your instructions. If the Chair is not instructed how to vote, he will vote as he thinks fit.

POSTAL VOTE

COMPLETE THIS SECTION IF YOU WILL NOT ATTEND THE MEETING BUT WISH TO CAST A POSTAL VOTE OR DIRECT YOUR PROXY HOW TO VOTE AT THE MEETING

☐ I/We wish to vote by Postal Vote (please tick the box).

APPOINTMENT OF PROXY

COMPLETE THIS SECTION IF YOU WILL NOT ATTEND THE MEETING BUT WISH TO APPOINT SOMEONE TO ATTEND ON YOUR BEHALF

I/We being a shareholder/s of Heartland Group Holdings Limited hereby appoint:

Full name _____ of _____

as my/our proxy (or representative, if a body corporate) to attend the meeting on my/our behalf and any adjournment of the meeting and to vote on my/our behalf at the meeting and any adjournment of the meeting in accordance with my/our directions below.

RESOLUTIONS

Cast a postal vote, or instruct a proxy to vote, by placing a tick in the relevant box.

If you have appointed a proxy and want him/her to decide how to vote on the resolution, tick the box "Proxy's Discretion".

Proxy's discretion is not applicable for a postal vote.

| | For | Against | Proxy's Discretion | Abstain |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
| 1. That Jeff Greenslade, who retires by rotation and is eligible for re-election, be re-elected as a director of Heartland Group. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. That Geoffrey Ricketts, who retires by rotation and is eligible for re-election, be re-elected as a director of Heartland Group. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. That the board be authorised to fix the remuneration of Heartland Group's auditor, KPMG, for the financial year | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

SIGNATURE OF SHAREHOLDER(S)

Signature(s) of shareholder(s)

Signature(s) of shareholder(s)

Signature(s) of shareholder(s)

/ /2019

Date of signing

Day time contact phone no.

ELECTRONIC INVESTOR COMMUNICATION

If you received the Notice of Meeting and this form by mail and would like to receive all future shareholder communications electronically (by email) where possible, please write your email address below

Email _____

**Mahi
tika
Mahi
tahi
Mahi
toa
Mahi
tipu**

**Our mātāpono
(values) underpin who
we are and everything
we do. They were
created by our people
to be shared with our
customers, partners,
communities and
shareholders.**



Mahi tika

DO THE RIGHT THING
Kia tika, kia pono. Do what's
right and true.



Mahi tahi

BE ONE TEAM
He waka eke noa. We're all
in this together.



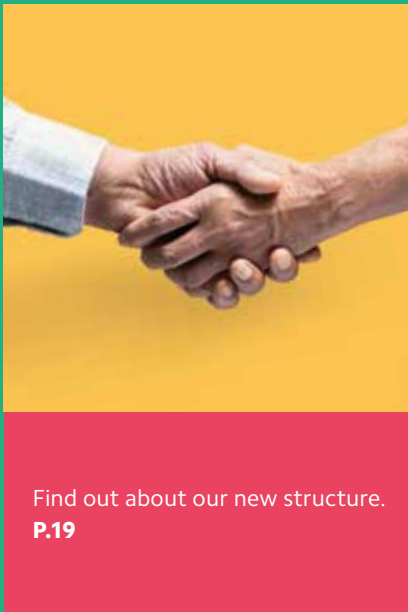
Mahi toa

HAVE BIG AMBITION
Tū whitia te hopo. Feel the
fear and do it anyway.



Mahi tipu

BE ALWAYS EVOLVING
Whāia te iti kahurangi.
Strive for excellence.



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STRIVE FOR EXCELLENCE

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**FEEL THE FEAR AND
DO IT ANYWAY**

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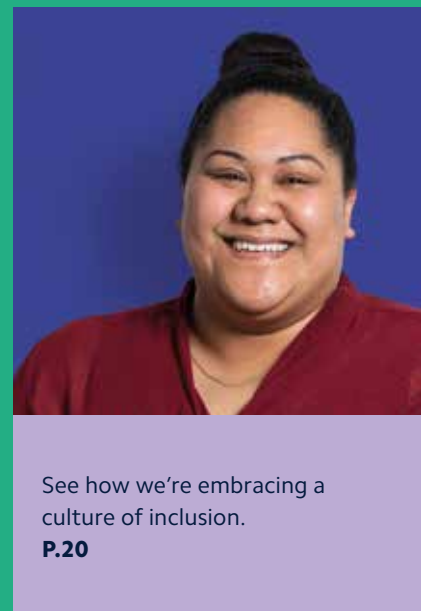
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DIRECTORY





Find out how we keep our customers at the heart of everything we do.

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Our whakapapa goes back nearly 150 years and we're always evolving – mahi tipu. We're constantly looking for new ways to grow, deliver more for our customers and adapt to their needs.

WHĀIA TE ITI KAHURANGI



Kia ora

STRIVE FOR EXCELLENCE

We have big ambition – mahi toa. This last year we said kia ora to a new structure, new products and new markets. We enhanced our digital platforms, renewed focus on the values which underpin our culture and took our customer experiences to new heights.



Find out more about our digital developments.

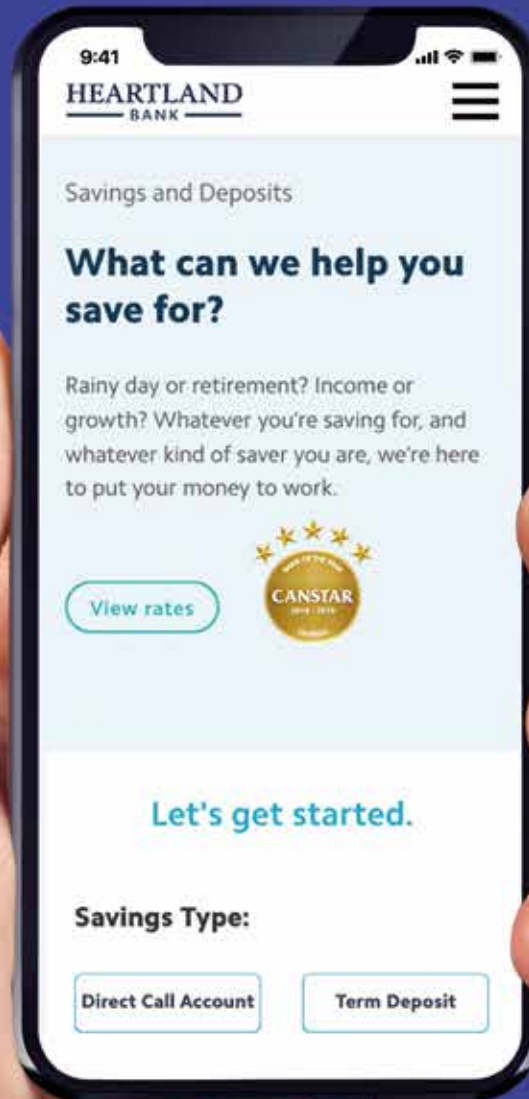
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Read what our Chair and CEO have to say about the year that's been and what's ahead.

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TŪ WHITIA TE HOPO





Find out how we're building a sustainable business.

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For the year ahead, our sights are set on welcoming more customers through even better customer experiences, benefits and outcomes. We're confident this focus will deliver greater opportunities for our people and more value for our shareholders.

FEEL THE FEAR AND DO IT ANYWAY

Heartland



See our results for the 2019 financial year.

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2019 Results

- 1 Total shareholder return (TSR) means share price appreciation plus dividends received. TSR has been calculated including the benefit of imputation credits.
- 2 KPMG FIPS Report March 2019.

DELIVERING SHAREHOLDER VALUE

Total shareholder return of 132% for the five years ending 30 June 2019¹.

↑ **132%**

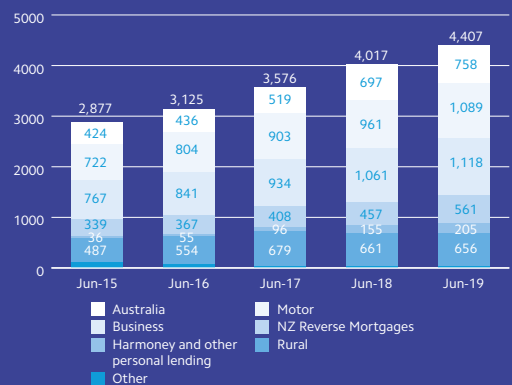


STRONG GROWTH ACROSS THE GROUP

Growth in gross finance receivables of 10.5% to \$4.4 billion.

↑ **10.5%**

Gross finance receivables (\$million)

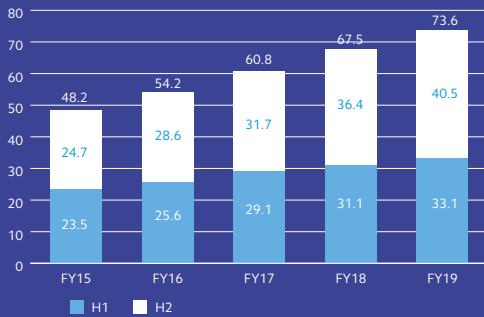


PROFITABILITY CONTINUES TO INCREASE

Net profit after tax of \$73.6 million,
an increase of 9.0%.

↑ 9.0%

Net profit after tax



11.1%

RETURN ON
EQUITY

13.0

CENTS PER SHARE
Earnings per share

6.5

CENTS PER SHARE
Final dividend declared

10.0

CENTS PER SHARE
Total dividend for the year

BBB

HEARTLAND BANK
CREDIT RATING
(FITCH RATING)
Outlook Stable
Investment Grade



CONSISTENTLY HIGH NET INTEREST MARGIN

Net interest margin of 4.33% - higher than our
banking peers².

4.33%

Our business

Reverse Mortgages



AUSTRALIA

- Gross finance receivables \$757.6m, up 24.0%.
- Distributed through brokers and our sales team in Australia.

NEW ZEALAND

- Gross finance receivables \$561.2m, up 11.4%.
- Primarily distributed through our sales team in New Zealand.

Motor Vehicle Finance



- Gross finance receivables \$1,088.6m, up 13.3%.
- Distributed direct to customers and through our motor vehicle dealer network to enable customers to access finance at the point of sale.

1,318.8M

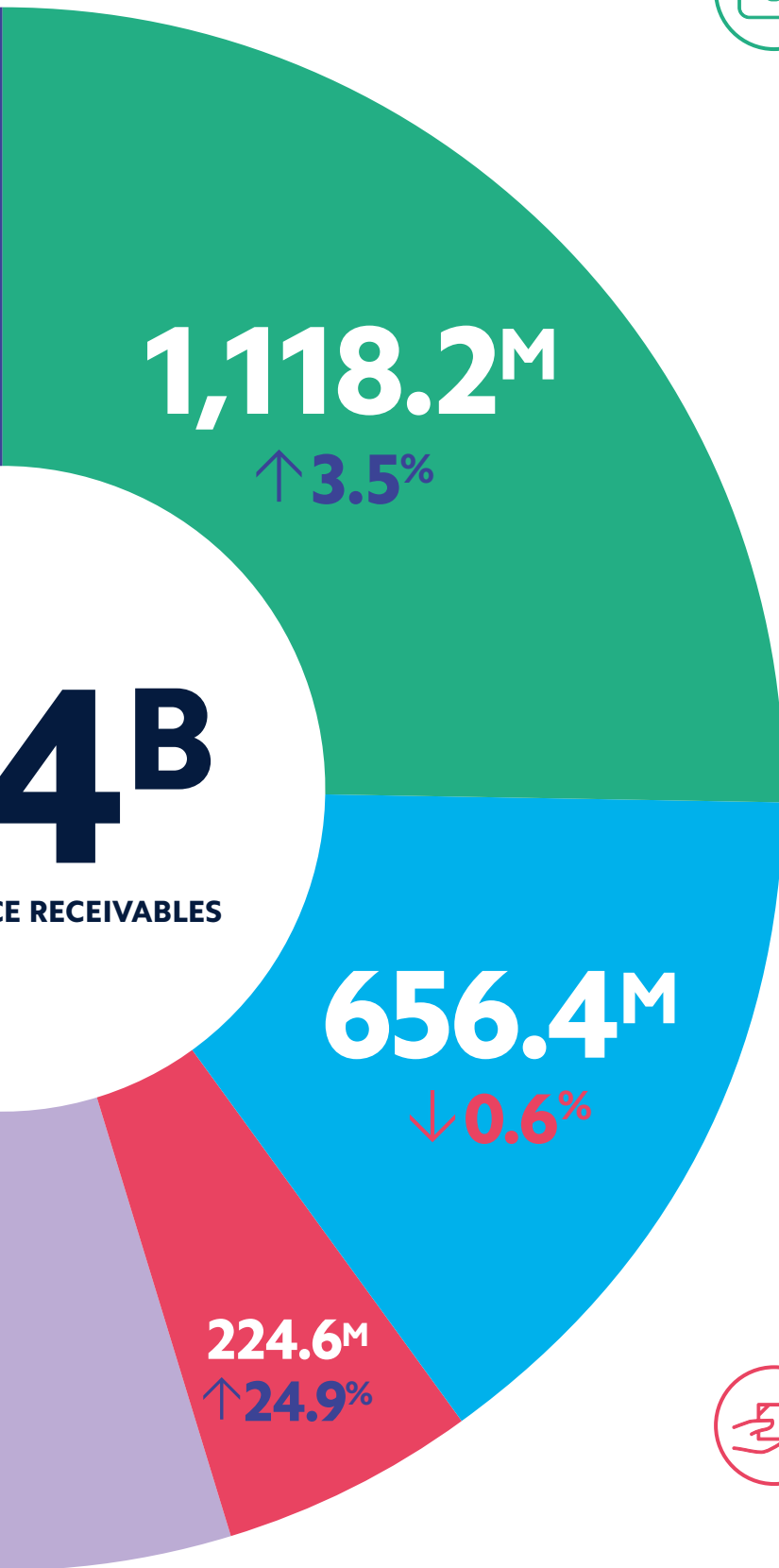
↑19.4%

4.4

GROSS FINANCE

1,088.6M

↑13.3%



Business Finance

OPEN FOR BUSINESS

- Gross finance receivables \$133.3m, up 48.2%.
- Finance for small-to-medium sized businesses available online through Heartland's digital Open for Business platform.

BUSINESS INTERMEDIATED

- Gross finance receivables \$425.4m, up 31.4%.
- Working capital and plant and equipment finance distributed through our partners and intermediaries.

BUSINESS RELATIONSHIP

- Gross finance receivables \$559.4m, down 16.1%.
- Working capital and plant and equipment finance distributed through our relationship managers.



Rural Finance

LIVESTOCK FINANCE

- Gross finance receivables \$121.6m, up 18.8%.
- Livestock finance for farmers available online through Heartland's Open for Livestock platform.

RURAL RELATIONSHIP

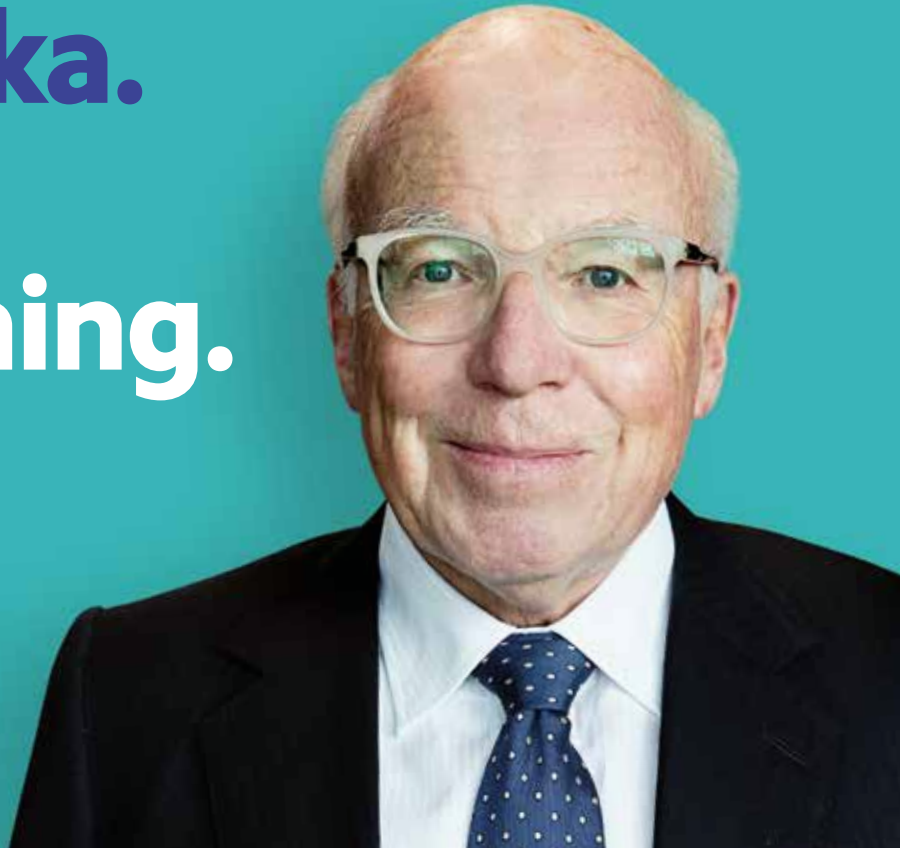
- Gross finance receivables \$534.8m, down 4.2%.
- Rural loans distributed through Heartland's relationship managers.



Harmony and other consumer lending

- Gross finance receivables \$224.6m, up 24.9%.
- Distributed through intermediary partners and brokers, and enabled by Heartland's partnership with Harmony.

Mahi tika. Do the right thing.



INCREASE IN PROFITABILITY
FOR HEARTLAND.

On behalf of the Board, it is my pleasure to report another successful year for Heartland. The Group delivered a net profit after tax of \$73.6 million, representing an increase of 9.0% in profitability. At the centre of Heartland's continued growth is an intensified focus on our customers and support for the communities we serve.

KEEPING CUSTOMERS AT OUR HEART

Doing the right thing for our customers is essential to building a sustainable, successful business. We build a strong foundation for this when we keep our customers' needs at heart and focus on their long-term outcomes in everything we do. Doing the right thing is something we pride ourselves on, and is reflected in one of Heartland's mātāpono (values) – mahi tika.

Heartland is proud to offer products that can contribute to positive social outcomes. Examples of this include through our Heartland Reverse Mortgage, both in New Zealand and Australia, which provides people with the ability to enjoy a more comfortable retirement in their own home – a place that so often connects people with their friends, family and community.

Heartland's small business loans are another great example – we recognise the crucial role these businesses play in our economy. We support the growth of these businesses, helping the owners to reach their goals with secured or unsecured loans – meaning they don't have to mortgage the family home to finance their business.

The financial services sector has seen considerable regulatory activity this financial year with the FMA and RBNZ reporting on their findings following a review of conduct and culture in New Zealand retail banks. Overall, the findings from the review concluded that there does not appear to be widespread conduct and culture issues in New Zealand banks¹, but there is room for improvement.

Heartland 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 across the organisation.

\$617.3k

**PAID TOWARDS SPONSORSHIP AND
COMMUNITY ACTIVITIES THIS YEAR
BY THE HEARTLAND TRUST.**

SUPPORTING OUR COMMUNITIES

Heartland recognises the responsibility it has to the communities in which we serve and aims to give back and provide a positive social impact through a range of sponsorships from the Heartland Trust².

This year, the Heartland Trust continued its support of education through the InZone Education Foundation which aims to enhance the educational outcomes of Māori and Pasifika youth by providing them opportunities to access high-performing state schools through boarding hostels within school zones.

As part of our support of InZone, Heartland's internship programme continued, this time welcoming 20 students into paid internship positions over their summer holiday. The internship programme has been a success so far, leading to seven interns continuing employment with Heartland Bank, and we look forward to welcoming more students in December.

Furthering our support of te reo Māori and education, the Heartland Trust this year began sponsorship of Te Matatini festival (New Zealand's national kapa haka festival held every two years), and the Kupe Leadership Scholarship (a scholarship which aims to develop our country's future leaders).

Mental wellbeing is another area of high importance to Heartland, and this year the Heartland Trust continued to sponsor Lifeline (a confidential phone line service for New Zealanders going through difficult times) and Auckland City Mission's HomeGround project (a purpose-built facility which aims to provide much needed support to those who need it most).

¹ 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".

² The Heartland Trust is a registered charitable trust which is independent from, but closely supported by, Heartland Bank and Heartland Group.

This year was the Heartland Trust's third year as the platinum sponsor of the Auckland Writer's Festival which once again featured a variety of speakers from a range of backgrounds. We're proud to sponsor an event that caters to a diverse audience, encouraging and inspiring people to fall in love with the written word.

This year, the Heartland Trust paid \$617,309 towards sponsorship and community activities.

BOARD APPOINTMENTS

During the year, we welcomed Kate Morrison to the Heartland Bank Board as an independent director. Kate brings outstanding leadership and governance experience, further diversifying the Board's skill set.

Kate has 20 years of experience of working in investment banking and co-runs a Christchurch-based consulting business, advising SMEs on succession planning, strategy and governance, as well as holding directorships with a number of companies.

CREATING SHAREHOLDER VALUE

The Board resolved to pay a fully imputed final dividend of 6.5 cents per share on Friday 6 September 2019 to all shareholders on Heartland's register at 5.00pm on Friday 23 August 2019.

Together with the interim dividend of 3.5 cents per share, the total dividend for the year was 10.0 cents per share, an increase of 1.0 cent per share from the total dividend for 2018.

Total shareholder return³ (TSR) was 132% for the five years ending 30 June 2019, compared with TSR of 104% for the NZX50. This is an excellent outcome for our shareholders.

OUTLOOK

The Board is confident in Heartland's ability to continue achieving strong growth and profitability, while maintaining positive outcomes for customers. Heartland expects its net profit after tax for the year ending 30 June 2020 to be in the range of \$77 million to \$80 million.

Finally, I wish to thank the Heartland team for their significant efforts this year in helping Heartland continue to deliver value to its customers, communities and shareholders.



Geoff Ricketts

Chair

³ Total shareholder return (TSR) means share price appreciation plus dividends received. TSR has been calculated including the benefit of imputation credits.

Mahi toa. Have big ambition.



FROM THE CEO

Heartland achieved another strong year of growth. Importantly, we also made great progress towards non-financial goals. In particular, our renewed Heartland mātāpono (values) reflect the importance we place on diversity, inclusion, and supporting the wellbeing of our people while keeping our customers' needs at the forefront of our business decisions.

FINANCIAL PERFORMANCE

Heartland's Net Profit after Tax (**NPAT**) was \$73.6 million (9% increase) and was impacted by one-off costs of \$4.2 million associated with the corporate restructure and ASX listing. We consider this to be a good financial result.

A Net Interest Margin (**NIM**) of 4.33% was achieved for the year. The NIM was 0.09% lower than the previous financial year despite relatively strong growth in lower margin reverse mortgages and \$1.1 million of break costs incurred due to the early repayment of the Tier 2 Australian dollar subordinated bond. Excluding the break costs, NIM was 4.35%.

Return on Equity (**ROE**) was 11.1%, unchanged from the previous financial year. However, ROE in the second half of this financial year improved to 12.2% from 10.3% in the first half. Net Tangible Assets (**NTA**) increased by \$9.0 million to \$593.5 million. NTA per share was \$1.04, unchanged from the previous financial year.

Continued efficiencies leveraged through scalable growth, digital initiatives and cost control resulted in a cost to income ratio of 41.6%. Excluding one-off costs related to the corporate restructure and ASX referred to above, the cost to income ratio was 39.9% – an improvement from 40.9% the prior year.

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, impairment expense for this year was not directly comparable to the previous year primarily due to the new requirement to provide for impairment losses on all loans, not just those past due or impaired. This particularly impacted Harmony and Motor which had high growth and, in the case of Harmony, higher expected loss rates than other segments.

GROWTH ACROSS THE GROUP

Our ambitions are big. Heartland's attention remains on providing banking and financial products to people who have traditionally been under-served by mainstream banks. We do this across our three areas of strategic focus: New Zealand Banking, Australian Reverse Mortgages and Digital.

NEW ZEALAND BANKING

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

Strong growth was achieved in **New Zealand Reverse Mortgages**, with net receivables growing by 11.4%. Reported growth increased 22.8% to \$561.2 million due to \$54.7 million of Australian Reverse Mortgages being transferred from Australia to New Zealand, offset by an adverse foreign exchange impact of \$2.0 million. There are significant growth opportunities for New Zealand Reverse Mortgages and increased investment in marketing is planned for the 2020 financial year to raise product awareness.

Heartland's **Motor vehicle finance** book continued its strong growth with a 13.3% increase in net receivables through motor dealer lending (car dealerships, brokers and partnerships such as Holden and Jaguar Land Rover).

Business Intermediated lending continues to deliver growth, with net receivables up 31.4%. Business Relationship lending continues to be managed down as part of our strategy to reduce low margin risk concentration. Accordingly, Business Relationship receivables reduced by \$107.0 million.

Open for Livestock is Heartland's livestock finance online channel which helps farmers to purchase and trade livestock without having to mortgage their farm. **Livestock Finance** receivables increased 18.8%. Overall Rural receivables decreased by 0.6% as Heartland continues to manage down larger **Rural Relationship** lending to reduce low margin risk concentration in this area.

Retail deposits increased by \$271.9 million (9.4% growth) to \$3.2 billion. Heartland continues to provide market leading call account 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. For the second year in a row, Heartland was awarded Canstar's 2019 Bank of the Year – Savings Award, and for the fourth year in a row, Heartland's Direct Call Account was awarded Canstar's 5-Star Rating for Outstanding Value Savings Account.

This year we also entered into a new Retail market with the launch of YouChoose – a savings account with an arranged overdraft. YouChoose offers customers the flexibility to save when they can and spend when they want to with competitive savings and overdraft interest rates.

AUSTRALIAN REVERSE MORTGAGES

Australian Reverse Mortgage net receivables increased by 24.0%, 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 the transfer of reverse mortgages to New Zealand and an adverse foreign exchange impact of \$31.0 million.

Reflecting the work our team does to enable people to live a more comfortable retirement while staying in their home, our Australian Reverse Mortgages business was awarded Best Reverse Mortgage 2019 by Money Magazine for the fourth consecutive year.

DIGITAL

We continue to evolve into a financial technology group with a bank licence, from a conventional bank. This distinction ensures a focus on customer experience which we believe is integral to good customer outcomes.

Our digital strategy aims to make products more easily available to customers through online channels, and to achieve low cost reach to a broad target market. Uptake of the Heartland Mobile App continues to rise, increasing by 72% in the six months from January to June 2019.

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

Open for Business (O4B) is Heartland's digital-led small business lending product. The product supports small businesses to grow with secured or unsecured finance. O4B lending was up 48.2% this financial year. In July 2019 a new television campaign, accompanied by other marketing activity, was launched to grow product awareness and target market reach.

CORPORATE RESTRUCTURE

The corporate restructure was completed in October 2018. All of the shares in Heartland Bank were exchanged for shares in Heartland Group, and Heartland Bank became a wholly owned subsidiary of Heartland. In addition, the Australian group companies were transferred from Heartland Bank to Heartland Group.

The corporate restructure provides greater flexibility for growth and access to funding options in New Zealand and Australia.

MANAGEMENT CHANGES

During the year, Heartland welcomed Cherise Barrie to the role of Chief Financial Officer. Cherise is a Chartered Accountant with significant financial service and executive experience, and is a passionate advocate of women in business, being a member of Global Women.

This year we also reviewed our internal structure and made changes to our Business Enablement and Technology teams, establishing these teams as separate functions to enable greater investment in these areas to set them up to better support the business and our customers.

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

HE MANAWA TANGATA – OUR PEOPLE

This year, we refreshed Heartland's mātaḗpono (values).

The mātaḗpono underpin a culture that strives for excellence (mahi tipu) and respects the diversity we each bring to the workplace. Heartland must be a place where people feel included and value each other's differences (mahi tahi). Doing the right thing for our customers, communities and shareholders

(mahi tika) is paramount in an ever changing environment, where we continue to evolve to meet their needs and expectations.

This year we continued to improve the gender balance across the organisation, including increasing the number of females on the strategic management group to 37.5% male and 62.5% female.

Our internship initiative ran for the second year, this time welcoming 20 Māori and Pasifika students to work at Heartland. See more information in our 'Embracing a culture of inclusion' story on page 20.

In 2018, Heartland also began working towards achieving the Rainbow Tick, and our Diversity Committee continued to celebrate the diversity of our people by holding events recognising Diwali, Matariki, Chinese New Year and Māori Language and Samoan Language Weeks, among many other events and initiatives to help create a safe, welcoming and inclusive environment.

LOOKING FORWARD

In the coming year, we expect to see continued asset growth from core lending activities, 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.

We will continue to invest in growth through increased marketing activity to build awareness and by increasing processing capacity in areas of new growth.

A lot has been achieved in the past year. I would like to take this opportunity to thank our people for living our Heartland mātaḗpono. I also wish to thank our shareholders for their continued support of Heartland.

Ngā mihi nui,



Jeff Greenslade
Chief Executive Officer

Nā te kaiwhakahaere matua

He tau hāwera anō tēnei mō Heartland. Mātua rā, i pai te ahunga whakamuatanga i te wāhi ki ngā whāinga utukore. Pēnei i te whakahoutanga o ngā mātāpono o Heartland, e whai nei ki te whakanui i te kanorau, i te whakakotahitanga, me te tautoko i te oranga tonutanga o ō mātou kaimahi, i a mātou e whakamātāmua ana i ngā hiahia o te kiritaki mō ngā whakatau ā-pakihi.

HE KITENGA PŪTEA

I te \$73.6 miriona ngā Painga More i muri i te Tāke (PMMT) a Heartland (9% te pikinga), ā, i tukia e ngā utu tukutahi o te \$4.2 miriona. E whai pānga ana tēnei utu ki ngā panonitanga ā-pakihi me te rārangi ASX. Ki a mātou nei, he pai te hua i puta.

I tae te nui o te Paenga Huamoni More (PHM) ki te 4.33%, 0.09% noa iho te hekenga nō tērā tau pūtea, ahakoa te tipunga nui i te mōkete tauaro hauraro me tētahi pūtea tukuwehe \$1.1 miriona, nā te whakahoki wawe o te pūtea ki te pūtea taurewa Ahitereiria Taumata 2. Ka kore ana e aro ki ēnei utu, kei te 4.35% te PHM.

I te 11.1% te Whakahokinga Tūtanga (WT), kāhore he rerekētanga nō tērā tau pūtea. Heoi, i pai ake te wāhanga tuarua o te tau pūtea, i eke ki te 12.2% mai i te 10.3% nō te wāhanga tuatahi o te tau. I piki ngā Rawa Tūturu More (RTM) mā te \$9.0 miriona, ki te \$593.5 miriona. Ko te utu o ia hea RTM ko te \$1.04, kāhore he rerekētanga nō tērā tau pūtea.

Nā te toaitanga o ngā mahinga i eke ai i roto i ngā pūtea aupiki auheke, ā, ko te ōwehenga utu ki te whiwhinga pūtea ko te 41.6%. Hāunga ngā utu tukutahi e whai pānga ana ki ngā panonitanga ā-pakihi me ngā kōrero ASX o runga ake, ko te ōwehenga utu ki te whiwhinga pūtea ko te 39.9% - he pai ake i te 40.9% nō tērā tau.

I te 1 o Hōngongoi 2018, i whakaturehia te paerewa kaute hou e whai pānga ana ki ngā whakahauātanga, IFRS9. I te paerewa nei, me tuku ngā whakahauātanga me ngā whakakitenga o ngā whakangarotanga hei te rangi ka mana te pūtea taurewa. Me te aha, kāore i taea te whakataurite hāngai i ngā utu whakahauātanga o tēnei tau ki ngā utu o tērā tau, nā tēnei paerewa hou, ki te whakaora i ngā ngarohanga whakahauā i ngā pūtea taurewa katoa, kua noa iho i ngā pūtea taurewa tārea,

whakahauā rānei. Ko Harmony me Motor i tino whai pānga ki tēnei. I tino tipu a Motor, ā, nā Harmony ngā whakakitenga whakangarohanga tiketike tēnā i ētahi atu wāhi.

TE WHAKATIPURANGA WHĀNUI

Kei ngā rangi ō mātou whakaeaea. Ka aro tonu a Heartland ki te tuku i ngā āhuatanga pūtea katoa ki ngā tangata, i ōna wā, kua noho-mūhore ki ngā pēke auraki. Koinā tā mātou i ngā wāhanga aronui e toru: Te mahi pēke i Aotearoa, Ngā mōkete tauaro o Ahitereiria, Te Pae Mamati.

TE MAHI PĒKE I AOTEAROA

Ko tā Heartland he aro ki te kounga o te tuku i ngā hua katoa ki ngā kaiwhakakuhu pūtea me ngā kaitono pūtea taurewa mā te whakatipu i ngā mākete motuhake.

He nui te tipu i te wāhanga **Mōkete Tauaro o Aotearoa**. I tipu ngā raumata nama mai mā te 11.4%. Ko te tipunga ā-ripoata ka tipu mā te 22.8%, arā, ki te \$561.2 miriona, nā te \$54.7 miriona o ngā Mōkete Tauaro Ahitereiria i whakawhiti mai i Ahitereiria ki Aotearoa, i whakatauritehia ai e te pāpātanga whakawhiti nui, arā, e te \$2.0 miriona. He nui ngā āheinga whakatipu hirahira mō ngā Mōkete Tauaro Aotearoa, ā, kei te whakamaheretia te whakatipunga whakangao mō te tau pūtea 2020 ki te whakatairanga i ngā mahinga pēke.

I tipu tonu te pukapuka **Ahumoni Waka** a Heartland mā te pikinga 13.3% o te raumata nama mai mā ngā ahumoni i ngā wāhi hoko waka (wāhi hoko waka, kaitakawaenga hoko waka, me ngā haumitanga pērā i a Holden, Jaguar Land Rover).

Kei te tipu tonu te wāhanga **Tuku Pūtea Pakihi Paewaenga**, kua piki ngā raumata nama mai ki te 31.4%. Kei te whakahekietia te tuku pūtea Hononga Pakihi, inā rā, ko tā mātou rautaki ko te whakaheke i te tūraru paeraro. Nā konā i whakahekietia te nama mai o te Hononga Pakihi mā te \$107.0 miriona.

Mō te wāhi ki te Kararehe Pāmu, ko te hanga ahumoni a Heartland e āwhina ana i ngā kaupāmu ki te hoko me te whakawhiti kararehe pāmu, kāore nei he take ki te mōkete i tā rātou pāmu. I piki ngā nama mai o te **Ahumoni Kararehe Pāmu** mā te 18.8%. I heke ngā nama mai o te wāhanga Taiwhenua whānui

mā te 0.6%, i a Heartland e whakaheke tonu ana i ngā **Hononga Taiwhenua** nui, e tuku pūtea ana ki te whakaheke i ngā tūraru paeraro o tēnei wāhanga.

I piki ngā **moni kuhu kaihoko** mā te \$271.9 miriona (9.4% te tipu) ki te \$3.2 piriona. Ka tukuna tonu e Heartland tētahi o ngā tino kōwhiringa utu moni kuhu, e tuku nei ki ngā kiritohu ngā utu pūtea āpiti pai, e wātea ana ki te tango pūtea mā te Heartland Direct Call Account. Koinei te tau tuarua karapīpiti kua riro i a Heartland te tohu Pūtea Tiaki a Canstar Bank of the Year. Mō te tau tuawhā karapīpiti kua riro i a Heartland te taumata tuarima mō te Outstanding Value Savings Account.

I tēnei tau, i kuhu mātou ki tētahi māketē hokohoko hou me te whakaputanga o YouChoose – he pēke pūtea tiaki me te pūtea tarepa kua whakaritea. Ka whakangāwari a YouChoose i te ara ki te tiaki pūtea mō ngā kiritohu, i a rātou e hiahia tonu ana ki te hokohoko, inā rā, he pai ngā utu āpiti i te wāhi ki ngā pūtea tiaki me te pūtea tarepa.

MŌKETĒ TAUARO AHITEREIRIA

I piki ngā raumata nama mai i te wāhi ki te **Mōketē Tauaro Ahitereiria** mā te 24.0%, hāunga te whai pānga o ngā panonitanga i te utu whakawhiti pūtea o tāwāhi me ngā whakawhitinga mōketē tauaro ki Aotearoa. I ripoatanga te tipunga \$79.6 miriona (11.7% te tipunga) ki te \$757.6 miriona nā te whakawhitinga o ngā mōketē tauaro ki Aotearoa, ā, ko te \$31.0 miriona te nui o te whai pānga o te utu whakawhiti pūtea o tāwāhi.

Hei āpiti ki ngā mahi ka tutuki i tō mātou kāhui ki te whakawātea i te iwi kia hāneanea te tāoki i te noho ki ō rātou kāinga, tā mātou pakihi Mōketē Tauaro Ahitereiria te tohu Best Reverse Mortgage 2019 nā te maheni Money Magazine mō te tau tuawhā karapīpiti.

PAE MAMATI

Kei te tipu tonu mātou hei rōpū Hangarau Pūtea me tētahi raihana pēke, tēnā i te pēke noa. Nā tēnei āhuatanga i aro ai mātou ki te hononga i waenganui i te wheako kiritohu me ngā putanga kiritohu pai.

Hei tā tā mātou rautaki pae mamati, ka whakangāwari ake te ara mā ngā kiritohu ki te wherawhera i ngā mahinga pēke mā te pae ipurangi,

waihoki kia whānui te toro ki te makiu tāngata me te utu o te paeraro. Kei te whanake tonu te taupānga Heartland Mobile, i tipu mā te 72% i ngā marama e ono mai i te Kohitātea ki te Pipiri 2019.

Tuia ki tēnei, me whakawhiti kōrero tonu a Heartland ki ngā kiritohu, ā, e mōhio ana, ahakoa he ao pae mamati, me whakawhiti kupu tonu te tangata. Nā konā kua tino aro ki te whakapiki i ngā pukenga ā-waea me te manaaki kiritohu i Hakatere.

Ko **Open for Business (O4B)** te mahinga pūtea o runga mā ngā pakihi iti. Hei tā tēnei mahinga pēke he tautoko i ngā pakihi iti ki te tipu me te pūtea haumarū, pūtea haumarū-kore rānei. I piki te tukunga pūtea a O4B mā te 48.2% i tēnei tau pūtea. I te Hōngongoi 2019 i puta tētahi whakatairanga pouaka whakaata hou, me ētahi atu mahi whakatairanga, kia mōhio ai te makiu mō ngā mahinga pēke, kia whānui ake ai te toro ki te makiu.

PANONITANGA Ā-PAKIHI

I tutuki ngā panonitanga ā-pakihi i te Whiringa-ā-nuku 2018, inā rā te whakawhitinga o ngā hea katoa i te Heartland Bank ki ngā hea i te Heartland Group, ā, ka noho a Heartland Bank hei whakahaeretanga turuki mā Heartland. Tuia ki tērā, i whakawhiti ngā kamupene i te peka Ahitereiria mai i te Heartland Bank ki te Heartland Group.

Mā te panonitanga ā-pakihi ka wātea ake ngā kōwhiringa whai pūtea i Aotearoa me Ahitereiria.

PANONITANGA Ā-WHAKAHAERE

I roto i te tau, i pōhiritia a Cherise Barrie e Heartland ki te tūranga Tumu Whakahaere Pūtea. He Kaikaute Paerunga a Cherise, ā, he nui ngā wheako whakawhiti pūtea i te ao paerunga, ā, e ngākaunui ana ki te wahine i te pakihi, inā rā, he mema ia nō Global Women.

I tēnei tau, i arotakengia ngā paemahi o roto i te whare, ā, i panonihia ngā tari Business Enablement me te Technology. I whakawehea ēnei ohu mahi kia nui ake ai ngā hua i ēnei wāhanga, kia pai ake ai tā rātou taunaki i te kamupene me ā mātou kiritohu anō hoki.

Ā raurangi, ka arohia hoki te tari Finance and Compliance, inā rā, kua piki ngā here me ngā tono i ēnei wāhanga.



**I TE \$73.6 MIRIONA NGĀ PAINGA
MORE I MURI I TE TĀKE A HEARTLAND
(9% TE PIKINGA), Ā, I TUKIA E NGĀ UTU
TUKUTAHU O TE \$4.2 MIRIONA.**

HE MANAWA TANGATA – Ā MĀTOU TĀNGATA

I tēnei tau, i whakahoutia ngā mātāpono o Heartland. Koinei te tūāpapa o te ahurea mahi e whai ana i te karamatamata (mahi tipu), ā, ka whakautengia te pukenga rau o tēnā, o tēnā, e āpiti nei ki te wāhi mahi. Me wāhi whakauruuru, me wāhi whakaute tangata rau a Heartland (mahi tahi). E mātāmua ana te tika o ngā mahi (mahi tika) ki ā mātou kiritaki, hāpori, kaupupuri hea anō hoki, i tēnei ao tūnekeneke, i a mātou e whanake tonu ana hoki kia whakaeatia ā rātou hiahia.

I tēnei tau, i whanake hoki mātou i te wāhi ki te kanorau ira tangata, tae noa ki ngā wāhine i te pae whakahaere. I tēnei wā, 37.5% he tāne, 62.5% he wahine.

Koinei te tau tuarua o tā mātou rautaki kaimahi tauira, ā, i pōhiritia te 20 tauira Māori, Moana Nui a Kiwa ki Heartland – he tārua i te nama kaimahi tauira nō tērā tau. Tirohia ngā mokamoka katoa o tēnei kaupapa i te wāhanga 'Embracing a culture of inclusion' whārangi 20.

I te 2018, i tīmata a Heartland ki te whai i te Rainbow Tick, waihoki, i whakanui tonutia te Komiti Kanorau te kanorau o ā mātou tāngata, e whakanui ana i a Matariki, i te Diwali, i te tau hou Haina, ngā wiki o te reo Māori me te Hāmoa, me te huhua noa atu, kia haumarū, kia whakamanuhiri, kia whakauruuru te taiao mahi.

TE AHUNGA WHAKAMUA

Hei te tau e tū mai nei, ko ngā whakakitenga ko te whakatipunga tonutanga o ngā rawa nā ngā mahinga tuku pūtea matua, ina koa ko ngā Mōkete Tauaro i Ahitereiria me Aotearoa, ngā pakihi iti, waihoki te whakahaerenga tonutanga o ngā whakahaerenga whakahekenga i te hononga tuku pūtea i te Pakihi me te Taiwhenua.

Ka whakangaoa tonutia ngā rawa mā te whakapiki i ngā mahi whakatairanga, me te whakapiki i te nui o te whakatutukihanga i ngā wāhanga o te whakatipunga hou.

Kua nui ngā hua i tēnei tau. Anei e tuku nei i ngā mihi ki ā tātou tāngata, mō rātou nei e whakatinana ana i ā mātou mātāpono. E mihi ana hoki ki ngā kaupupuri hea i tā rātou tautoko nui mai i a Heartland ao noa, pō noa.

Ngā mihi nui,



Jeff Greenslade

Kaiwhakahaere Matua

Heartland's corporate restructure

On 31 October 2018, Heartland completed its corporate restructure. As a result of the restructure, shares in Heartland Group were listed on both the NZX Main Board and the ASX (under a Foreign Exempt Listing) and Heartland Group commenced trading under the HGH ticker code from 1 November 2018.

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

The restructure and the ASX listing are significant milestones for the Group and provide a more suitable platform for future growth. The restructure removes constraints on growth previously arising from Reserve Bank of New Zealand regulations, and will provide greater flexibility to explore and take advantage of future growth opportunities in New Zealand and Australia outside the banking group. A Foreign Exempt Listing on the ASX is expected to expand the capital sources available to Heartland in order to fund growth.

As part of the restructure and in order to ensure greater efficiency and capacity, Chris Flood was appointed to the new role of CEO of Heartland Bank. Jeff Greenslade remains CEO of Heartland Group.



Embracing a culture of inclusion

Inclusion is a vital element of a business' sustainability and social purpose. It is the right thing to do – mahi tika.

The vision for Heartland is to be an accepting and welcoming workplace for all people, where diversity of thought and cultural intelligence is valued.

Diversity brings fresh ideas and different perspectives. This is at the heart of our aim to be always evolving – mahi tipu. A welcoming and accepting workplace makes it possible to realise the best of everyone, to have big ambition – mahi toa – and to work together as one team – mahi tahi.

One of Heartland's objectives is to be the employer of choice for Māori. Part of this means creating an environment where Māori language, culture and values are embraced. In doing so, the foundation is built to become an inclusive and welcoming environment for all cultures.



Piripi Gordon was one of the 20 students to join Heartland's internship programme in 2018/19.

Ko tētahi o ngā whāinga a Heartland kia noho mātāmua hei wāhi mahi mō Ngāi Māori. Inā rā, ka whakatūria he taiao mahi e manaaki nei i te reo Māori, i te ahurea Māori me ngā mātāpono Māori. Mā tēnei ka rite te tūāpapa kia tū ai te whare hei whakamanuhiri i ngā ahurea katoa.

Initiatives to increase the presence and use of Māori culture and language underway include:

- ▲ free reo and tikanga Māori lessons
- ▲ creation of Manawa Whenua, a group to support and inform Māori initiatives within Heartland
- ▲ Māori signage and Mahi Māori video series
- ▲ increased use of te reo Māori and tikanga in formal occasions
- ▲ Māori translations of website and annual reports
- ▲ Māori language and symbolism within Heartland mātāpono (values).

The benefits of these initiatives are starting to show internally, particularly in the increased capability of Heartland people in respect of te reo Māori. This has led to more use of te reo Māori throughout daily work life. The introduction of bilingual values was warmly welcomed by all employees, including in Australia, and reo and tikanga Māori lessons are being extended into an internal video series.

“Kua tawhiti kē te haerenga mai, kia kore e haere tonu. He nui rawa te mahi, kia kore e mahi tonu.”

We've gone too far not to go further.
We've done too much not to do more.
– Sir James Henare



Heartland's internship cohort for 2018/19. The internship programme is based on the Māori concept of 'ako'.

Although progress has been made over the last two years since we set out on this journey, Māori are still under-represented in Heartland's workplace – 4% of Heartland's people identify as Māori. While this is above average for the sector (of those who identify as Māori in the working population, 2.8% work in the financial and insurance services sector¹), it is well below Māori representation in the workforce, where Māori make up 13% of the New Zealand labour force.²

This lack of representation of Māori in the financial sector means that the onus on us is not simply to recruit but to encourage participation generally.

Supporting the Māori community is just as important as ensuring we continue to encourage and develop Māori culture and inclusivity internally. In FY2019, the Heartland Trust sponsored:

- ▲ Te Matatini Festival – a Māori performing arts event central to Māori identity and culture
- ▲ Kupe Leadership Scholar Tāmati Rākena – a Masters of Education student with a passion for supporting Māori communities
- ▲ InZone Education Trust – an organisation that aims to enhance the outcomes of Māori youth by providing opportunities for students to attend high-performing state schools.

In addition, Heartland's internship programme is based on the Māori concept of 'ako' which means to learn and to teach. As such, it provides a rich opportunity for interns to learn from us about the world of work, and for us to learn from them.

By increasing the presence of Māori culture and language at Heartland, and by showing our commitment and support to Māori, we are creating a workplace where Māori can see a career pathway. In doing so, we are also providing a valuable opportunity for our people to increase their cultural awareness and intelligence by learning more about New Zealand's rich and diverse culture, setting Heartland up to become a place that is welcoming to all people.

Strong progress in FY2019 has been made towards inclusivity for Māori, and it is recognised that there is more to do.

¹ Māori Labour Market trends – June 2019. Ministry of Business, Innovation & Employment.

² Household labour force survey: March 2019. Statistics New Zealand.



Being digital

Digital is one of Heartland's three core strategic focus areas alongside Australian Reverse Mortgages and New Zealand Banking.

WHAT IS DIGITAL?

The concept of digital is frequently defined by the internet or mobile phones or APIs (Application Programming Interface). These are digital tools. Being digital is a way of doing things:

"Digging down, digital is about two things: speed and agility – externally to your customers and market and internally within your organisation."
– John Rossman¹

One of Heartland's mātaḥpono, or values, is mahi tipu – always evolving. This is the essence of being digital. The purpose is to deliver great customer outcomes by always striving to deliver fast and simple service. Increasingly, how we are judged will be by how successful we are in delivering excellent User Experience (UX).

WHAT IS UX?

UX encompasses all aspects of a customer's interaction with our products and services.²

A good UX is one which makes it easy for the customer to access services and which delivers the desired outcome quickly. UX is a constantly evolving challenge: identifying user pain points to address, gathering insights about how we can do things better, and letting our customers know that their experience with us matters.

Examples of UX in action at Heartland include: usability testing of new websites, updates to the Heartland Mobile App and new digital products; the introduction of online, real-time customer feedback mechanisms on the Heartland website; and using online qualitative analytics tools to record UX and customer journeys across all webpages.

Prioritising UX means we keep our customers at the forefront of decision making. This leads to better customer loyalty and retention, and better business outcomes.

DIGITAL AT HEARTLAND

Our Digital strategy has two objectives.

1: To give our customers products accessible online or via an app, and provide simple, frictionless and fast on-boarding and processing.

2: To reach as many customers as possible at the lowest cost, through online and smartphone access and highly automated processes.

In practice, digital is a way of operating – how we get things done. A digital mindset enables us to remain agile and innovate at speed to meet changing customer expectations.

To deliver low cost on-boarding and transaction processing we will ensure we have the right technology and infrastructure in place to provide a seamless customer experience that ultimately reduces costs across the business. According to research by PWC, people who manage their finances online are more cost effective to serve and are more likely to purchase financial services products than those who conduct their banking in person.³

By automating processes behind the scenes, Heartland will create more capacity to do more for customers.



OUR DIGITAL ACHIEVEMENTS

As Heartland's digital offering increases, we expand our reach to customers. This presents an opportunity for digital innovation to help us grow and meet the needs of new customers. A number of digital achievements were realised in FY2019, including the following.

YouChoose

In May 2019, Heartland Bank launched YouChoose – a savings account with an arranged overdraft, designed to provide customers with the flexibility to save when they can and spend when they want to.

Biometrics, DocuSign and document uploads

Facial recognition technology (biometrics) for ID verification, online document signing via DocuSign and document upload functionality was introduced this year, enabling easier and faster customer on-boarding⁴.

Heartland Mobile App

App downloads have increased significantly. The app has been installed over 5,900 times. This is a 72% increase since the start of 2019. This year, 24 app improvement updates saw more functionality built in to provide greater security with PIN and fingerprint login features, and to allow customers greater access to Heartland's products.

Online EFTPOS

In order to provide customers with greater flexibility in how they spend their money, Heartland Bank has partnered with Paymark to deliver Online EFTPOS services to our YouChoose customers. Online EFTPOS will allow customers to shop online from participating retailers without the need for a debit card.

Open for Business (O4B)

O4B is Heartland's digital-led small business lending product and has been continuously improved to ensure a frictionless end-to-end process. The three minute application with real-time technology manages credit risk by reviewing a number of data points to assess the applicant's situation and give them a more personalised response. The number of people visiting the O4B webpages in FY2019 increased by 163%⁵, and the number of online applications increased by 160%⁶.

Guaranteed Minimum Future Value (GFV) finance calculator

Heartland Bank, in partnership with Jaguar Land Rover, launched their first fully integrated online GFV calculator for a third party finance provider. Customers can use the calculator to generate an indicative GFV finance quote which lets them know what the minimum trade value will be at the end of the vehicle loan, provided they keep within the terms of their agreement.

THE YEAR AHEAD

In FY2019 we completed beta testing of our new Heartland Digital platform with a select group of customers. The Heartland Digital platform provides an efficient, user-friendly online banking solution that savings and deposits customers can access in place of internet banking on a desktop or devices which don't support the app. In FY2020 we will continue to roll the platform out to our Heartland customers.

FY2020 welcomes some exciting digital advancements. Online calculators and automated application decisioning, based on lending criteria, for Reverse Mortgage customers in New Zealand will help customers get the information they need to progress their loan applications. Similar online calculators are also being developed for Australian Reverse Mortgages to assist the huge broker network in Australia and will provide customers with more personalised information that is relevant to them. Work will also begin on the creation of a GFV calculator for Holden Financial Services, similar to the one launched this year for Jaguar Land Rover Financial Services.

Heartland has also taken a keen interest in the launch of two new API standards which help New Zealand take a step towards Open Banking. The standards provide the opportunity for banks to work together and with third parties to launch new financial services for customers. Heartland is working with PaymentsNZ to register as an API provider which will allow us to use the new standards. We believe Open Banking will improve banking processes and services for customers, and contribute towards the development of simple, secure, personalised banking for each customer's needs.

Being digital is a mindset and way of working. We've been incorporating that mindset throughout our products, services and operations throughout FY2019 and will increase that focus in the year ahead to ensure we're always evolving and continue to strive for excellence – whāia te iti kahurangi.

1 John Rossman, Think Like Amazon: 50 ½ Ideas to Become A Digital Leader (2019).

2 <https://www.nngroup.com/articles/definition-user-experience/>

3 <https://www.pwc.com/us/en/financial-services/publications/assets/pwc-fsi-whitepaper-digital-bank-transformation.pdf>

4 For customers using our biometric solution, the average time taken to complete is 10 minutes.

5 Data source: Google Analytics, 30 June 2019.

6 Data source: Proprietary data collection platform, 30 June 2019.



JEFF GREENSLADE
Heartland Group CEO
and Executive Director

Jeff has over 20 years' experience as a senior banking executive, including with the ANZ National Banking Group, where he last held the position of Managing Director of Corporate and Commercial Banking.

GEOFF RICKETTS
Chair, Independent
Non-Executive Director

Geoff is a company director and investor with wide experience in the New Zealand and Australian business environments.

ELLIE COMERFORD
Independent Non-Executive
Director

Ellie has worked for more than 30 years in financial services in Australia and overseas across a number of banking and insurance businesses.



Heartland Group Board

HEARTLAND GROUP BOARD

SIR CHRIS MACE
**Independent Non-Executive
Director**

Sir Chris is an Auckland based businessman and company director with experience in the New Zealand and Australian business environments.

GREG TOMLINSON
**Non-Executive
Director**

Greg is a Christchurch based businessman and investor with 40 years' experience owning, managing and building businesses.



For full profiles, visit
shareholders.heartland.co.nz

Heartland Bank Board



VANESSA STODDART
Independent Non-Executive Director

Vanessa is an experienced director and currently serves on the boards of New Zealand Refining Company Ltd, OneFortyOne Plantations Pty Limited, Tertiary Education Commission and the Financial Markets Authority.

BRUCE IRVINE
Chair, Independent Non-Executive Director

Bruce is a chartered accountant and was admitted into the Christchurch partnership of Deloitte in 1988. He was Managing Partner from 1995 to 2007 before his retirement from Deloitte in May 2008 to pursue his career as an independent director.

JEFF GREENSLADE
Executive Director

Jeff has over 20 years' experience as a senior banking executive, including with the ANZ National Banking Group, where he last held the position of Managing Director of Corporate and Commercial Banking.



HEARTLAND BANK BOARD

ELLIE COMERFORD

Independent Non-Executive Director

Ellie has worked for more than 30 years in financial services in Australia and overseas across a number of banking and insurance businesses.

KATE MORRISON

Independent Non-Executive Director

Kate has 20 years' experience working in investment banking in the UK in the areas of financial risk management, structured financing and investments.

GEOFF RICKETTS

Independent Non-Executive Director

Geoff is a company director and investor with wide experience in the New Zealand and Australian business environments.

JOHN HARVEY

Independent Non-Executive Director

John has considerable financial services experience and 36 years in the professional services industry, including 23 years as a partner of PricewaterhouseCoopers.



For full profiles, visit
shareholders.heartland.co.nz

Strategic Management Group

STRATEGIC MANAGEMENT GROUP





From left to right:

ROCHELLE MOLONEY
Chief Culture & Communications
Officer (joint)

GRANT KEMBLE
Chief Risk Officer

LYDIA ZULKIFLI
Chief Digital Officer

JEFF GREENSLADE
CEO, Heartland Group

LAURA BYRNE
Chief Culture & Communications
Officer (joint)

CHRIS FLOOD
CEO, Heartland Bank

CHERISE BARRIE
Chief Financial Officer

SARAH SMITH
Chief Technology Officer



For full profiles, visit
shareholders.heartland.co.nz

Our sustainable business

Our customers



Delivering great customer outcomes.



Our community



Making a contribution in our communities.

He manawa whenua, he manawa tangata.

Due to regulatory demand, Heartland is only at the start of our journey to better understand our environmental impact.

While Heartland has taken some small steps towards this, we know we need to do more and will be evaluating our overall Environmental, Social and Governance (ESG) strategy in FY2020.

He manawa whenua: Our Heartland



Providing a diverse and inclusive work environment.



Our environment



Considering the impact of our operations on the environment.



Our customers

OUR CUSTOMERS



The sustainability of our business is only possible if we can demonstrate a relevant positive social contribution. Heartland seeks to do this in a number of ways, including by providing support to customers whose needs aren't met by mainstream banking.

- Our Reverse Mortgage product enables us to provide people with the opportunity to enjoy a better retirement with the peace of mind, independence and security that comes from remaining in their own home.
- Open for Business supports the growth and development of small businesses through the provision of business loans – including unsecured up to \$100,000, so business owners don't have to mortgage the family home to finance their business.
- Heartland's Deposit products provide New Zealanders with competitive on call and term deposit rates to reach their savings goals.

- Heartland Bank and MARAC car loans give New Zealanders the opportunity to buy safer, more fuel efficient motor vehicles.
- Heartland's livestock finance supports the agriculture sector through specialist finance which gives farmers the opportunity to purchase livestock in a flexible and efficient way without having to use the farm as security.
- YouChoose gives customers the flexibility to choose how they use their money with just one account – save with a healthy interest rate, or spend with a competitive overdraft rate.

We recognise that how we behave toward our customers directly impacts lives and it is imperative that our products and services meet their needs over the longer term. The recent FMA and RBNZ review into banks' conduct and culture identified findings across four key themes for all banks:

- greater board ownership and accountability, including being able to properly measure and report on conduct and culture risks and issues.
- delivery of good customer outcomes through product design and management, sales processes, incentives and vulnerable customer handling.
- prioritising the identification of issues and accelerating remediation; prioritising investment in systems and frameworks, processes, controls and training, including staff reporting channels such as whistleblower processes.



Thanks to Heartland Bank support, Remarkables Towing in Central Otago has come a long way since co-owner Anna Tomkinson started the company as a side project.



Heartland has developed a work plan to address the regulators' observations and recommendations and believes that this work will strengthen the oversight, controls and processes Heartland has in place to manage its conduct risks.

ACHIEVEMENTS AND NEW DEVELOPMENTS

FY2019 saw many achievements and new developments aimed at improving our customers' experience and outcomes.

Our Australian Reverse Mortgage product was awarded 'Best Reverse Mortgage' in Money Magazine's 'Best of the Best' awards for the fourth year running. The award is a testament to Heartland's Reverse Mortgage being flexible, yet simple, with considerable consumer protection and broad criteria. The Australian Reverse Mortgages team have helped more than 18,000 Australians live a more comfortable retirement.

Our Australian Reverse Mortgage business was also recognised as a finalist in the Australian Lending Awards and the Australian Mortgage Awards.

In April 2019, Heartland Bank celebrated a significant milestone – helping more than 15,000 New Zealanders enjoy a better retirement by enabling them to stay in their own home for as long as they choose.

For the second year, in July 2019 Heartland Bank received the Bank of Year – Savings Award from Canstar, recognising Heartland as the financial institution that provides the strongest combination of products and services for savers in New Zealand. Heartland's Direct Call Account was also awarded Canstar's 5-Star Rating for Outstanding Value Savings Account for the fourth year in a row.

Furthering our offering to New Zealanders, Heartland Bank this year launched YouChoose – a new savings account with an arranged overdraft. YouChoose aims to help people save when they can and spend when they want to, with competitive interest rates on credit and debit balances.

The introduction of DocuSign, biometrics and document upload functionality for Heartland's products makes it easier and faster for new customers to open an account and verify their identity from a location that suits them – as customers can use these services online from their mobile device.



Open for Business customer Kerry Bradburn recognises the power of an online business model.



Our community

OUR COMMUNITY



We recognise we have a responsibility to assist the communities we've served for over a century. We get involved and do what's right for our communities, local businesses and families – mahi tika. We aim to make a positive difference by providing support and opportunity to those in need.

Through Heartland Bank and the Heartland Trust, we support a number of organisations, clubs and schools both regionally and nationally. The Heartland Trust is a registered charitable trust which is independent from, but closely supported by, Heartland Bank.

NURTURING MĀORI LEADERSHIP

The Heartland Trust is a proud supporter of the InZone Education Foundation, a registered charitable trust that aims to enhance the educational outcomes of Māori and Pasifika youth. It does this by establishing and running boarding hostels that provide an opportunity for motivated students to access high-performing state schools within the school zones.

As part of our support of InZone, Heartland runs an internship programme each year. The programme welcomes a number of students to work in paid internship positions throughout the business over their summer holiday. The internship programme is based on the Māori concept of 'ako' which means to learn and to teach. The programme provides students with experience in and exposure to the corporate world, and enables Heartland to learn how it can become a more welcoming and inclusive environment for its people.

Heartland also provided scholarships to a number of Māori students, enabling them to attend high-performing schools they would otherwise be unable to attend.



The Heartland Trust this year began sponsoring Kupe Leadership Scholarship recipient Tāmati Rākena, a Masters of Education student at Auckland University.

Through the Kupe Leadership Scholarship, Heartland provides funding to Heartland Scholar and Masters of Education student, Tāmati Rākena. The prestigious Kupe scholarship aims to develop future leaders who are committed to New Zealand and to creating a successful future for our country. Through the scholarship, Tāmati receives a generous stipend, personal mentor and participation in the leadership programme.

CELEBRATING THE ARTS AND SPORT

The Heartland Trust was once again the platinum sponsor of the Auckland Writers Festival, an event that caters for a diverse range of ages, interests and cultures, inspiring people to fall in love with books. The Trust also sponsored the WORD Christchurch Festival, the largest literary event in the South Island. WORD partnered with Auckland Writers Festival in May this year for an autumn season event.

In 2019, the Heartland Trust was proud to sponsor Te Matatini Festival. Te Matatini is the pinnacle cultural event of Māori performing arts, central to Māori identity and culture, aligned to our aspirations to develop cultural awareness and intelligence at Heartland.

Heartland has, for a long time, been involved in supporting school and club rugby. This year, we continued to support many school First XV rugby teams across the country, with an increased focus on girls' rugby. Our support has assisted the teams with funding uniforms and training equipment.



The Heartland Trust continues to provide sponsorship for school and club rugby, including the Otago University women's team.



In 2019, Heartland was the platinum sponsor of the Auckland Writers Festival for the third year.

WELLBEING IN THE COMMUNITY

Heartland employees volunteer annually at the Special Children's Christmas Party, an event established for children who suffer from life threatening illness, physical and intellectual impairment, domestic violence or who are living in underprivileged circumstances.

Heartland also supports Lifeline. With Heartland's sponsorship, among others, Lifeline is able to offer a free 24-hour, 7 days a week phone line service. The confidential service supports Kiwis going through difficult times.

Heartland Bank has provided sponsorship to Silverline, to support their establishment. Silverline is a free confidential 24/7 helpline offering information, friendship and advice to people over 55 throughout New Zealand.

The Heartland Trust provides donations towards Auckland City Mission's HomeGround project. Due to be complete in 2020, HomeGround is a purpose-built facility that will include 80 apartments for permanent housing, space for the Mission to continue to support those who need it most, a place where low-cost medical treatment will be offered and a commercial kitchen where the Mission will prepare meals and teach basic cooking skills.



He manawa whenua: our Heartland

HE MANAWA WHENUA



A DIVERSE WORKFORCE

Our vision is for Heartland to be an accepting and welcoming workplace to all people, where diversity of thought and culture is valued and we come together as one team – mahi tahi.

To help us achieve this, we have a few key areas of focus: addressing imbalances in gender and ethnic representation, becoming an employer of choice for Māori, celebrating diversity and inclusion, and providing best practice support to our people in relation to mental health and wellbeing.

Led by Heartland's Diversity Committee, several celebrations of Heartland's diversity have taken place throughout the year, including events celebrating cultural identity, gender diversity and overall inclusion in the workplace. A Rainbow Committee has also been formed to work towards obtaining the Rainbow Tick for Heartland. The Rainbow Tick will acknowledge Heartland as a workplace that supports and values our rainbow community.

In 2017, Heartland partnered with Global Women to access thought leadership and best practice in the promotion and facilitation of diversity. Heartland Group Chief Executive Officer Jeff Greenslade is a member of Champions for Change, demonstrating Heartland's commitment to creating a more diverse workplace.

Heartland's Kia Eke group, established in 2018, continues to provide support and development opportunities for female employees at an early stage in their career, supporting them to grow into leadership roles. While gender diversity at different levels across the organisation has improved on last year, there is more work to be done.

See the Diversity report in Heartland's 2019 Financial Report for more information about Heartland's progress towards encouraging diversity and inclusion in the workplace, including an employee gender breakdown.



Ten of the 12 people who make up Heartland's recently formed shadow board.



AN INCREASINGLY YOUNGER WORKFORCE

The workforce in New Zealand continues to evolve with Millennials now making way for Generation Z in the workplace. At a macro level, these generations are driving changes, among other things, around the way people relate to and interact with brands and consume products. Attitudes, beliefs and behavioural changes are also showing up in the workplace at an employment level and shifting the way employees have traditionally approached the workplace and their career.

At Heartland, 49% of our total workforce are aged 35 and under, and 76% of that group are aged 30 and under. The 25-30 age group are currently the largest demographic cohort in the organisation, making up 21% of our people. Heartland recognises the importance of understanding more about the needs of our younger people, and specifically what drives and motivates them about a workplace and career. A number of initiatives are in place to support this understanding.

This group is relatively balanced in gender and inherently more diverse across ethnicity – for example, 45% identify as New Zealanders, 11% as Indian, 7% as European, 6% as Chinese and 4% as Māori.

Heartland has recently formed a shadow board with the dual purpose of providing meaningful career development opportunities for our people aged under 35, as well as ensuring that the unique perspectives and expectations of the Millennial and Gen Z generations form part of our business decision-making. The shadow board is made up of 12 of our people, all aged under 35. The shadow board will be tasked with providing insights and perspectives to Heartland's Strategic Management Group, and ultimately the Board, in relation to a number of areas including our sales and distribution strategy, customer experience, internal culture and digital projects.

OUR WELLBEING – WELL AT HEART

Heartland's Wellbeing Committee has organised various wellbeing events for Heartlanders, including facilitating yoga and mindfulness sessions, access to corporate massages, sport and team challenges, and has hosted a number of speakers to present to our people about managing and supporting their mental health and wellbeing.

Heartland employees are also encouraged to take a day to give back by volunteering. The volunteer day gives teams an opportunity to connect outside of the office, give back to their community and look after their mental wellbeing.

In May 2019, Heartland launched its new Prevention of Harassment, Discrimination and Bullying Framework. The framework intends to provide our people with a safe and inclusive work environment that is free from all forms of harassment, discrimination and bullying, to ensure all people feel valued and treat one another with dignity and respect. The framework consists of four pillars: discuss, inform and educate, support and respond. As part of the support pillar, 18 people across the organisation have been identified and trained as support people. Their role is to be the first point of contact for anyone who would like to talk to someone about having potentially experienced or witnessed harassment, discrimination or bullying.

Heartland also provides financial support for our people to participate in team sports with their colleagues to support wellbeing and teamwork.



Our environment

OUR ENVIRONMENT



Heartland is committed to operating a sustainable business that delivers excellent customer experiences and outcomes while operating in a way that minimises our impact on the environment. We know this is important to our customers, our communities, our people and our shareholders and it's the right thing to do – kia tika, kia pono.

We are at the start of our journey to better understand our environmental impact. To catalyse action, we've recently joined the Climate Leaders Coalition and committed to measuring and reporting our greenhouse gas emissions and setting an emissions reduction target. We also hope to use the experience of other members in the Coalition to guide us in making faster progress toward this commitment.

OUR PROGRESS SO FAR

Over the last year we have made small steps toward improving our operations so that they are more environmentally sustainable. Pepa Iti and the implementation of various online technologies are some of the ways we're working towards achieving this.

Pepa Iti aims to build scalability and create capacity without increasing our impact on the environment. The project will enable an end-to-end digital process, improving customer experience, reducing print costs and paper wastage, and automating manual processes. Introducing secure facial recognition, online document uploading and digital signature solutions have been core deliverables of the project.



The introduction of facial recognition, document upload and digital signature solutions enables our people to work more digitally.



The volume of printing from office printers in FY2019 has only slightly increased by 1% from FY2018. Given the business growth (receivables are 7% higher in June 2019 versus June 2018), this is a good result. Encouragingly, print volumes for the month of June 2019 are down 12% on June 2018. We anticipate further roll out of automation and paperless initiatives will see continued efficiencies in this space. This is both a good outcome for our environmental footprint and cost efficiencies.

LOOKING AHEAD

We are committed to working together to do the right thing and start the journey towards helping New Zealand transition to a zero carbon economy. While we have taken some small steps toward this, we know we need to do more and are evaluating our overall sustainability strategy.

To achieve this, we will assess our current state and set reduction targets to monitor and measure Heartland's progress. Initiatives we are considering include:

- establishing a decarbonisation roadmap for the business to identify initial projects that can be implemented
- looking for opportunities to fund research and development initiatives that are aligned to and share our sustainability goals
- converting our vehicle fleet to electric and/or hybrid vehicles
- encouraging our people to use their volunteer days to support organisations and projects which align with our sustainability goals.



Heartland is looking to convert its vehicle fleet to electric or hybrid vehicles.

Financial commentary

Net profit after tax (**NPAT**) was \$73.6 million for the year ended 30 June 2019, an increase of 9.0% from the previous financial year ended 30 June 2018.

Heartland has achieved excellent growth in net finance receivables of 9.1% after the adoption of the new accounting standard for provisioning, IFRS9. Excluding the impact of IFRS9, net finance receivables increased by 10.7%.

NET OPERATING INCOME

Net Operating Income (**NOI**) was \$205.8 million for the year ended 30 June 2019, an increase of \$9.0 million (4.6% growth). Excluding the impact of the prior year's one off income of \$5.4 million, the growth was \$14.4 million (7.3% growth).

Heartland's Net Interest Margin (**NIM**) for the year ended 30 June 2019 was 4.33% compared to 4.42% for the year ended 30 June 2018. 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 further 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

Operating costs were \$85.6 million for the year ended 30 June 2019, 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.

The cost to income ratio increased to 41.6%, compared to 40.9% for 2018. Excluding one-off costs related to the corporate restructure and ASX listing referred to above, the cost to income ratio was 39.9% compared to 40.9% for 2018.

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, impairment expense for the year ended 30 June 2019 is not directly comparable to the year ended 30 June 2018

primarily due to the new requirement to provide for impairment losses on all loans, not just those past due or impaired. This particularly impacted Harmony and Motor which had high growth and, in the case of Harmony, higher expected loss rates than other segments.

Impaired asset expense decreased by \$1.4 million (6.3%) to \$20.7 million for the year ended 30 June 2019. \$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 the year ended 30 June 2019 under the previous applicable accounting standard.

Impaired asset expense as a percentage of average Receivables decreased from 0.58% in 2018 to 0.49% in 2019. Excluding the impact of IFRS9, the ratio was 0.42% in 2019.

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 \$19.3 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'.

BUSINESS PERFORMANCE

New Zealand Reverse Mortgages

New Zealand Reverse Mortgage Receivables increased \$52.0 million (11.4%). 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.

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

Motor

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

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

Harmony and other personal lending

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

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

Business

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%) to \$425.4 million and Open for Business lending up \$43.4 million (48.2%) 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.

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

Rural

Rural Receivables decreased by \$4.1 million (0.6%) 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%) to \$121.6 million.

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

Australia

Australian Reverse Mortgage Receivables increased \$163.0 million (24.0%) 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%) 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.

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

NET ASSETS

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. On a per share basis, NTA was \$1.04, unchanged from 2018.

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.

Heartland Bank successfully completed a \$125 million five-year unsubordinated, unsecured, medium term fixed rate note offer, which included \$50 million of oversubscriptions. The notes were issued on 12 April 2019 with a maturity date of 21 September 2022 and are quoted on the NZX Debt Market.

Heartland Australia Group Pty Limited issued an A\$50 million two-year unsubordinated, medium-term note on 8 March 2019 with a maturity date of 8 March 2021.

The Seniors Warehouse Trust Securitisation facility increased A\$50m during the year.

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.

CAPITAL

Heartland did not need to undertake an issue of capital during the current financial year, with the increase in new shares being due to the Dividend Reinvestment Plan (DRP).

A 2019 final ordinary dividend of 6.5 cents per share was declared bringing the 2019 full year ordinary declared dividend to 10.0 cents per share, 1.0 cent higher than the total dividend paid for 2018. The increase in the dividend reflects the performance of Heartland, particularly Australia, and also allows for investment in growth. The DRP remained in effect for the final dividend with a 2.0% discount.

Return on Equity (ROE) of 11.1% was consistent with 2018 as was Earnings per Share (EPS) at 13.0 cents.

CHANGE IN PROFITABILITY (\$MILLION)

| | |
|--|-------------|
| June 2018 net profit after tax | 67.5 |
| Net Interest Income | 14.9 |
| Lease, fee and other income | (4.7) |
| Selling and administration expenses | (2.1) |
| Impairment expense | 1.4 |
| Fair value movement on investment property | 1.9 |
| One-off operating expenses and break cost | (4.2) |
| Income tax expense | (1.1) |
| June 2019 net profit after tax | 73.6 |

Summary financials

Consolidated Statement of Comprehensive Income

For the year ended 30 June 2019

| \$'000's | June 2019 | June 2018 |
|--|----------------|----------------|
| Interest income | 334,330 | 309,284 |
| Interest expense | 136,747 | 125,483 |
| Net interest income | 197,583 | 183,801 |
| Net operating lease income | 1,835 | 1,670 |
| Lending and credit fee income | 3,117 | 2,351 |
| Other income | 3,307 | 8,972 |
| Net operating income | 205,842 | 196,794 |
| Operating expenses | 85,589 | 80,433 |
| Profit before impaired asset expense and income tax | 120,253 | 116,361 |
| Fair value movement on investment property | 1,936 | – |
| Impaired asset expense | 20,676 | 22,067 |
| Profit before income tax | 101,513 | 94,294 |
| Income tax expense | 27,896 | 26,781 |
| Net profit attributable to shareholders | 73,617 | 67,513 |
| Other comprehensive income for the year, net of income tax | (7,161) | 3,708 |
| Total comprehensive income for the year | 66,456 | 71,221 |
| Basic and diluted earnings per share (cents) | 13 | 13 |

SUMMARY FINANCIALS

Consolidated Statement of Cash Flows

For the year ended 30 June 2019

| \$'000's | June 2019 | June 2018 |
|--|-----------------|-----------------|
| Operating inflows | 314,339 | 295,810 |
| Operating outflows | (250,906) | (221,273) |
| Changes in operating assets and liabilities | (113,345) | (125,716) |
| Net cash flows applied to operating activities | (49,912) | (51,179) |
| Net cash flows from investing activities | (15,981) | (35,931) |
| Net cash flows from financing activities | 96,889 | 79,658 |
| Net increase/(decrease) increase in cash held | 30,996 | (7,452) |
| Cash and cash equivalents at the beginning of the year | 49,588 | 57,040 |
| Closing cash and cash equivalents | 80,584 | 49,588 |

Statement of Changes in Equity

For the year ended 30 June 2019

| \$'000's | June 2019 | June 2018 |
|--|----------------|----------------|
| Balance at beginning of the year | 664,160 | 569,595 |
| NZ IFRS9 adjustment | (19,283) | – |
| Restated balance at beginning of the year | 644,877 | 569,595 |
| Net profit attributable to shareholders | 73,617 | 67,513 |
| Other comprehensive income for the year, net of income tax | (7,161) | 3,708 |
| Dividends paid net of reinvested dividends | (36,266) | (35,150) |
| Issue of share capital net of transaction cost | (18) | 58,315 |
| Other movements | 619 | 179 |
| Balance at end of the year | 675,668 | 664,160 |

Consolidated Statement of Financial Position

As at 30 June 2019

| \$'000's | June 2019 | June 2018 |
|---|------------------|------------------|
| Cash and cash equivalents | 80,584 | 49,588 |
| Investments | 354,928 | 340,546 |
| Investment properties | 11,132 | 9,196 |
| Derivative financial instruments | 12,675 | 923 |
| Finance receivables | 3,029,231 | 3,984,941 |
| Finance receivables - reverse mortgages | 1,318,819 | – |
| Operating lease vehicles | 15,516 | 17,524 |
| Other assets | 21,309 | 14,411 |
| Intangible assets | 72,679 | 74,401 |
| Deferred tax asset | 9,531 | 5,319 |
| Total assets | 4,926,404 | 4,496,849 |
| Retail deposits | 3,153,681 | 2,881,805 |
| Other borrowings | 1,056,653 | 914,253 |
| Tax liabilities | 7,532 | 11,459 |
| Derivative financial instruments | 10,372 | 2,562 |
| Trade and other payables | 22,498 | 22,610 |
| Total liabilities | 4,250,736 | 3,832,689 |
| Equity | | |
| Share capital | 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 |

DIRECTORS

HEARTLAND GROUP BOARD

Geoff Ricketts

Chair and Independent Non-Executive Director

Jeff Greenslade

Executive Director and CEO

Ellie Comerford

Independent Non-Executive Director

Sir Chris Mace

Independent Non-Executive Director

Greg Tomlinson

Non-Executive Director

HEARTLAND BANK BOARD

Bruce Irvine

Chair and Independent Non-Executive Director

Ellie Comerford

Independent Non-Executive Director

Jeff Greenslade

Executive Director

John Harvey

Independent Non-Executive Director

Kate Morrison

Independent Non-Executive Director

Geoff Ricketts

Independent Non-Executive Director

Vanessa Stoddart

Independent Non-Executive Director

STRATEGIC MANAGEMENT GROUP

Jeff Greenslade

CEO, Heartland Group

Chris Flood

CEO, Heartland Bank

Cherise Barrie

Chief Financial Officer

Laura Byrne

Chief Culture & Communications Officer (joint)

Grant Kemble

Chief Risk Officer

Rochelle Moloney

Chief Culture & Communications Officer (joint)

Sarah Smith

Chief Technology Officer

Lydia Zulkifli

Chief Digital Officer

REGISTERED OFFICE

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Auckland 1023

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AUDITOR

KPMG

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T 09 367 5800

SHARE REGISTRY

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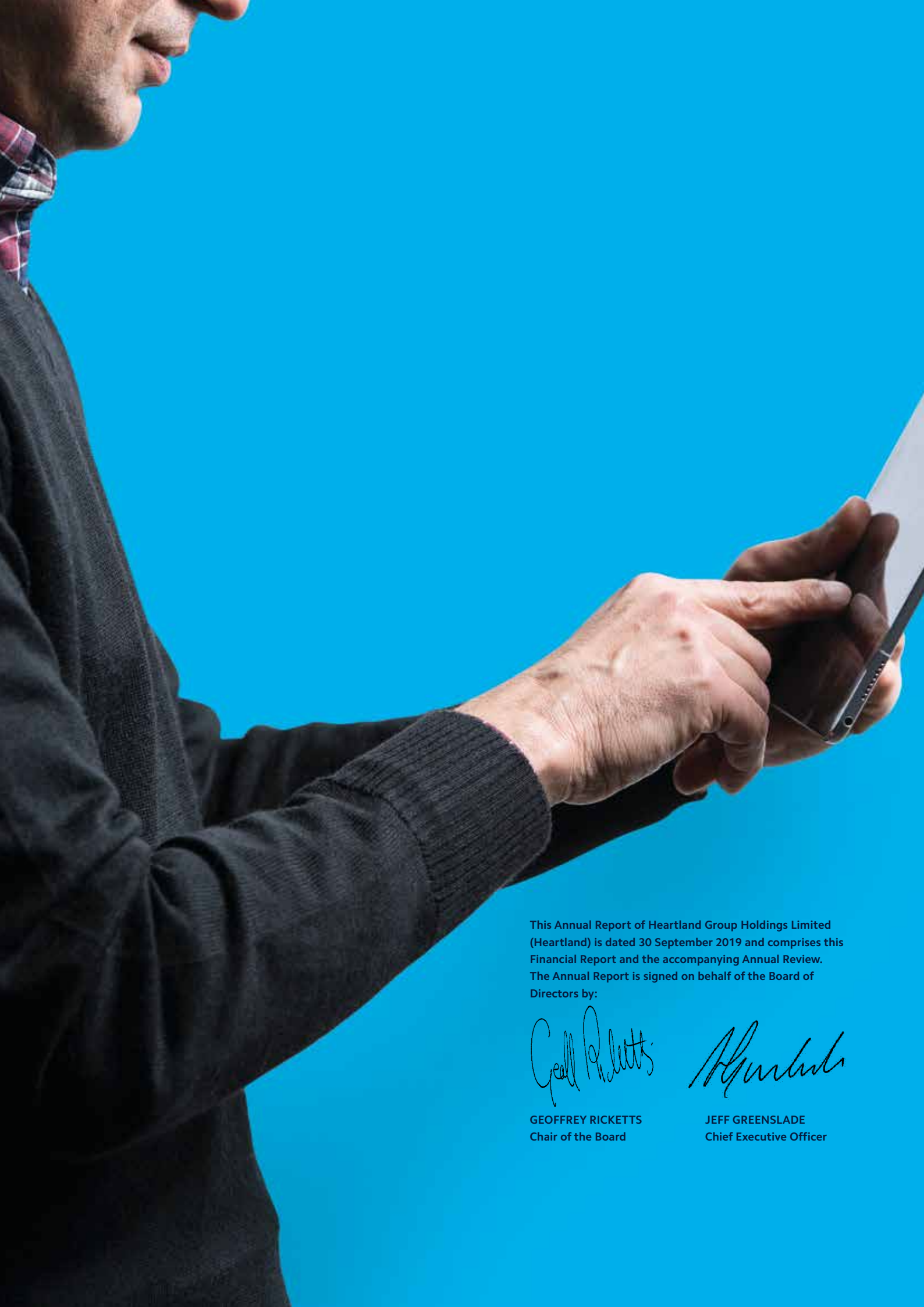
**Do the
right thing**

**Be one
team**

**Have big
ambition**

**Be always
evolving**

**Do the
right thing
Be one
team
Have big
ambition
Be always
evolving**



This Annual Report of Heartland Group Holdings Limited (Heartland) is dated 30 September 2019 and comprises this Financial Report and the accompanying Annual Review. The Annual Report is signed on behalf of the Board of Directors by:

A handwritten signature in black ink, appearing to read 'Geoff Ricketts'.

GEOFFREY RICKETTS
Chair of the Board

A handwritten signature in black ink, appearing to read 'Jeff Greenslade'.

JEFF GREENSLADE
Chief Executive Officer



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Financial statements

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 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

Qualifications: BEc

Type of Director: Independent Non-Executive Director

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 Christopher Robert Mace KNZM

Qualifications: CMInstD

Type of Director: Independent Non-Executive Director

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

Qualifications: AME

Type of Director: Independent Non-Executive Director

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

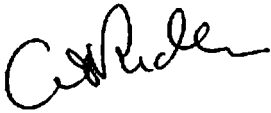
OTHER MATERIAL MATTERS

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.

Financial statements

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 | | | |
| <i>Items that are or may be reclassified subsequently to profit or loss:</i> | | | |
| 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 10 to 50 are an integral part of this consolidated financial statement.

Financial statements

Consolidated statement of changes in equity

For the year ended 30 June 2019

| \$'000's | Note | June 2019 | | | | June 2018 | | | |
|---|------|----------------|----------------|-------------------|-----------------|----------------|--------------|-------------------|----------------|
| | | 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 10 to 50 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 10 to 50 are an integral part of this consolidated financial statement.

Financial statements

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 10 to 50 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 10 to 50 are an integral part of this consolidated financial statement.

Financial statements

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.

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.

1 Financial statements preparation (continued)

After initial recognition, the Group applies a three stage test to measuring ECLs. 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 Group's 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 |

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Notes to the financial statements

For the year ended 30 June 2019

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.

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.

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Notes to the financial statements

For the year ended 30 June 2019

1 Financial statements preparation (continued)

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.

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Notes to the financial statements

For the year ended 30 June 2019

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 |

NOTES

| \$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 |

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For the year ended 30 June 2019

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 ECLs. 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 |

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For the year ended 30 June 2019

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.

NOTES

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 2019 | June 2018 |
|---------------------------|-----------|-----------|
| 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 |

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For the year ended 30 June 2019

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.

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For the year ended 30 June 2019

12 Derivative financial instruments (continued)

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.

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.

NOTES

| | 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.

| \$'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 |

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13 Finance receivables (continued)

(a) Finance receivables held at amortised cost

| \$'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)

(a) Finance receivables held at amortised cost

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 \$1.8 million. Net growth in receivables of \$339 million added \$3.0 million to stage 1 provisions. This was offset by a reduction in provisions of \$2.1 million 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 \$289 million loans moving from stage 2 to stage 3 or specifically provided, offset by \$134 million of loans moving from stage 2 and 3 or specifically provided.

Collective lifetime not credit impaired provisions (stage 2) increased \$0.4 million. \$282 million of receivables transferred to stage 2 due to deterioration in credit quality and \$8 million transferred from stage 3 due to improvement in asset quality. These were offset by \$209 million 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 \$3.1 million driven primarily by a net increase in receivables of \$17 million. This was due to a net increase transferred to stage 3 of \$57 million offset by \$40 million 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 \$24 million of loans transferred from collectively provided off set by the release of provisions on \$14 million 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.

| \$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 | - | - |

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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.

15 Borrowings (continued)

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 | June 2019 | 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 |

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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.

| \$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 (**CGUs**). 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) |

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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 |

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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 |

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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 performed 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.

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.

21 Enterprise risk management program (continued)

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.

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21 Enterprise risk management program (continued)

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 |

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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 World¹ | 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 |

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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 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 |

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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 liabilities | – | – | – | – | – | 30,031 | 30,031 |
| Total financial liabilities | 2,395,573 | 519,676 | 729,734 | 212,575 | 351,321 | 41,716 | 4,250,595 |
| Effect of derivatives held for risk management | (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 mortgages | 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 liabilities | – | – | – | – | – | 22,610 | 22,610 |
| Total financial liabilities | 2,402,670 | 485,825 | 543,746 | 150,230 | 207,596 | 31,163 | 3,821,230 |
| Effect of derivatives held for risk management | 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 Group's 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.

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For the year ended 30 June 2019

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) |

(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) |

26 Structured entities (continued)

(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.

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 plan (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.

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For the year ended 30 June 2019

27 Staff share ownership arrangements (continued)

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.

| | 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 | – |

27 Staff share ownership arrangements (continued)

PR Plan 2018 tranche (PR plan 2018) (continued)

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 | |

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Notes to the financial statements

For the year ended 30 June 2019

28 Concentrations of funding

(a) Concentrations of funding by industry

| \$000's | June 2019 | June 2018 |
|--------------------------------|------------------|------------------|
| Agriculture | 68,559 | 69,245 |
| Forestry 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 6.5 cents 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 5 to 50:

- 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.

Financial statements



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

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.

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.

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.

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:

- Assessing the Group's governance and oversight, including the continuous reassessment of overall provisioning;
- Assessing the Group's significant accounting policies and expected credit loss ("ECL") modelling methodology against the requirements of the standards and underlying accounting records;
- Assessing the disclosures in the consolidated financial statements against the requirements of NZ IFRS;
- Testing key controls over arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and model validations;
- 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;
- Assessing individually significant loans in arrears not specifically



| The key audit matter | How the matter was addressed in our audit |
|--|---|
| <p>determine the collective provision based on historical data, adjusted for forward looking information.</p> <p>Additionally management apply judgement in the determination of provision overlays to adjust for future market conditions.</p> <p>The level of judgement involved in determining the provision for collectively impaired assets requires us to challenge the appropriateness of management's assumptions.</p> | <p>provided for, to determine whether they were being appropriately monitored and incorporated into the provision for collectively impaired assets;</p> <ul style="list-style-type: none"> — Testing key inputs used in the ECL calculation for significant portfolios. This included testing data reconciliation controls between the ECL models and source systems; — 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 — 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. <p>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.</p> <p>We did not identify any material issues or exceptions from our procedures.</p> |

Valuation of finance receivables - reverse mortgages

Refer to notes 13 and 20 to the consolidated financial statements.

| | |
|--|---|
| <p>The Group's reverse mortgage portfolio is held at fair value.</p> <p>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.</p> <p>The inherent uncertainties include estimated future mortality and move to care rates, voluntary exits, house price changes and interest rate margin.</p> | <p>Together with KPMG valuation specialists, our procedures over the fair value loan portfolios included:</p> <ul style="list-style-type: none"> — Testing key controls over the accuracy of historic data impacting the fair value assessment; — Assessing evidence of a relevant active market or observable inputs; and — Challenging the key assumptions used by the Group in determining the portfolio's fair value. <p>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.</p> <p>We did not identify any material issues or exceptions from our procedures.</p> |
|--|---|

Operation of IT systems and controls

| | |
|---|--|
| <p>The Group is heavily dependent on complex IT systems for the processing and recording of significant volumes of transactions and other core banking activity.</p> <p>For significant financial statement balances, such as finance receivables and deposits, our</p> | <p>Our audit procedures, amongst others, included:</p> <ul style="list-style-type: none"> — 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; |
|---|--|

Financial statements



| The key audit matter | How the matter was addressed in our audit |
|--|--|
| <p>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.</p> <p>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.</p> | <ul style="list-style-type: none"> — Assessing the effectiveness of the IT control environment, including core banking IT systems, key automated controls and reporting; and — Evaluating general IT controls relevant to IT system changes and development, IT operations, developer and user access controls. <p>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.</p> <p>In response, we performed additional compensating control tests and substantive audit procedures:</p> <ul style="list-style-type: none"> — We carried out substantive testing on IT systems and controls to assess: <ul style="list-style-type: none"> (i) the accuracy of automated controls and IT system calculated transactions and balances, such as interest income and expense; (ii) the reliability of automated reporting, such as IT system generated arrears reporting; and (iii) the operation of technology dependent manual controls; — We performed additional control testing on compensating controls, including management and governance review controls; and — We completed further substantive audit procedures over significant financial statement balances, where required to support our audit. <p>We did not identify any material issues or exceptions from those additional procedures.</p> |



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
Auckland

15 August 2019

Corporate governance

Corporate governance

This corporate governance statement describes Heartland Group Holdings Limited's (**Heartland**) corporate governance policies and practices as at 30 June 2019.

Heartland, as the parent company of the Group, is committed to ensuring that Heartland's policies and practices reflect current best practice, in the interests of Heartland's shareholders and other stakeholders. In addition to information about Heartland's corporate governance policies and practices, this section also includes information about Heartland Bank Limited's (**Heartland Bank**) corporate governance policies and practices. Heartland Bank has its own Board and Board Committees, and makes independent decisions (including on corporate governance matters), however Heartland and Heartland Bank Board and Committee meetings are held consecutively and members of both Boards or Committees (as applicable) attend both meetings. Heartland's important corporate governance policies and practices either apply to, or have been adopted by, Heartland Bank.

Heartland is pleased to report that, other than in respect of the matter explained in the "Principle 3 – Board Committees" section below, it was fully compliant with the corporate governance principles contained in the *NZX Corporate Governance Code* (the **NZX Code**) as at 30 June 2019.

PRINCIPLE 1 – CODE OF ETHICAL BEHAVIOUR

Directors should set high standards of ethical behaviour, model this behaviour and hold management accountable for these standards being followed throughout the organisation.

Codes of Conduct

Heartland's Code of Conduct and Directors' Code of Conduct set out the ethical and behavioural standards expected of Heartland and its subsidiaries' (the **Group**) directors, employees and intermediaries. The Codes of Conduct are available on Heartland's shareholder website, shareholders.heartland.co.nz.

The Codes of Conduct cover a wide range of areas, including:

- ▲ Heartland's responsibilities towards shareholders and the financial community, its customers, clients and service providers, and its employees;
- ▲ conflicts of interest, including the receipt of gifts and other corporate opportunities;
- ▲ confidentiality; and
- ▲ the procedure for advising Heartland of a suspected breach.

Every new director or employee is to be provided with a copy of the Code of Conduct and must confirm that they have read and understand it. Each director and staff member has an obligation, at all times, to comply with the spirit as well as the letter of the law, to comply with the principles of the Code of Conduct, including exhibiting a high standard of ethical behaviour. The Codes of Conduct are subject to annual review.

Insider Trading Policy

In addition to the prohibition on insider trading, the Group's directors, senior employees and other restricted persons are prohibited from buying or selling the Group's quoted financial products during 'blackout periods' – which are periods that commence before the end of the half-year and the full-year and end once the financial results from the half-year or the full-year have been released to the market. In addition, all of the Group's directors, senior employees and other restricted persons are required to obtain consent before buying or selling the Group's quoted financial products outside of blackout periods, and to certify that their decision to buy or sell has not been made on the basis of inside information.

The Board continually assesses, with the assistance of the Heartland Bank Board, whether any matters under consideration are likely to materially influence Heartland's share price and therefore whether additional trading restrictions should be imposed on directors, senior employees and other restricted persons.

The Insider Trading Policy is available on Heartland's shareholder website, shareholders.heartland.co.nz. Through our share registrar, Link Market Services, we actively monitor trading in Heartland shares by directors, senior employees and other restricted persons.

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE

To ensure an effective board, there should be a balance of independence, skills, knowledge, experience and perspectives.

Role of the Board

The Board is responsible for corporate governance and setting the Group's overall strategic direction. The Board charter regulates Board procedure and describes the Board's role and responsibilities in detail, and is available on Heartland's shareholder website, shareholders.heartland.co.nz. The Board establishes objectives, strategies and an overall policy framework within which the Group's business is conducted.

The Board schedules regular meetings at which it receives briefings on key strategic and operational issues from management.

Board processes

The Board held five meetings, and the Heartland Bank Board held eight meetings, during the year ended 30 June 2019. The following table shows attendance by each director at the meetings of the Heartland and Heartland Bank Boards and Heartland Board Committees of which he or she was a member.

| | Board | | | |
|-----------------------------|---------------------------------|-----------------------|--------------------------------------|----------------------------|
| | Heartland Eligible to attend | Heartland Attended | Heartland Bank Eligible to attend | Heartland Bank Attended |
| J K Greenslade | 5 | 5 | 8 | 8 |
| E F Comerford | 5 | 5 | 8 | 8 |
| E J Harvey | – | – | 8 | 8 |
| B R Irvine | – | – | 8 | 8 |
| G Kennedy (retired 28/3/19) | – | – | 8 | 8 |
| C R Mace | 5 | 4 | 3 | 3 |
| K Morrison (appt 29/3/19) | – | – | 1 | 1 |
| G T Ricketts | 5 | 5 | 8 | 8 |
| V C M Stoddart | – | – | 8 | 8 |
| G R Tomlinson | 5 | 5 | 3 | 2 |

| | Audit Committee | | | | Risk Committee | | | | Corporate Governance, People, Remuneration and Nominations Committee | | | | Corporate Finance Committee | |
|-----------------------------|-----------------|------------|-------------|------------|----------------|------------|-------------|------------|--|------------|-------------|------------|-----------------------------------|------------|
| | HGH Elig | HGH Att | HBL Elig | HBL Att | HGH Elig | HGH Att | HBL Elig | HBL Att | HGH Elig | HGH Att | HBL Elig | HBL Att | HGH Elig | HGH Att |
| J K Greenslade | – | – | – | – | – | – | – | – | – | – | – | – | 0 | 0 |
| E F Comerford | 3 | 2 | – | – | 3 | 3 | 6 | 6 | – | – | – | – | 0 | 0 |
| E J Harvey | – | – | 5 | 5 | – | – | 6 | 6 | – | – | – | – | – | – |
| B R Irvine | – | – | 5 | 5 | – | – | – | – | 3 | 3 | 1 | 1 | 0 | 0 |
| G Kennedy (retired 28/3/19) | – | – | 2 | 2 | – | – | 5 | 5 | – | – | – | – | – | – |
| C R Mace | 3 | 3 | – | – | 3 | 3 | – | – | – | – | – | – | – | – |
| K Morrison (appt 29/3/19) | – | – | – | – | – | – | 1 | 1 | – | – | – | – | – | – |
| G T Ricketts | 3 | 3 | 5 | 5 | – | – | – | – | 3 | 3 | 1 | 1 | 0 | 0 |
| V C M Stoddart | – | – | 3 | 2 | – | – | 6 | 5 | – | – | 1 | 1 | – | – |
| G R Tomlinson | – | – | – | – | – | – | – | – | 3 | 3 | 1 | 1 | 0 | 0 |

Note: Elig = Eligible to attend; Att = Attended; HGH = Heartland; and HBL = Heartland Bank.

All of the then serving members of the Heartland Bank Board attended the Annual Meeting held on 19 September 2018.

Director appointment

The Corporate Governance, People, Remuneration and Nominations Committee is tasked with the role of reviewing Heartland Board composition, and reviewing and making recommendations in relation to nominations, for the Board's consideration.

Each new director of Heartland is required, pursuant to the Heartland board charter, to enter into a written agreement with Heartland in respect of his or her appointment and Heartland has a pro forma director appointment letter which is tailored for individual appointments.

Corporate governance

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE (CONTINUED)

Board membership, size and composition

The NZX Main Board Listing Rules provide that the number of directors must not be fewer than three. Subject to this limitation, the size of the Board is determined from time to time by the Board.

As at 30 June 2019, the Board comprised five directors, being an independent Chairman, the Chief Executive Officer and three non-executive directors. The Board encourages rigorous discussion and analysis when making decisions.

As mentioned above, Heartland Bank has its own Board and Board Committees, and meetings are held consecutively with Heartland Board and Board Committees meetings. Members of both Boards and Committees (as applicable) attend both Heartland and Heartland Bank Board or Committee meetings (as applicable), which further encourages rigorous discussion and analysis.

The Board recognises the need to have a range of complementary skills, knowledge and experience in order to support the Group's implementation of its strategic priorities, and for the Board to have a balance of skills and attributes in order to support diversity at board level. With this in mind, both the Heartland and the Heartland Bank Boards regularly reviews their composition and formally assess their collective skills, knowledge and experience using a skills matrix developed specifically for the Group. This exercise provides an opportunity to reflect on and discuss current Board composition, as well as succession planning. The current Boards comprise directors with a mix of qualifications, skills and attributes who hold diverse business, governance and industry experience.

Set out below is a table summarising the skills, knowledge and experience of the Heartland and Heartland Bank Boards as at 30 June 2019. The results of the assessment are provided as the average score across all of the directors for a particular category. Details regarding the scoring system are also provided below.

| Category | Description | Average score |
|---------------------------------------|---|---------------|
| Risk Management | Risk management frameworks, setting risk appetite, building and adapting organisational risk culture, regulatory relationships, assessing the effectiveness of senior leadership. | 4 |
| Governance and Compliance | Implementing organisation-wide governance and compliance systems, processes and frameworks, regulatory compliance, assessing the effectiveness of senior leadership. | 4.5 |
| Capital/Financial/M&A Acumen | Implementation of financial and capital management strategies, corporate finance restructuring, capital raisings within risk appetite/ICAAP, M&A experience. | 4 |
| Corporate Strategy | Reviewing and setting organisational strategy, organic growth opportunities, merger and acquisition opportunities (including joint ventures). | 4.25 |
| Leadership | Driving engagement and enablement, evaluating employee and executive performance, strategic workforce planning, succession, leading organisation change and talent development. | 4.75 |
| Remuneration | Detailed executive remuneration matters (including scorecard target setting), incentive arrangements, staff superannuation. Understanding of the relevant legislative/contractual framework for remuneration. | 3.75 |
| Health & Safety | Implementing health, safety and wellbeing strategies, proactive identification and prevention of health and safety risks. | 3.75 |
| Government Relations/Policy | Interaction with Government, Regulators, and Reserve Bank at all levels, influencing public policy decisions and outcomes. | 3.5 |
| Banking | Domestic and/or international experience in Banking, including the regulatory landscape for banks. | 3.75 |
| Liquidity and Funding | Broad experience in funding and liquidity strategies and management, regulatory requirements and options available to registered banks. | 3.5 |
| Issues/Event Management | For example, credit rating downgrade, social media events, regulatory breaches or changes and other reputational events. | 4 |
| Related Industries/Insurance | Broad experience across industries related to banking, funds management, reverse mortgages, consumer finance, general insurance. | 3.25 |
| Customer Data/CRM | Experience in driving strategic insights from the collection and analysis of customer data, experience in customer relationship management, cloud computing and software delivery. | 3.5 |
| Digital and Information Technology | Understanding digital distribution and latest innovations and technologies disrupting traditional distribution processes. Domestic and/or international experience in IT strategies, IT networks, cloud computing and software delivery. | 3 |
| RBNZ/Regulatory Compliance | Experience relating to RBNZ compliance regime and other applicable compliance with regulatory bodies (e.g. Australia). | 3.5 |
| Australian Experience | Experience in banking/financial and related markets. Experience with regulatory bodies, APRA, ASIC, ASX, etc. | 4 |
| Corporate Emotional Intelligence (EQ) | Personal attributes relevant to the Board environment including communication skills, the ability to constructively challenge, championing an environment that effectively deals with complex issues and continually seeking to "lift the bar". | 4 |

PRINCIPLE 2 – BOARD COMPOSITION AND PERFORMANCE (CONTINUED)

| Level | Descriptor | Summary of skill / experience |
|-------|------------------------------|---|
| 0 | No skills/experience | Limited-to-no skills/experience and exposure (either as a Senior Manager or Non-Executive Director (NED) or a combination of both). |
| 1 | Basic skills/experience | Basic level of exposure and skills/experience (either as a Senior Manager or NED or a combination of both). |
| 2 | Moderate skills/experience | Adequate exposure and skills/experience (either as a Senior Manager or NED or a combination of both). |
| 3 | Proficient skills/experience | Full capability and experience to draw upon and contribute to Board (either as a Senior Manager or NED or a combination of both). |
| 4 | Strong skills/experience | Extensive skill and experience over a significant amount of time and multiple companies (either as a Senior Manager or NED or a combination of both). |
| 5 | Expert skills/experience | Deep subject matter expertise across all facets of the relevant skill/experience (either as a Senior Manager or NED or a combination of both). |

Board training and performance assessment

To ensure on-going education, directors are regularly informed of developments that affect the industry and business environment, as well as company and legal issues that impact the directors themselves. Directors have access to management and any additional information they consider necessary for informed decision making.

The Boards of Heartland and Heartland Bank undertake a formal review of their own, their committees' and individual directors' performance at least annually, and – as noted above – reviews their composition using a skills matrix. This is to ensure that they each have a range of complementary skills, knowledge and experience in order to effectively govern the Group, to monitor its performance, and to support the implementation of its strategic priorities – in the interests of its shareholders and other stakeholders.

Diversity and inclusion

In order to articulate its commitment to diversity, Heartland has developed a Diversity & Inclusion Policy, which requires the Board, with the help of the Diversity Committee, to set measurable objectives for achieving diversity and to track progress against them. *Heartland's Diversity & Inclusion Policy* is available on Heartland's shareholder website, shareholders.heartland.co.nz.

A discussion of Heartland's Diversity and Inclusion Policy and a report on the measurable objectives which were set for 2019 is included on page 73 of this Financial Report.

PRINCIPLE 3 – BOARD COMMITTEES

The board should use committees where this will enhance its effectiveness in key areas, while still retaining board responsibility.

Board Committees

As at 30 June 2019, Heartland had four permanently constituted Board Committees, each of which is tasked with working with management in its specific area of responsibility and reporting its findings and recommendations to the Board. Management attend committee meetings as required (however, in the case of Audit Committee and Corporate Governance, People, Remuneration and Nominations Committee meetings, management attend only at the invitation of the relevant Committee).

Each of these Committees has a charter which sets out the committee's objectives, membership, procedures and responsibilities. A Committee does not take action or make decisions on behalf of the Board unless it is specifically mandated to do so. The charter of each Committee is available on Heartland's shareholder website, shareholders.heartland.co.nz.

The Board is comfortable that no other standing Committees are necessary at this stage; however other ad hoc Committees are established for specific purposes from time to time.

As at 30 June 2019, Heartland Bank also had a permanently constituted Risk Committee and an Audit Committee which are tasked with working with management and reporting their findings and recommendations to the Heartland Bank Board.

Audit Committee

Membership is restricted to non-executive directors, with at least three members, the majority of whom must be independent. The Chair of the Audit Committee must be an independent director who is not the Chair of the Board.

As at 30 June 2019, the members of the Audit Committee were E F Comerford (Chair), C R Mace and G T Ricketts.

Corporate governance

PRINCIPLE 3 – BOARD COMMITTEES (CONTINUED)

The role of the Audit Committee is to advise and provide assurance to the Board in order to enable the Board to discharge its responsibilities in relation to the oversight of:

- ▲ The integrity of financial control, financial management and external financial reporting.
- ▲ The internal audit function.
- ▲ The independent audit process.

The Audit Committee works closely with the Heartland Bank Audit Committee, which has similar responsibilities in relation to Heartland Bank, and their meetings occur consecutively. As at 30 June 2019, the Board determined that all committee members had a recognised form of financial expertise in accordance with the Audit Committee's charter.

Risk Committee

Membership of the Risk Committee is restricted to non-executive directors, with at least three members, the majority of whom must be independent. The Chair of the Risk Committee must be an independent director who is not the Chair of the Board.

As at 30 June 2019, the members of the Risk Committee were E F Comerford (Chair), C R Mace and G T Ricketts.

The role of the Risk Committee is to advise and provide assurance to the Board in order to enable the Board to discharge its responsibilities in relation to the oversight of:

- ▲ the formulation of its risk appetite
- ▲ to provide the Board with assurance that all risks within the key risk categories which are relevant to the Group have been appropriately identified, managed and reported to the Board.

The Risk Committee works closely with the Heartland Bank Risk Committee, which has similar responsibilities in relation to Heartland Bank, and their meetings occur consecutively.

Corporate Governance, People, Remuneration and Nominations Committee

The Corporate Governance, People, Remuneration and Nominations Committee is required to have at least three directors, the majority of whom must be independent.

As at 30 June 2019, the members of the Corporate Governance, People, Remuneration and Nominations Committee were G T Ricketts (Chair), B R Irvine and G R Tomlinson. Although B R Irvine is a director of Heartland Bank and not Heartland, the Board are of the view that a director of Heartland Bank should be a member of the Corporate Governance, People, Remuneration and Nominations Committee given that the vast majority of employees of the Group are employed by Heartland Bank. B Irvine, as Chairman of Heartland Bank, represents Heartland Bank's position in that regard. Accordingly, Heartland has not strictly complied with recommendation 3.3 of the NZX Code as the majority of the committee are not independent directors of Heartland. Instead, the committee has one independent director of Heartland and one independent director of Heartland Bank but, as described above, the Board considers this appropriate for Heartland.

The role of the Corporate Governance, People, Remuneration and Nominations Committee includes advising and making recommendations to the Board regarding:

- ▲ corporate governance matters
- ▲ people strategy, including organisation structure, performance, succession planning, development, culture, diversity and remuneration strategy and policies and any other strategic people initiatives
- ▲ remuneration of the directors, Chief Executive Officer and senior executives
- ▲ the performance of the Chief Executive Officer including setting and review of annual KPIs
- ▲ director and senior executive appointments, Board composition and succession planning.

PRINCIPLE 3 – BOARD COMMITTEES (CONTINUED)

Corporate Finance Committee

The Corporate Finance Committee is required to have at least three directors, the majority of whom must be independent, and one of whom will be the Chief Executive Officer.

As at 30 June 2019, the members of the Corporate Finance Committee were G T Ricketts (Chair), E F Comerford, J K Greenslade, B R Irvine and G R Tomlinson.

The role of the Corporate Finance Committee is to advise and provide assurance to the Board in order to enable the Board to discharge its responsibilities in relation to the oversight of the management of Heartland's financial resources and major financial strategies and transactions.

Takeovers Response Manual

The Board has documented and adopted a Takeover Response Manual document, which is designed to give the board and management clear direction on the steps that needed to be taken following receipt of a takeover offer.

The document, amongst other things, includes an "independent director" protocol for directors who are involved in or associated with the bidder, talks to the scope of independent advisory reports to shareholders, and prompts the Board to consider the option of establishing an independent takeover committee following receipt of a takeover offer.

PRINCIPLE 4 – REPORTING AND DISCLOSURES

The board should demand integrity in financial and non-financial reporting, and in the timeliness and balance of corporate disclosures.

Heartland appreciates that its investors and other stakeholders value both financial and non-financial reporting, and Heartland seeks to ensure that its investors have timely access to full and accurate material information about Heartland which is factual and balanced.

Heartland's Disclosure Policy sets out procedures that are in place to make sure all material information is identified and disclosed in a timely manner, and to prevent the selective disclosure of material non-public information. Under the Policy, potentially 'material information' is required to be brought to the attention of the Disclosure Committee, which is ultimately responsible for determining whether information is material, and approving the form and content of material information that is disclosed. Heartland also monitors information in the market about itself and (with the assistance of the Disclosure Committee) will release information to the extent necessary to prevent development of a false market for the Group's quoted financial products.

All of Heartland's key governance documents, including the Disclosure Policy, are available on Heartland's shareholder website, shareholders.heartland.co.nz. Heartland also maintains copies of its stock exchange announcements, and half-year and full-year reports, investor presentations and details of annual shareholder meetings, on its shareholder website.

Audit Committee

The Audit Committee oversees the quality and timeliness of all external financial reports, including all disclosure documents issued by Heartland.

The Audit Committee oversees the preparation of Heartland's financial statements and setting policy to ensure the information presented is useful for investors and other stakeholders. Heartland makes its financial statements easy to read by using clear, plain language, and structuring them so that key information is prominent. In addition to the full-year audit, Heartland's external auditor completes a review of the interim financial statements.

The Chief Executive Officer and Chief Financial Officer are also required to certify to the Audit Committee that the financial statements of Heartland and its subsidiaries present a true and fair view of Heartland and comply with all relevant accounting standards.

Non-financial reporting

Heartland is committed to delivering value for its customers, shareholders, employees, communities, partners and intermediaries. This is the second year that Heartland has reported against a Corporate Social Responsibility Framework in order to provide more detailed information on the value created for Heartland's stakeholders. Refer to page 30 of the 2019 Annual Review.

Corporate governance

PRINCIPLE 5 – REMUNERATION

The remuneration of directors and executives should be transparent, fair and reasonable.

Heartland's remuneration strategy is designed to create a high performance culture which attracts and retains quality candidates by incentivising and rewarding exceptional performance.

Heartland has developed a Remuneration Policy which explains its remuneration strategy and its approach to setting remuneration in more detail. The key principles are that Heartland's remuneration policy:

- ▲ supports the attraction, retention and engagement of quality, diverse candidates;
- ▲ does not discriminate on the basis of gender, ethnicity, sexuality or any other individual factor;
- ▲ should further Heartland's aspiration to achieve pay equity across the organisation;
- ▲ rewards for high performance;
- ▲ has the flexibility to cater for Heartland's operational differences;
- ▲ recognises the link between company performance and remuneration, and the importance of creation of shareholder value; and
- ▲ is understood by employees.

The full Remuneration Policy is available on Heartland's shareholder website at shareholders.heartland.co.nz.

Heartland's Corporate Governance, People, Remuneration and Nominations Committee (the **Committee**) is kept up to date with relevant market information and best practice, obtaining advice from external advisors when necessary. Heartland has used PriceWaterhouseCoopers as a consultant for advice on various remuneration activities including, but not limited to, the structure of its Long Term Incentive Schemes and the valuation of the performance rights under these schemes.

Remuneration levels are reviewed annually for market competitiveness and alignment with strategic and performance priorities. All senior executive performance is assessed by the Committee with reference to Group risk management policies and frameworks.

Non-executive directors' remuneration

Total remuneration available to the Group's non-executive directors is determined by Heartland's shareholders. The current aggregate approved amount by shareholders is \$1,200,000 per annum.

Heartland's policy is to pay directors' fees in cash. There is no requirement for directors to take a portion of their remuneration in shares and nor is there a requirement for directors to hold shares in Heartland. However, as at 30 June 2019, a number of the directors held shares, or a beneficial interest in shares, in Heartland (see the Directors' Disclosures section of this Financial Report for further details).

Senior executive remuneration

The objective is to provide competitive remuneration that aligns executives' remuneration with shareholder value and rewards the executives' achievement of the Group's strategies and business plans.

All senior executives receive a base salary and are also eligible to participate in short-term and, in some cases, long-term incentive plans under which they are rewarded for achieving key performance and operating results.

Disclosure of the CEO's remuneration is included in the Directors' Disclosures section on page 69 of this Financial Report.

PRINCIPLE 6 – RISK MANAGEMENT

Directors should have a sound understanding of the material risks faced by the issuer and how to manage them. The Board should regularly verify that the issuer has appropriate processes that identify and manage potential and material risks.

Risk management

The Board ensures that Heartland has a Risk Management Programme in place which identifies, manages and communicates the key risks that may impact Heartland's business. Specific risk management strategies have been developed for each of the key risks identified. The Risk Committee of the Board oversees the risk management programme and strategy. Heartland also has in place insurance cover for insurable liability and general business risk.

Health and safety

Heartland promotes a working environment where we engage with all our people, so that together we can ensure a workplace that is mentally and physically safe and healthy; and to promote a positive health and safety culture. We engage with our people to identify, assess, control and review risk, with a focus on continuous improvement of health and safety.

All Group employees are required read and attest to our Health, Safety and Wellbeing Policy. Induction includes instruction on our Health and Safety Policy and procedures. The Health & Safety Committee, representing all employees, convenes every second month to discuss reported incidents, accidents and near misses, initiatives and tabled reports. Incidents, accidents and near misses are registered in our Risk Management System (RMS). A Health & Safety Report that includes RMS data, number of employee insurance claims, number of employees accessing counselling, and summaries of initiatives is provided to the Executive Risk Committee and to the Board.

In the year ended 30 June 2019, there have been no notifiable events to report to Worksafe New Zealand.

PRINCIPLE 7 – AUDITOR

The board should ensure the quality and independence of the external audit process.

The Audit Committee is responsible for overseeing the external, independent audit of Heartland's financial statements. This encompasses processes for sustaining communication with Heartland's external auditor, ensuring that the ability of the external auditor to carry out their statutory audit role is not impaired, or could reasonably be perceived to be impaired, to address what other services may be provided by the external auditor to Heartland, and to provide for the monitoring and approval of any such services.

Heartland's External Auditor Independence Policy provides guidelines to ensure that non-audit related services do not conflict with the independent role of the external auditor, and the Audit Committee ensures that non-audit work undertaken by the auditor is in accordance with that Policy. That Policy also sets out guidelines in relation to the tenure and re-appointment of the external auditor, which the Audit Committee ensures are complied with. Refer to Heartland's shareholder website, shareholders.heartland.co.nz, for a copy of the External Auditor Independence Policy.

The external auditor monitors its independence and reports to the Audit Committee bi-annually to confirm that it has remained independent in the previous six months, in accordance with Heartland's External Auditor Independence Policy and the external auditor's policies and professional requirements. There have been no threats to auditor independence identified during the year ended 30 June 2019.

Heartland also has an internal audit function which is independent of the external auditor. The Audit Committee approves the annual internal audit programme, which is developed in consultation with management of Heartland.

PRINCIPLE 8 – SHAREHOLDER RIGHTS & RELATIONS

The board should respect the rights of shareholders and foster constructive relationships with shareholders that encourage them to engage with the issuer.

The Board is committed to maintaining a full and open dialogue with all shareholders, as outlined in the Disclosure Policy which is available on Heartland's shareholder website, shareholders.heartland.co.nz. Heartland keeps shareholders informed through:

- ▲ periodic and continuous disclosure to NZX and ASX
- ▲ information provided to analysts and media during briefings
- ▲ Heartland's shareholder website (shareholders.heartland.co.nz)
- ▲ the Annual Meeting, at which shareholders have the opportunity to ask questions
- ▲ annual and half year reports.

The Board encourages full participation of shareholders at the Annual Meeting to ensure a high level of accountability. Heartland's external auditor also attends the Annual Meeting and is available to answer questions relating to the external audit.

Disclosures

Directors' disclosures

DIRECTORS

The following persons were directors of Heartland and its subsidiaries during the year ended 30 June 2019.

| Company | Directors | |
|--|---|--|
| Heartland Group Holdings Limited | Geoffrey Thomas Ricketts Ellen Frances Comerford Jeffrey Kenneth Greenslade Christopher Robert Mace Gregory Raymond Tomlinson | Independent Director (Chair)* Independent Director* Executive Director (commenced 19/07/2018)* Independent Director* Non-Independent Director* *Appointed 31/10/2018 (as a result of the corporate restructure) |
| Heartland Bank Limited | Bruce Robertson Irvine Ellen Frances Comerford Jeffrey Kenneth Greenslade Edward John Harvey Graham Russell Kennedy Christopher Robert Mace Kathryn Morrison Geoffrey Thomas Ricketts Vanessa Cynthia May Stoddart Gregory Raymond Tomlinson | Independent Director (Chair) Independent Director (re-elected 22/11/2017) Non-Independent Director Independent Director (re-elected 19/09/2018) Independent Director (retired 28/03/2019) Independent Director (resigned 31/10/2018) Independent Director (appointed 29/03/2019) Independent Director (re-elected 22/11/2017) Independent Director (re-elected 19/09/2018) Non-Independent Director (resigned 31/10/2018) |
| ASF Custodians Pty Limited | Andrew John Ford Richard Glenn Udovenya | |
| Australian Seniors Finance Pty Limited | Andrew John Ford Richard Glenn Udovenya | |
| Heartland Australia Holdings Pty Ltd | Ellen Frances Comerford Christopher Patrick Francis Flood Andrew John Ford Jeffrey Kenneth Greenslade Geoffrey Thomas Ricketts Gregory Raymond Tomlinson | Christopher Flood resigned 31/10/2018 and Jeffrey Greenslade, Geoffrey Ricketts and Gregory Tomlinson were appointed. |
| Heartland Australia Group Pty Ltd | Ellen Frances Comerford Christopher Patrick Francis Flood Andrew John Ford Jeffrey Kenneth Greenslade Geoffrey Thomas Ricketts Gregory Raymond Tomlinson | Christopher Flood resigned 31/10/2018 and Jeffrey Greenslade, Geoffrey Ricketts and Gregory Tomlinson were appointed. |
| Heartland NZ Trustee Limited | Philippa Rosemary Drury Christopher Patrick Francis Flood | |
| Heartland PIE Fund Limited | Jeffrey Kenneth Greenslade Bruce Robertson Irvine | |
| MARAC Insurance Limited | Andrew James Aitken Christopher Patrick Francis Flood Christopher Robert Mace Sarah Elizabeth Ann Smith | |
| Seniors Finance Custodians Pty Limited | Andrew John Ford Richard Glenn Udovenya | |
| Seniors Finance Pty Limited | Andrew John Ford Richard Glenn Udovenya | |
| Sentinel Custodians Limited | Christopher Patrick Francis Flood | (amalgamated with Heartland Bank from 1 October 2018) |
| VPS Properties Limited | Christopher Patrick Francis Flood | |

When determining whether a director of Heartland is independent, the factors described in the NZX Code as possibly impacting a director's independence were considered and it was determined that none of those factors applied to the directors noted above as independent.

INTERESTS REGISTER

The following are the entries in the Interests Register of Heartland (and its subsidiaries) made during the year ended 30 June 2019.

Indemnification and insurance of directors

Heartland has given indemnities to, and has effected insurance for, directors of Heartland and its subsidiaries to indemnify and insure them in respect of any liability for, or costs incurred in relation to, any act or omission in their capacity as directors, to the extent permitted by the Companies Act 1993. The cost of the insurance premiums to the Group for the year ended 30 June 2019 was \$87,975.00 (including GST).

Share dealings by directors

Details of individual directors' share dealings as entered in the Interests Register of Heartland and Heartland Bank (in respect of share dealings prior to 31 October 2018) under Section 148(2) of the Companies Act 1993 during the year ended 30 June 2019 are as follows (all dealings are in ordinary shares unless otherwise specified):

E J Harvey

| Date of acquisition/ disposal | Nature of relevant interest | Acquisition/disposal | No. of shares | Consideration |
|-------------------------------|-----------------------------|----------------------|---------------|---------------|
| 21 September 2018 | Allotment under DRP | Acquisition | 3,779 | \$6,140.88 |
| 29 March 2019 | Allotment under DRP | Acquisition | 2,740 | \$4,030.27 |

J K Greenslade

| Date of acquisition/ disposal | Nature of relevant interest | Acquisition/disposal | No. of shares | Consideration |
|-------------------------------|-----------------------------|----------------------|---------------|---------------|
| 22 February 2019 | Purchase of shares | Acquisition | 141,000 | \$195,194.47 |
| 29 March 2019 | Allotment under DRP | Acquisition | 74,118 | \$109,020.17 |

B R Irvine

| Date of acquisition/ disposal | Nature of relevant interest | Acquisition/disposal | No. of shares | Consideration |
|-------------------------------|-----------------------------|----------------------|---------------|---------------|
| 29 March 2019 | Allotment under DRP | Acquisition | 8,892 | \$13,079.24 |
| 29 March 2019 | Allotment under DRP | Acquisition | 2,564 | \$3,771.39 |

G R Tomlinson

| Date of acquisition/ disposal | Nature of relevant interest | Acquisition/disposal | No. of shares | Consideration |
|-------------------------------|-----------------------------|----------------------|---------------|----------------|
| 20 February 2019 | Purchase of shares | Acquisition | 500,000 | \$675,000 |
| 21 February 2019 | Purchase of shares | Acquisition | 500,000 | \$685,000 |
| 29 March 2019 | Allotment under DRP | Acquisition | 1,217,286 | \$1,790,505.98 |

Disclosures

General notice of disclosure of interests in the interests register

Details of any changes to Heartland and Heartland Bank directors' general disclosures entered in the relevant interests register under Section 140 of the Companies Act 1993 during the year ended 30 June 2019 are as follows:¹

| | |
|----------------|--|
| E J Comerford | Ceased directorship of Cash Converters International Limited from 30 September 2018. |
| E J Harvey | Appointed director to Port of Napier Limited on 7 February 2019. Ceased directorship of New Zealand Opera Limited on 28 September 2018. |
| B R Irvine | Appointed director to Scenic Hotel (Haast) Limited from 29 January 2019, Gough Transport Supplies Limited from 13 May 2019, Gough Finance Limited, Gough Gough and Hamer Limited, Gough Group Limited, Gough Holdings Limited and Gough Transport NZ Limited from 5 November 2018, Kaipaki Holdings Limited and Kaipaki Properties Limited from 18 October 2018 and Kaipaki Berryfruits Limited from 17 October 2018. Ceased directorship of PGG Wrightson from 30 April 2019, Cowes Bay Holdings (NZ) Limited from 5 April 2019, Market Gardeners Orders (Christchurch) Limited and Market Gardeners Orders Wellington Limited from 17 October 2018. |
| C R Mace | Appointed director to Akitu Group Company No 1 Limited, Akitu Group Company No 2 Limited and Akitu Group Company No 3 Limited from 18 October 2018 and Akitu Investments No 2 Limited from 17 October 2018. Ceased directorship to The New Zealand Initiative Limited from 13 September 2018. |
| G T Ricketts | Appointed director to Oceania North Limited from 12 February 2019, MCF3 GP Limited, MCF3A General Partner Limited and MCF3B General Partner Limited from 31 October 2018 and MCF2 FFF – GK Limited from 23 October 2018. Ceased directorship of Highground Trust Limited from 30 January 2019, MCF 1 Limited from 5 December 2018, MCF 3 Limited from 18 October 2018 and MCF5 Limited from 13 September 2018. |
| V C M Stoddart | Appointed director to Nelson Forests Limited from 31 May 2019, Nelson Management Limited, OneFortyOne Plantations Holdings Pty Limited, OneFortyOne Plantations Pty Ltd, OneFortyOne Plantation Holdings No. 2 Pty Ltd, OneFortyOne Wood Products Pty Ltd and OneFortyOne NZ Holdings Limited from 7 February 2019, and Stoddart & Co Limited from 19 December 2018. Ceased directorship of Alliance Group Limited from 11 April 2019. |
| G R Tomlinson | Appointed director to Tomlinson Ventures Limited from 1 May 2019. Ceased directorship of Oceania Healthcare Holdings Limited from 22 May 2019. |

Details of Heartland Bank directors' general disclosures entered in the relevant interest register under Section 140 of the Companies Act 1993 prior to 1 July 2018 can be found in earlier Annual Reports.

Specific disclosures of interest in the interests register

There were no specific disclosures of interests in transactions entered into by Heartland or its subsidiaries (including Heartland Bank) during the period 1 July 2018 to 30 June 2019.

Information used by directors

No director of Heartland or its subsidiaries (including Heartland Bank) disclosed use of information received in his or her capacity as a director that would not otherwise be available to that director.

HEARTLAND AND HEARTLAND BANK DIRECTORS' RELEVANT INTERESTS

| Director | Number of ordinary shares – beneficial | Number of ordinary shares – non-beneficial ² | Number of options |
|----------------|--|---|-------------------|
| J K Greenslade | 3,421,443 | Nil | 1,720,881 |
| E J Harvey | 126,506 | 6,475,976 | Nil |
| B R Irvine | 528,856 | 6,475,976 | Nil |
| C R Mace | 14,337,489 | 6,475,976 | Nil |
| G T Ricketts | 13,267,285 | 6,475,976 | Nil |
| G R Tomlinson | 56,192,322 | Nil | Nil |

1. For the purposes of this disclosure, whilst Heartland's interests register was created during the relevant financial year and as such all of the entries made in that register immediately after the corporate restructure (which occurred on 31 October 2018) were "new", only entries which related to matters which occurred during the relevant financial year have been disclosed.

2. The non-beneficial interest in the 6,475,976 shares arises from those directors being a trustee of the Heartland Trust, which held 6,475,976 shares in Heartland as at 30 June 2019.

DIRECTORS' REMUNERATION

The current total fee pool for the non-executive directors of Heartland and its subsidiaries approved by shareholders at the Annual Shareholder Meeting of Heartland Bank Limited held on 22 November 2016 is \$1,200,000 per annum.³

The table below sets out the fees payable to the non-executive directors of Heartland for the year ended 30 June 2019 based on the position(s) held.

| Board/Committee ⁴ | Position | Fees (per annum) |
|--|---------------------------|------------------|
| Board of Directors | Chair | \$150,000 |
| | Deputy Chair ⁵ | \$110,000 |
| | Member | \$100,000 |
| Audit Committee | Chair | \$15,000 |
| | Member | Nil |
| Risk Committee | Chair | \$15,000 |
| | Member | Nil |
| Corporate Governance, People, Remuneration and Nominations Committee | Chair | \$15,000 |
| | Member | Nil |
| Corporate Finance Committee | Chair | Nil |
| | Member | Nil |

The total remuneration and value of other benefits⁶ received by each non-executive director who held office in Heartland and/or any of its subsidiaries during the year ended 30 June 2019 is set out in the table below. Directors' fees exclude GST where appropriate.

| Director | Board Fees | Audit Committee | Risk Committee | Corporate Governance, People, Remuneration and Nominations Committee | Other | Total Remuneration |
|--|-------------------------|-----------------------|-----------------------|--|-------|---------------------------------|
| Heartland Group Holdings (HGH) and Heartland Bank Limited (HBL) directorships | | | | | | |
| E F Comerford | \$100,000 | \$10,000 ⁷ | \$10,000 ⁸ | – | – | \$120,000 |
| E J Harvey | \$100,000 | \$10,000 ⁹ | \$5,000 ¹⁰ | – | – | \$115,000 |
| B R Irvine | \$136,667 ¹¹ | \$5,000 ¹² | – | – | – | \$141,667 |
| G R Kennedy | \$75,000 ¹³ | – | – | – | – | \$75,000 |
| K Morrison | \$25,000 ¹⁴ | – | – | – | – | \$25,000 |
| C R Mace | \$100,000 | – | – | – | – | \$100,000 |
| G T Ricketts | \$150,000 ¹⁵ | – | – | \$15,000 | – | \$165,000 |
| V C M Stoddart | \$100,000 | – | – | – | – | \$100,000 |
| G R Tomlinson | \$100,000 | – | – | – | – | \$100,000 |
| Subsidiary directorships | | | | | | |
| A J Aitken | \$32,000 ¹⁶ | – | – | – | – | \$32,000 |
| E F Comerford | A\$50,000 ¹⁷ | – | – | – | – | A\$50,000 |
| P Drury | \$20,000 ¹⁸ | – | – | – | – | \$20,000 |
| C R Mace | \$15,000 ¹⁹ | – | – | – | – | \$15,000 |
| R G Udovenya | A\$30,000 ²⁰ | – | – | – | – | A\$30,000 |
| Total | | | | | | \$1,092,869²¹ |

- On 4 October 2018, NZX granted Heartland a waiver from Rule 3.5.1, to the extent that this Rule requires the Directors' Remuneration Pool to be authorised by an Ordinary Resolution of Heartland (as opposed to Heartland Bank).
- If a director sits on both the Heartland and Heartland Bank boards, they are only entitled to receive one fee.
- To 31 October 2018 as Heartland no longer remunerates Deputy Chairs after the corporate restructure.
- In addition to these amounts, Heartland meets costs incurred by directors, which are incidental to the performance of their duties. This includes providing directors with telephone concessions and paying the cost of directors' travel. As these costs are incurred by Heartland to enable directors to perform their duties, no value is attributable to them as benefits to directors for the purposes of the tables included in this report.
- Chair of Heartland Audit Committee from 1 November 2018.
- Chair of Heartland Bank Risk Committee from 1 November 2018 and Chair of Heartland Risk Committee from 1 January 2019.
- Chair of Heartland Bank Audit Committee from 1 November 2018.
- Chair of Heartland Bank Risk Committee to 31 October 2018.

- Deputy Chair of Heartland Bank Board to 31 October 2018, then Chair of Heartland Bank Board from 1 November 2018.
- Chair of Heartland Bank Audit Committee to 31 October 2018.
- Retired from Heartland Bank Board 28 March 2019.
- Commenced as Heartland Bank director from 29 March 2019.
- Chair of Heartland Bank Board to 31 October 2018, then Chair of Heartland Board from 1 November 2018.
- Fees paid to A J Aitken as a director of MARAC Insurance Limited.
- Fees paid to E F Comerford as a director of Heartland Australia Group Pty Limited and Heartland Australia Holdings Pty Limited.
- Fees paid to P Drury as a director of Heartland NZ Trustee Limited.
- Fees paid to C R Mace as Chair of MARAC Insurance Limited.
- Fees paid to R G Udovenya as a director of ASF Custodians Pty Limited, Australian Seniors Finance Pty Limited, Seniors Finance Custodians Pty Limited and Seniors Finance Pty Limited.
- For the purposes of this table, A\$ fees have been converted to NZ\$ using an exchange rate of \$1.05252.

Disclosures

REMUNERATION AND/OR OTHER BENEFITS FROM THE COMPANY AND ITS SUBSIDIARIES TO EXECUTIVE DIRECTORS

The remuneration for the Executive Director (being, in Heartland's case, the CEO) includes a fixed remuneration component, a variable remuneration component comprising short-term incentives (**STIs**) and long-term incentives (**LTIs**), and other benefits. LTIs are offered to selected employees (including the CEO) in order to incentivise them to enhance long term shareholder value.

STI Scheme

The CEO is entitled to receive STIs which are cash payments, determined by the Board, and paid at the end of a financial year for exceeding performance expectations in the relevant financial year. Ultimately, STI payments are entirely discretionary and entitlement is not guaranteed even if performance expectations have been met or exceeded.

LTI Schemes

Set out below is a summary of the grants made to the CEO under LTI schemes relating to the periods covered in this section.

Senior Executive Scheme

Certain previous share options schemes were all extinguished in June 2016 in consideration for participation in the Senior Executive Scheme, which resulted in the CEO acquiring Heartland shares on market at that time.

Although the shares were received in June 2016, they vested over a three year period (which has now elapsed). Accordingly, for the purposes of this disclosure, Heartland has treated the shares as vesting in three equal tranches in FY17, FY18 and FY19, with the economic value at the date of vesting being a product of the number of shares which are treated as vesting in that period and the share price on the final trading day of the relevant period.

Performance Rights Plan – 2017 Grant

Under the Performance Rights Plan – 2017 Grant, the CEO and other Senior Executives were issued performance rights which, subject to continued employment and achievement of the Total Shareholder Return (**TSR**)²² target over the measurement period of between 31 August 2016 and the date falling 10 business days following the date on which Heartland announced its full year results for the financial year ended 2019, were to vest into one share in Heartland for each Performance Right held.

During FY19, the Group was restructured, resulting in one-off costs of \$4.2 million, and there were significant changes announced in respect of regulatory requirements for conduct and culture and for regulatory capital to be held by banks. The Scheme Rules provide for adjustments to be made to account for such circumstances, and so the Board resolved that the TSR performance condition was satisfied having regard to the original spirit and intent of the Scheme and the 2017 Grant vested in accordance with its terms.

Performance Rights Plan – 2018/2019 Grant

Under the Performance Rights Plan – 2018/2019 Grant, the CEO and other Senior Executives were issued performance rights which, subject to continuous employment and achievement of certain market capitalisation and share price targets over the period between 12 September 2017 and the date falling 20 business days following the date on which Heartland announces its full year results for the financial year ended 2021, were to vest into up to one share in Heartland. The Performance Rights Plan – 2018/2019 Grant was made to provide a long term incentive for the 2018 and 2019 financial years so no separate LTI grant was made to the CEO in respect of the 2019 financial year.

Following the recent Financial Markets Authority and Reserve Bank Conduct and Culture Review, the Board determined that the performance hurdles for the 2018/2019 Grant should be amended to reference appropriate culture and conduct measures and achievement of key strategic objectives, in addition to encompassing a broader range of financial measures. The Board also determined to adjust the performance period by extending it until the end of FY22.

The Scheme Rules provide flexibility to adjust the relevant performance hurdles, including in order to account for changes during the performance period. This feature, in conjunction with the other features of the Performance Rights Plan, ensures that the 2018/2019 Grant will vest only if, and to the extent, that sustainable shareholder value is created during the performance period.

22. TSR is calculated as the combination of share price movement and cash dividends assumed to be reinvested on the ex-dividend date, expressed as a percentage of the opening share value on the Issue Date.

CEO remuneration disclosures

In the year ended 30 June 2019, the CEO received a fixed salary, a variable remuneration component comprising STI and LTI, and other benefits as detailed in the below tables. The tables also show a comparison between the year ended 30 June 2019 and the year ended 30 June 2018 and a summary of the CEO's total remuneration over the last five financial years.

This year, Heartland has presented the summary using both the accounting cost of all current LTI grants made to the CEO (which shows the cost of those arrangements to Heartland), and also the value of the awards which actually vested during the relevant financial year (which shows what remuneration was received by the CEO during the relevant financial year). The accounting cost of all current LTI grants differs from the value of the awards which actually vested. This is because the accounting cost of a grant is determined at the time the grant is made, reflects the uncertainty around whether the relevant performance criteria will be met, and is spread over the entire performance period of that grant.

CEO remuneration (FY19 and FY18)

| Financial year ended | Salary | Benefits | At risk pay | | | Total |
|----------------------|-----------|------------------------|-------------|---------------------------------|---------------------------|-------------|
| | | | STI | LTI | | |
| 30 June 2019 | \$989,200 | \$10,800 ²³ | \$450,000 | Accounting cost of all grants | \$683,552 ²⁴ | \$2,133,552 |
| | | | | Value of awards actually vested | \$1,379,161 ²⁵ | \$2,829,161 |
| 30 June 2018 | \$989,200 | \$10,800 ²⁶ | \$900,000 | Accounting cost of all grants | \$683,552 ²⁷ | \$2,583,552 |
| | | | | Value of awards actually vested | \$736,489 ²⁸ | \$2,636,489 |

23. Motor Vehicle.

24. The accounting cost of the Senior Executive Scheme, the 2017 Grant and the 2018/2019 Grant was spread over a period including FY19.

25. This represents the value of the Senior Executive Scheme shares which are being treated as vesting in FY19, and the value of the 2017 Grant based (on the share price on 9 September 2019, but noting that the shares had not yet been issued on that date). For further information about the Senior Executive Scheme shares, see the Senior Executive Scheme section.

26. Motor Vehicle.

27. The accounting cost of the Senior Executive Scheme, the 2017 Grant and the 2018/2019 Grant was spread over a period including FY18.

28. This represents the value of the Senior Executive Scheme shares which were treated as vesting in FY18. For further information, see the Senior Executive Scheme section.

Disclosures

Five year summary of total CEO remuneration

Heartland has presented the below summary using only the value of the awards which actually vested during the relevant financial year (which shows what remuneration was received by the CEO during the relevant financial year), as the accounting treatment of historic schemes is complex and, in Heartland's view, of no real significance to current shareholders.

| Financial Year ended | Total Remuneration Paid (including value of LTI awards actually vested) | Percentage STI against maximum ²⁹ | Percentage LTI against maximum ³⁰ | Span of LTI performance period |
|----------------------|---|--|--|--------------------------------|
| 30 June 2019 | \$2,829,161 | 45% | 100% | FY19 ³¹ |
| 30 June 2018 | \$2,636,489 | 90% | 100% | FY17 – FY19 |
| 30 June 2017 | \$2,736,489 | 100% | 100% | FY18 ³² |
| 30 June 2016 | \$1,700,000 | N/A | N/A | FY17 ³³ |
| 30 June 2015 | \$2,652,538 ³⁴ | N/A | N/A | N/A |
| | | | | FY13 – FY15 ³⁵ |

Breakdown of CEO At Risk Pay (FY19)

| | Description | Performance Measures | Percentage Achieved |
|-----|--|--|---------------------|
| STI | Up to 100% of base salary based on the achievement of financial and non-financial performance expectations | Based on achievement of financial and non-financial performance expectations. ³⁶ | 45% |
| LTI | Shares received in June 2016 under the now lapsed Senior Executive Scheme | The Senior Executive Scheme shares were held in escrow for a service period which expired on 30 June 2019. | 100% |
| | 2017 Grant | Continued employment during, and achievement of TSR target over, the performance period. | 100% |

29. Where "N/A", there were no maximum limits for the relevant period.

30. Where "N/A", there were no maximum limits for the relevant period.

31. The service period for the Senior Executive Scheme shares which are being treated as vesting in FY19 was FY19. For further information, see the Senior Executive Scheme section.

32. The service period for the Senior Executive Scheme shares which are being treated as vesting in FY18 was FY18. For further information, see the Senior Executive Scheme section.

33. The service period for the Senior Executive Scheme shares which are being treated as vesting in FY17 was FY17. For further information, see the Senior Executive Scheme section.

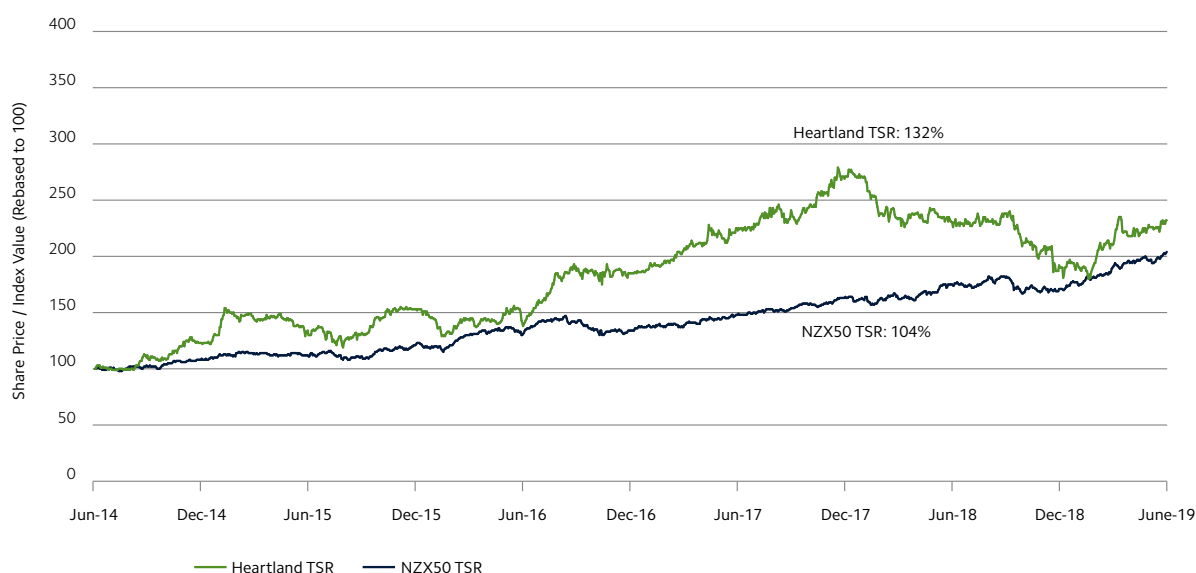
34. This includes the value of the Cash Scheme (\$647,000). It also includes the value of the FY13 Options (\$667,809), which has been calculated as if those options were settled on the final date of the service period (rather than when they were actually exercised).

35. The service period for the Cash Scheme was FY13 – FY15 (though it was settled prior to the end of that service period) and for the FY13 Options was FY13 – FY15.

36. STI payments are entirely discretionary and entitlement is not guaranteed even if measures are achieved.

CEO Grant under Performance Rights Scheme (FY18/FY19)

| Type of scheme interest | Basis of award | Face value of award and % of award vesting at threshold | Length of vesting period | Summary of performance measures and targets |
|---------------------------------------|---|--|--|---|
| Performance rights (2018/2019 Grant). | A number of performance rights equal to 200% of 2017 base salary divided by the Heartland volume weighted average share price on the date of issue. | \$2,000,000 face value. 100% vesting on full achievement of performance measures or partial vesting depending upon the extent to which performance measures were met. | 12 September 2017 to the date falling 20 business days following the date on which Heartland announces its full year results for FY22. | Continued employment during, and achievement of certain financial performance, culture and conduct, and strategic objectives during the vesting period. |

Five year summary of Heartland's TSR performance

The above five year total shareholder return (TSR) performance graph is provided to aid comparability between Heartland's performance and the remuneration information provided in this section. TSR has been calculated as at the end of the five year period, including the benefit of imputation credits. A comparison is shown against the NZX50 Index which measures the performance of the 50 largest eligible stocks listed on the NZX Main Board by float-adjusted market capitalisation.

CEO remuneration as a multiple of staff remuneration

The CEO's salary as a multiple of the staff average is 10.11 times (FY18: 10.5 times), and his total remuneration as a multiple of the staff average is 19.77 times (FY18: 19 times).

Disclosures

Executive remuneration

The number of employees of Heartland and its subsidiaries (including former employees), other than directors, who received remuneration, including non-cash benefits, in excess of \$100,000 during the year ended 30 June 2019 is set out in the remuneration bands detailed below.

| Remuneration | No. of Staff |
|-----------------------|--------------|
| \$100,000 - \$109,999 | 13 |
| \$110,000 - \$119,999 | 15 |
| \$120,000 - \$129,999 | 17 |
| \$130,000 - \$139,999 | 8 |
| \$140,000 - \$149,999 | 15 |
| \$150,000 - \$159,999 | 14 |
| \$160,000 - \$169,999 | 5 |
| \$170,000 - \$179,999 | 2 |
| \$180,000 - \$189,999 | 5 |
| \$190,000 - \$199,999 | 3 |
| \$200,000 - \$209,999 | 2 |
| \$220,000 - \$229,999 | 2 |
| \$230,000 - \$239,999 | 1 |
| \$240,000 - \$249,999 | 2 |
| \$250,000 - \$259,999 | 1 |
| \$270,000 - \$279,999 | 2 |
| \$280,000 - \$289,999 | 1 |
| \$290,000 - \$299,999 | 1 |
| \$300,000 - \$309,999 | 2 |
| \$360,000 - \$369,999 | 1 |
| \$380,000 - \$389,999 | 2 |
| \$400,000 - \$409,999 | 1 |
| \$410,000 - \$419,999 | 3 |
| \$450,000 - \$459,999 | 1 |
| \$490,000 - \$499,999 | 1 |
| \$640,000 - \$649,999 | 1 |
| \$950,000 - \$959,999 | 1 |
| Grand Total | 122 |

EXECUTIVE REMUNERATION

Diversity report

Heartland considers diversity, in all its forms, a strength. We are committed to supporting initiatives which foster diversity at all levels of the organisation to put us in a better position to attract the widest pool of talent, understand and respond to our diverse stakeholder needs, and provide us with a broad experience base from which to identify new opportunities, solve problems and make the right decisions. By promoting a culture of inclusion and embracing diversity, we believe our people will be engaged and motivated to create the best outcomes for our customers and stakeholders.

In order to articulate our commitment to diversity, Heartland has a Diversity and Inclusion Policy. The Diversity and Inclusion Policy is available on our shareholder website: shareholders.heartland.co.nz

Diversity is the many characteristics that make each of us different, including gender, ethnicity, heritage, sexual orientation, age, religious beliefs or other ideologies, family status, language, cultural background, and physical and mental disability.

An **inclusive** workplace is one where all those forms of diversity are valued, respected and leveraged, creating equal opportunities for all employees.

Under this policy, the Board, with the assistance of the Diversity Committee, is responsible for setting measurable objectives and reviewing progress against them.

In 2018, the Board set the following objectives to measure Heartland's performance against its Diversity and Inclusion Policy.

- a) To improve the inclusiveness of our workplace by increasing cultural awareness and celebrating diversity in all of its forms.
- b) To achieve a gender balance at all levels of the organisation as soon as possible.
- c) To be recognised as a preferred employer for emerging Māori talent, and thereby create a pathway to being an employer that is welcoming to all cultures and ethnicities.
- d) To create an environment where having English as a second language does not present a hurdle to being employed by, or succeeding at, Heartland.

The following section reports on the progress, which continues to be made against these objectives during the 2019 financial year.

TO IMPROVE THE INCLUSIVENESS OF OUR WORKPLACE BY INCREASING CULTURAL AWARENESS AND CELEBRATING DIVERSITY IN ALL OF ITS FORMS.

Heartland has a workforce with diverse ethnicities, heritages, backgrounds, cultures, genders and ages. We are focused on continuing to develop a culture that embraces and celebrates this diversity and encouraging our people to be authentic and share their thoughts and ideas.

Heartland's Diversity Committee is a forum for our people to come together and share ideas to measure, celebrate and promote diversity and inclusion. The Committee arranges events and reports to the Board on diversity related matters, including those in relation to Heartland's progress towards achievement of the measurable objectives. Heartland's CEO is a member of Champions for Change and uses this forum to exchange ideas with peers on the appropriate ways to increase our diversity and inclusiveness.

This year the Diversity Committee coordinated a number of events to celebrate Christmas, Eid, Diwali, Chinese New Year, Samoan Language Week, and St Patrick's Day as well as an International shared lunch to celebrate the diverse cultures of our people. Māori language and culture continues as a key focus – Matariki was also celebrated, and we took the opportunity to recognise our people and hear their own stories. The Māori language has taken prominent place in our refreshed Heartland mātāpono (values) and has become used more widely in general communications, proving valuable in developing new relationships with customers and communities.

A Rainbow Committee has also been formed. The Rainbow Committee aims to make Heartland more inclusive for our Rainbow community and is working towards achieving the Rainbow Tick. International Women's Day was celebrated in March this year, where we acknowledged the importance of gender balance and recognised the women at Heartland. Pink Shirt Day, with its focus on bullying, also saw the launch of our Prevention of Bullying, Harassment and Discrimination framework. There has been a continued focus on growing the organisational awareness of diversity and inclusion through communication channels, including environmental spaces and online platforms, which have included regular news and interest stories.

Employees provide information on a voluntary basis to help us better understand the diverse backgrounds of our workforce. This includes which ethnicity individuals identify with. The data we collect conforms to the guidelines set by the Champions for Change and in 2019 we provided a snapshot of this information to the Champions for Change. We have also taken a deeper look at our age profile across the organisation, and it was revealed that our largest emerging workforce is aged 30 and under, with 37% of our total workforce in this age group.

Disclosures

TO ACHIEVE A GENDER BALANCE AT ALL LEVELS OF THE ORGANISATION AS SOON AS POSSIBLE.

Heartland continues to identify and address the imbalance of gender at any level where one exists. The following table shows the gender diversity of directors and employees of Heartland as at 30 June 2019 and 30 June 2018.

| Positions | As at 30 June 2019 | | | | | As at 30 June 2018 | | |
|---|--------------------|--------------|----------------|------------|-------|--------------------|-------------|-------|
| | Female | Male | Gender Diverse | Not Stated | Total | Female | Male | Total |
| Board ¹ | 4 (33.33%) | 7 (58.3%) | 0 | 1 (8.3%) | 12 | 2 (22.2%) | 7 (78.8%) | 9 |
| Strategic Management Group | 5 (62.5%) | 3 (37.5%) | 0 | 0 | 8 | 4 (50.0%) | 4 (50.0%) | 8 |
| People in key leadership roles ² | 12 (40.00%) | 18 (60.00%) | 0 | 0 | 30 | 5 (29.4%) | 12 (70.6%) | 17 |
| All staff | 226 (50.45%) | 212 (47.32%) | 1 (0.22%) | 9 (2.01%) | 448 | 191 (51.1%) | 183 (48.9%) | 374 |

1 The Heartland Group Holdings Limited Board was established on 31 October 2018. All comparisons are of the Heartland Bank Limited Board on 30 June 2018 and the combined Heartland Bank Limited and Heartland Group Holdings Limited boards on 30 June 2019.

2 This group was labelled 'Senior Leadership Team' in 2018 report and has since had further inclusions.

This data in this table is inclusive of all employees across Australia and New Zealand (note Australian headcount was not included in 2018 report).

There is a strong pipeline of leadership talent coming through from our younger workforce, with 33% of employees occupying 'key leadership roles' aged 35 and under age. In the '30 and under' age group, there is an encouraging gender balance in our younger workforce, with 47% reporting as male, 51% reporting as female and the remaining employees opting not to state a gender.

To further our commitment in achieving gender balance, we continue our partnership with Global Women. This partnership enables Heartland to access best practice trends and opportunities and to collaborate with other organisations that are leading diversity and inclusion in New Zealand. There is a strong commitment from the Board to furthering this objective and the following table summarises the Directors' participation in diversity forums and the aims of each of these forums.

| Director | Forum | Aim |
|-----------------------------------|---|---|
| Jeff Greenslade | Champions for Change | To exchange ideas with peers of appropriate ways to improve our diversity and inclusiveness. |
| Ellie Comerford | Chief Executive Women | To educate and influence Australian business and government on the importance of gender balance. |
| Vanessa Stoddart | Global Women in New Zealand (member and former Chair) | To access best practice, trends and opportunities to collaborate with other organisations who are leading diversity and inclusion in New Zealand. |
| Geoffrey Ricketts Bruce Irvine | IOD mentoring for diversity | To promote diversity in its wider sense including ethnicity, age, skills and experience in addition to gender. |

This year, Heartland has undertaken a number of pay parity exercises to identify whether there are any like-for-like, by level or organisation wide gender pay gaps. We look to sophisticate and formalise the way that we assess pay parity with development of a framework to guide our approach. We are encouraged by the representation of women in the Strategic Management Group and continue to seek to understand how this will evolve and how we can maintain a gender balance as our workplace demographic evolves. We have invested in the individual development of female talent and have also continued with the Kia Eke programme. The Kia Eke programme is a support network and talent development programme for females at the early stages of their career to support their professional and career development. The programme aims also to build a strong pipeline of female employees to promote into senior leadership roles.

The Flexible Working Policy remains in place and managers are encouraged to take an open minded approach to requests for flexible working, reinforcing the benefits to Heartland and its customers by providing flexibility to employees who value it. Whilst we see this as one of the many ways in which we can attract and retain women in more senior roles in the organisation, the benefits of having a flexible working policy extends beyond fostering a gender balance – it is also aligned to Heartland's objective to be a more generally diverse and inclusive workplace. Giving all employees flexibility enables them to access personal pursuits such as sport, community work, religious celebrations or care for family members.

TO BE RECOGNISED AS A PREFERRED EMPLOYER FOR EMERGING MĀORI TALENT, AND THEREBY CREATE A PATHWAY TO BEING AN EMPLOYER THAT IS WELCOMING TO ALL CULTURES AND ETHNICITIES.

To improve our ethnic and cultural diversity we're starting close to home with New Zealand's own people: our tangata whenua. Māori have a unique and significant role in Aotearoa, which Heartland is embracing – we aspire to be an employer of choice for Māori. It is our belief that if we can enhance our working environment so that Māori language, culture and values are embraced and Māori feel confident to join us and succeed authentically as Māori, then we will have set a good foundation for being a more welcoming place for people of all cultures and ethnicities. Initiatives undertaken to further this objective include:

- ▲ continuation of the internship programme for Māori students in partnership with Inzone Education Foundation and select secondary schools
- ▲ forming partnerships with Māori based organisations such as Te Matatini, in which we sponsored the national kapa haka competition; Māori Translators and the Māori Language Commission
- ▲ continued access for employees to free reo and tikanga Māori lessons which have seen 115 employees participate
- ▲ the creation of Manawa Whenua, an internal support network for Māori employees and allies
- ▲ te reo Māori and tikanga incorporated into formalities and events, including welcoming new employees with a whakatau (informal welcome), welcoming of guests and cultural practices as part of shared meals
- ▲ increasing the use of bilingualism throughout the organisation and translation of our key webpages into Māori.

In 2019 Heartland sponsored Aotearoa's national kapa haka competition, Te Matatini, which is central to Māori identity and culture. This is a significant event and has an estimated 20,000 people attend. Manawa Whenua, our Māori support network, has led new internal initiatives which created opportunities for our language and culture to be used. The combined increase in capability and opportunity has been a cornerstone for the visible cultural change regarding Māori in our workplace.

Māori language lessons continue to be popular and we're making it easier for more people to access these through online learning and video content. We are also working with Te Taura Whiri i te reo Māori (The Māori Language Commission) to develop a formal language plan.

Māori make up 4% of our Heartland population and with only 2.8% of people in the financial and insurance services sector identifying as Māori³⁷, we are working to create change and make Heartland and the sector more inclusive for Māori. We continue to make progress with our younger Māori workforce, with 50% of our employees who identify as Māori being aged 30 and under. This can be attributed to the efforts invested in the Māori internship programme, which has seen seven interns from the most recent cohort progress into formal employment with Heartland. The programme helps to build a workplace where Māori can see a career pathway and establish their career with cultural integrity.

CREATING AN ENVIRONMENT WHERE HAVING ENGLISH AS A SECOND LANGUAGE DOES NOT PRESENT A HURDLE TO BEING EMPLOYED BY, OR SUCCEEDING AT, HEARTLAND.

We recognise that given the number of ethnicities and cultures represented at Heartland, some of our employees are not native English speakers. Furthermore, our diverse customer and broader stakeholder base is comprised of people with a plethora of different native languages. To ensure that we understand the challenges that people who have English as a second language may face, we asked our employees to identify any real or perceived barriers to their success at Heartland as a result of them not being native English speakers. The feedback gained from this helped to inform initiatives around supporting and recognising various languages we have at Heartland. Overall, the feedback demonstrated to us that people who have English as a second language at Heartland generally feel supported by their teams and colleagues. The introduction of the Prevention of Bullying, Harassment and Discrimination framework reminded our people of the importance of respecting each other's differences and offers a support network in which employees can raise concerns if needed.

We are proud of what we have continued to achieve in 2019 in embracing and promoting the diversity of our people. We are creating a more welcoming and inclusive workplace where all people are respected and valued. We recognise that all forms of diversity bring different perspectives and expressions of ideas and opinions within the Board, the senior management team and throughout the organisation, and contribute to Heartland's productivity, profitability and connection with our communities and stakeholders.

In the year ahead we will continue to embrace and promote diversity, leverage diversity as a competitive advantage to attract, retain and motivate the widest possible pool of talent and recognise, understand and value individual contribution and performance across the organisation.

37. Māori Labour Market trends – June 2019. Ministry of Business, Innovation & Employment.

Disclosures

Shareholder information

SPREAD OF SHARES

Set out below are details of the spread of shareholders of Heartland as at 31 July 2019 (being a date not more than two months prior to the date of this Annual Report).

| Size of holding | Number of shareholders | Total shares | % of issued shares |
|-------------------------|------------------------|--------------------|--------------------|
| 1 - 1,000 shares | 1,165 | 663,021 | 0.12 |
| 1,001 - 5,000 shares | 2,913 | 8,098,950 | 1.42 |
| 5,001 - 10,000 shares | 2,318 | 17,144,767 | 3.01 |
| 10,001 - 50,000 shares | 4,516 | 100,098,377 | 17.58 |
| 50,001 - 100,000 shares | 795 | 54,438,974 | 9.56 |
| 100,001 shares and over | 505 | 388,893,638 | 68.31 |
| TOTAL | 12,212 | 569,337,727 | 100.00 |

TWENTY LARGEST SHAREHOLDERS

Set out below are details of the 20 largest shareholders of Heartland as at 31 July 2019 (being a date not more than two months prior to the date of this Annual Report).

| Rank | Shareholder | Total shares | % of issued shares |
|--------------|--|-----------------------|--------------------|
| 1 | Harrogate Trustee Limited | 56,192,322 | 9.87 |
| 2 | FNZ Custodians Limited | 32,982,131 | 5.79 |
| 3 | Citibank Nominees (NZ) Ltd | 26,949,288 | 4.73 |
| 4 | Oceania & Eastern Limited | 13,267,285 | 2.33 |
| 5 | Accident Compensation Corporation | 11,818,407 | 2.08 |
| 6 | Philip Maurice Carter | 11,416,647 | 2.01 |
| 7 | Forsyth Barr Custodians Limited | 9,641,622 | 1.69 |
| 8 | JPMORGAN Chase Bank | 8,595,307 | 1.51 |
| 9 | Investment Custodial Services Limited | 7,536,738 | 1.32 |
| 10 | Leveraged Equities Finance Limited | 7,363,598 | 1.29 |
| 11 | HSBC Nominees (New Zealand) Limited | 7,178,474 | 1.26 |
| 12 | HSBC Nominees (New Zealand) Limited | 6,904,252 | 1.21 |
| 13 | Heartland Trust | 6,475,976 | 1.14 |
| 14 | New Zealand Depository Nominee Limited | 6,167,310 | 1.08 |
| 15 | Custodial Services Limited | 5,050,203 | 0.89 |
| 16 | Jarden Custodians Limited | 4,800,000 | 0.84 |
| 17 | Custodial Services Limited | 4,447,867 | 0.78 |
| 18 | Pt Booster Investments Nominees Limited | 3,685,467 | 0.65 |
| 19 | Jeffrey Kenneth Greenslade & Sarah Ormond Greenslade | 3,421,443 | 0.60 |
| 20 | Cogent Nominees Limited | 3,303,218 | 0.58 |
| Total | | 237,197,555.00 | 41.65 |

SUBSTANTIAL PRODUCT HOLDERS

As at 30 June 2019, the following product holders are substantial product holders in Heartland.

| Name | Number of shares | Class of shares | Total number of shares in class |
|---|------------------|-----------------|---------------------------------|
| Harrogate Trustee Limited and Gregory Raymond Tomlinson | 56,192,322 | Ordinary | 569,337,727 |

Other information

AUDITOR'S FEES

KPMG has continued to act as auditor of Heartland and its subsidiaries. The amount payable by Heartland and its subsidiaries to KPMG as audit fees during the year ended 30 June 2019 was \$666,000. The amount of fees payable to KPMG for non-audit work during the year ended 30 June 2019 was \$52,000. These non-audit fees were primarily for review of regulatory returns, trust deed reporting, registry audits and other agreed upon procedures engagements.

CREDIT RATING

As at the date of this Annual Report, Heartland has a Fitch Australia Pty Limited long-term credit rating of BBB (outlook stable).

DONATIONS

The total amount of donations made by the Group during the year ended 30 June 2019 was \$241.

EXERCISE OF NZX DISCIPLINARY POWERS

NZX Limited did not exercise any of its powers under Listing Rule 9.9.3 in relation to Heartland and its subsidiaries during the year ended 30 June 2019.

NZX WAIVERS

Set out below is a summary of all waivers granted to the Group by NZX, or relied on by the Group, within the 12 month period preceding 30 June 2019.

Corporate Restructure – Offer of New Shares in Heartland Group

Heartland Bank relied on a waiver from Listing Rules 5.1.1 and 5.2.1 on 27 July 2018 and Heartland relied on a waiver from Listing Rules 5.1.1 and 5.2.1 on 16 August 2018 to the extent that those listing rules required the offer of new shares in Heartland Group as part of the corporate restructure to be made through a Primary Market Participant acting as an Organising Participant. This reasons for granting the waivers included that the offer of shares in Heartland were being made on a one for one basis to existing Heartland Bank shareholders, no subscription monies were to be received by Heartland and there was no change in the underlying listed enterprise or those involved in the management or governance of Heartland.

Corporate Restructure – Directors' Remuneration Pool

Heartland relied on a waiver from Listing Rule 3.5.1 on 4 October 2018 to the extent that it required the directors' remuneration pool to be authorised by an ordinary resolution of Heartland. The reasons for granting the waiver included that the directors' remuneration pool had already been approved by shareholders of Heartland Bank under Rule 3.5.1 at its 2016 Annual Meeting and that Heartland Bank shareholders had oversight of the initial directors' remuneration pool to be paid to Heartland Group directors through the scheme booklet relating to the restructure.

Disclosures

Directory

DIRECTORS

HEARTLAND GROUP BOARD

Geoff Ricketts

Chair and Independent Non-Executive Director

Jeff Greenslade

Executive Director and CEO

Ellie Comerford

Independent Non-Executive Director

Sir Chris Mace

Independent Non-Executive Director

Greg Tomlinson

Non-Executive Director

HEARTLAND BANK BOARD

Bruce Irvine

Chair and Independent Non-Executive Director

Ellie Comerford

Independent Non-Executive Director

Jeff Greenslade

Executive Director

John Harvey

Independent Non-Executive Director

Kate Morrison

Independent Non-Executive Director

Geoff Ricketts

Independent Non-Executive Director

Vanessa Stoddart

Independent Non-Executive Director

STRATEGIC MANAGEMENT GROUP

Jeff Greenslade

CEO, Heartland Group

Chris Flood

CEO, Heartland Bank

Cherise Barrie

Chief Financial Officer

Laura Byrne

Chief Culture & Communications Officer (joint)

Grant Kemble

Chief Risk Officer

Rochelle Moloney

Chief Culture & Communications Officer (joint)

Sarah Smith

Chief Technology Officer

Lydia Zulkifli

Chief Digital Officer

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