

Half-Yearly Report

for the period ended
31 December 2016

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The Board and Management of Heritage Bank Limited are pleased to announce our results for the six months ended 31 December 2016. The financial statements for this period have been reviewed by our external auditors.

Key performance measures are set out in Table 1:

- Heritage delivered a record half-year profit in this period. The \$29.92 million pre-tax profit was up 18.1% on the \$25.33 million earned in the same period the previous year. Profit after tax was \$20.89 million, up 17.3% on the corresponding period in the previous year.
- We also achieved markedly higher lending volumes. Loan approvals totalled \$1,129.77 million in this period, an increase of 39.4% on the \$810.50 million achieved in the same period in 2015.
- Our total loan book grew in this period, up \$299 million to \$7.362 billion.
- Retail deposits grew by \$537.76 million in this period, up 385% on the \$110.89 million achieved in the corresponding period in 2015.
- Several key factors drove the increased profit. The result included the proceeds from the sale of our financial advisory

business to Bridges Financial Services (see below for more information). It also reflects both the significant increase in our lending volumes, and our success in securing greater volumes of retail deposits, which had a positive impact on margins.

- Heritage has also placed greater focus on driving operational efficiencies and simplifying processes and procedures, as part of our mission to deliver a great customer experience every time.

Details of key period end information are set out in Table 2:

- Strong growth and profitability reflect our ambition to build sustainable ownership value for our members by balancing prudential capital requirements and delivering our customers outstanding value.
- Our capital adequacy ratio was down minimally from 13.95% at 30 June 2016 to 13.78% at 31 December 2016.
- Our liquidity ratio also decreased slightly from 15.94% to 15.77% in the same period.
- Growth in our loan volumes was reflected in an increase in our total consolidated assets, which were up 4.5% from \$8.44 billion to \$8.82 billion in the six months to 31 December 2016.

- Heritage's level of mortgage loan arrears over 30 days was 0.42% at 31 December 2016, well below the industry average.

Strong momentum

Our financial results in the first half of the 2016/17 financial year have laid solid foundations for future investment. A key objective of the business was to build momentum through lending and deposit growth in the first half without constraining profitability. This has been achieved in a challenging operating environment. The business is well positioned to embark on the strategic change program designed to increase digital capabilities and deliver an improved customer service proposition.

Heritage is Australia's largest customer-owned bank and we are determined to build our national profile. We will do that by not only continuing to leverage our branch distribution footprint in Queensland but also by increasing our penetration through the broker channel nationally. Improving our digital capabilities is a key to building our business as a whole, and we continue to invest in better online and app offerings, and in modernising and simplifying our processes.

Table 1

	Six months to 31 December 2016	Six months to 31 December 2015	Increase (Decrease)
	\$ million	\$ million	%
Profit before tax	29.92	25.33	18.1
Profit after tax	20.89	17.81	17.3
Loan approvals	1,129.77	810.50	39.4
Retail deposit growth	537.76	110.89	384.9

Transforming for our digital future

Digital technologies are rapidly changing the banking landscape. In response, we have initiated a multi-year program to transform Heritage into a digitally-led bank that will continue to meet changing customer needs. Heritage historically developed as a branch-based bank that added a digital presence. We now must shift to think of ourselves more as a digital bank with a branch presence. That shift presents a number of challenges, including the significant level of investment needed to improve our digital capabilities. As a result, our operating expenses will likely rise in coming years as we make the investments required. We will also need to refine our business model to ensure we focus our energies and resources on the core retail banking services that our customers need.

Sale of financial planning business

In December, Heritage announced the sale of our financial advisory business to Bridges Financial Services.

The decision had two main drivers – the desire to give customers access to the best financial planning service possible, and the strategic drive to focus Heritage’s energies on its core banking activities. The model of having a team of in-house advisers based

only in south-east Queensland no longer suited our position as Australia’s largest mutual bank, with a national presence. Aligning with Bridges allows us to provide customers with a wider range of products and services, greater scale, and access to a national team of advisers.

At the same time, the sale means Heritage no longer faces the risk and complexity of running a financial planning business, but can instead focus on our core business of retail banking. Heritage Bank will continue to provide financial planning services to our customers via a referral model to Bridges.

Closure of mini branch agency network

During this period Heritage took the decision to close down our network of mini branches, in response to rapidly changing transaction trends. Mini branches were small agencies co-located in existing businesses that allowed Heritage customers to carry out simple transactions, such as cash withdrawals.

The agency concept was introduced in the 1970s, at a time when people were still paid by cash or cheque and had to go to a counter to carry out transactions. As noted earlier, the rapid rise of online technologies, plus the widespread availability of other banking channels, has changed the nature of transactional banking.

With Heritage customers embracing the new banking channels now on offer, transaction volumes at agency outlets dropped to a level that was no longer sustainable as a network. As a result, Heritage has closed all but three of the 29 agencies that had been operating. In all areas where the agencies were closed, Heritage offers alternative banking methods, including the bank@post service at Australia Post outlets that provides simple cash transaction capabilities.

Community Branches

Heritage is particularly proud of our Community Branch model and the significant contribution they make to their communities. We have seven Community Branches – at Forest Lake, Karalee, Nanango, Millmerran, Palmwoods, Highfields and Crows Nest. They operate on a partnership model, as joint ventures between Heritage and a community company with local representation. Under the model, half the profits are given to the community company to provide grants for worthwhile local organisations and causes.

In the half-year to December, we reached the milestone of \$40 million in funds that these community branches have cumulatively injected back into their local communities since the first opened at Crows Nest in 1999. This figure is made up of community grants, sponsorships, wages, rent and payments for other services.

Table 2

	31 December 2016	30 June 2016
Total consolidated assets	\$8.82 billion	\$8.44 billion
Capital adequacy ratio	13.78%	13.95%
Liquidity ratio	15.77%	15.94%
Mortgage loan arrears	0.42%	0.30%

Transforming our branches

While we must change to meet the challenges of a digital future, we remain committed to maintaining our branch network. In fact, we are continuing a multi-million dollar program of investment in upgrading all of our 61 branches to a design that is more suited to the digital age. The new design eliminates the traditional row of tellers behind a counter and has moved to an open plan layout, with staff using tablet devices to serve customers throughout the branch.

In the half-year to December, we transformed our branches at Garden City, Noosa, Caloundra, Maroochydore and Booval. A further eight branches will be upgraded in the second half of 2016/17.

Expanding our ATM fleet

During this period, Heritage negotiated a new agreement with payments company Next Payments to expand our network of ATMs. As a result, 43 new Heritage-branded ATMs will be installed in Freedom Fuels service stations across the south-east Queensland region. This brings the total number of Heritage-branded ATMs to 145. When added to the 3,000 Westpac group ATMs, this means Heritage will offer its customers direct-fee free access to one of the largest and most convenient ATM networks in the country.

Mobile banking app upgrade

Heritage is continuing with an ongoing program of enhancements to our mobile banking app. In September 2016, we introduced fingerprint login capabilities for the app. It allows customers with compatible devices to securely log into the app using fingerprint authentication rather than a password or four-digit PIN. This feature

supports customer requests for quicker access to account balances and mobile banking services. Heritage recognises that our customers are changing the way they do their banking and we will continue to invest in our digital solutions to deliver a better customer experience.

Senior Executive changes

Heritage Bank made significant changes to its Senior Executive team during this period.

Mr Darren Stephens was appointed as Chief People Officer in December, following the retirement of Mr Bob Hogarth. Mr Stephens comes to Heritage after a 20-year career in Human Resources (HR) roles, most recently in his own management consultancy in Sydney, and prior to that in senior HR roles at Westpac and St George Bank.

At the same time, interim Chief Information Officer Mr Wayne Marchant was appointed to the role on a permanent basis.

Mr Marchant previously held senior IT roles at Billabong, Flight Centre and Woolworths, as well as leading a major revamp of the Queensland Main Roads IT department in a consultancy role.

Also in December, Chief Operating Officer (COO) Mr John Williams stood down from that role to take up the position of CEO with The Systems Works Group. The process to recruit a replacement for the COO role is currently underway.

Family guarantee loan

Heritage launched a new Family Guarantee loan in August 2016 that meets growing demand for a loan structure that enables parents to help their children into the property market.

The Family Guarantee allows parents to use the equity they have in their own home as security to help their children take out a home loan. It works by splitting the total amount across two loans – one loan secured

by the property being purchased, and the second loan partially secured by the parents' property as guarantors.

This structure helps the borrowers avoid the need for Lenders Mortgage Insurance, thus making the loan more affordable, and also helps limit the amount that the parents are guarantors for, which helps their peace of mind. The loan is available to both owner occupiers and investors.

Benefits to customers

At Heritage, we're passionate about people and strive to provide our customers with the best value we can, through our products, prices and service. We continue to offer some of the most competitive prices in the marketplace on home loans, as well as introducing more innovative ways for customers to go about their day-to-day banking using their mobile devices.

As a customer-owned bank, our pricing and product decisions reflect the goal of optimising value for customers. An independent analysis by CANSTAR found that our customers were \$58.81 million a year better off through banking with Heritage rather than the big four banks as at December 2016. This comprised a \$35.90 million benefit through better rates and fees on our deposit products, and a \$22.91 million benefit because of better interest rates and fees on our lending products.

Customer satisfaction

Heritage continues to enjoy strong endorsement from its customers. According to Roy Morgan Research, we had a 94.3% Main Financial Institution customer satisfaction rating as at December 2016, which was equal highest of all participating institutions in Queensland. Our customer advocacy score – the likelihood of a customer recommending us to family or friends – was 34.7 at December 2016,

continuing to indicate high levels of engagement with our customers. In comparison, the average of the big four banks was just -2.3 for the same period.

External recognition

Heritage continues to receive external awards and recognition that help measure our success in achieving our vision of being passionate about helping people.

In August 2016, Heritage was named Regional Bank of the Year in the prestigious AFR Smart Investor Blue Ribbon Awards for 2016. The Blue Ribbon Awards are highly sought after and highly regarded. They are given out by the Australian Financial Review's Smart Investor magazine, after an assessment process that is conducted by independent research partners.

In 2016, we also took out the following accolades:

- Canstar Blue's award for Most Satisfied Customers award in the Challenger Bank category;
- The Mozo People's Choice Award for overall Customer Satisfaction;
- Employer of Choice at the 2016 Australian Business Awards, for the sixth year in a row;
- Highest customer satisfaction rating in Australia in JD Power's inaugural Australia Retail Banking Satisfaction Survey.

Corporate Ratings

We continue to hold strong ratings from independent agencies. Both the Moody's rating of A3/P2 and the Fitch rating of BBB+/F2 were reaffirmed in 2016 reflecting the quality of business and our focus on long-term sustainability through prudent financial, risk management and operational outcomes.



KERRY J. BETROS
Chairman



Peter Lock
Chief Executive Officer

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