

Half-Yearly Report

For the period ended 31 December 2014



People first.

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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 2014. The financial statements for the period have been reviewed by our external auditors. Key performance measures are set out in Table 1.

- Our profit performance remained firm in this period, which featured continued fierce competition and also an increased level of investment in the business, particularly digital transformation related initiatives. We not only invested more in IT infrastructure but also added an extra 8 positions to our staffing levels during the six months. We will continue to invest further in the technology and staffing resources required to meet customers' changing banking practices in the years ahead.
- The \$23.174 million pre-tax profit was down 5.5% on the \$24.520 million in the same period the previous year. Profit after tax was \$16.230 million, down 9.5% on the corresponding period in the previous year.
- Loan approvals totalled \$793 million in the period, an increase of 20.7% on the \$657 million achieved in the same period in 2013. Heritage is actively targeting

increased lending business in 2014/15 and this six month period has delivered on that goal. Heritage offered extremely competitive loan rates during this period on both fixed and variable home loans.

- Retail deposits grew by \$69 million in this period. This reflected a deliberate decision to manage the retail funding mix, reduce excess liquidity and improve our margin. While term deposit growth moderated over the period, our savings account deposits actually increased by \$172 million, which is consistent with the \$186 million growth recorded in the same period last year. This was a positive outcome for Heritage in terms of managing our core retail funding channels.

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

- Heritage continues to balance the need to generate profits to boost retained earnings and capital and providing customers with attractively priced products and services. Heritage has a goal of increasing our lending volumes and our customer base in coming years, while also investing in technology and process improvements that better fit the needs of an increasingly digital world.

- The importance of carefully managing our capital requirements is shown in our total consolidated assets, which decreased 2.3% from \$8.519 billion to \$8.322 billion in the six months to 31 December 2014. This reflects the desire to grow our prudential capital ratio, to support lending related ambitions and meet new regulatory requirements being introduced next year.
- We lifted our Tier 1 capital ratio from 11.89% as at 30 June 2014 to 12.01% as at 31 December 2014. The total capital ratio decreased from 13.33% to 12.07% following the redemption of the Heritage Notes in October 2014. Similarly, our liquidity ratio decreased from 22.23% to 19.31% in the same period.
- Heritage maintained net interest margin income at the same level during this period, reflecting our aim of balancing the imperative to grow retained earnings against our goal of providing great value to customers.
- Similarly, non-interest income levels remained steady in this period. We achieved modest growth in revenue from business streams such as insurance, financial planning, payment technology and pre-paid cards, while we continue to receive reduced amounts in fees and

TABLE 1

| | Six months to 31 December 2014 | Six months to 31 December 2013 | Increase (Decrease) |
|-----------------------|-----------------------------------|-----------------------------------|------------------------|
| | \$ million | \$ million | % |
| Profit before tax | 23.17 | 24.52 | (5.5) |
| Profit after tax | 16.23 | 17.93 | (9.5) |
| Loan approvals | 792.97 | 657.00 | 20.7 |
| Retail deposit growth | 69.28 | 256.20 | (73.0) |

charges from our customers as we deliver on our mutual model.

- Heritage's rate of mortgage loan arrears over 30 days was just 0.41% at 31 December 2014. Heritage is extremely proud of this achievement, which is around one third of the industry average. This outcome flows from the extremely responsible approach we take in assessing loan candidates to ensure that our customers can afford the debts that they will incur. If customers do encounter a change in their circumstances, we work closely with them to find a way forward that is best for both parties.

CORPORATE RATINGS

Heritage continues 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 2014. These independent assessments of Heritage's quality and resilience speak volumes about our long-term sustained financial, risk management and operational outcomes.

CUSTOMER SATISFACTION

Heritage also continues to enjoy strong endorsement from its customers. According to Roy Morgan Research, Heritage had a 92.8% customer satisfaction rating as at

December 2014*. This was the highest in Queensland and Heritage was the only financial institution with a rating above 90%. The four major banks averaged just 82.5% in the same survey.

FINANCIAL BENEFITS TO CUSTOMERS

Heritage lives its mutual status as a key advantage in delivering a comprehensive suite of products and services to customers at competitive rates, with service excellence a point of differentiation.

That approach has translated into significant financial benefits for our customers.

Independent analysis by CANSTAR found that Heritage customers were \$37.44 million a year better off through banking with Heritage rather than the big four banks (on average) as at December 2014. Our customers gained a \$24.29 million benefit through better rates and fees on our deposit products, and a \$13.15 million benefit because of better interest rates and fees on our lending products.

GREAT DEALS AND PRICING ON PRODUCTS

Heritage continues to enhance our product and pricing offering for customers. In this period we:

- Launched a new Visa Platinum credit card, providing enhanced benefits and features for customers.
- Introduced a 3.99% rate on a one-year fixed rate home loan, for a limited period.
- Reduced the interest rate on our Discount Variable home loan to 4.39%, and on our Standard Variable home loan to 4.69%, for a limited period.
- Waived application fees on our Discount Variable and Standard Variable home loans in the lead-up to Christmas.

EXTERNAL RECOGNITION

Importantly, external recognition validates our success in delivering a great customer experience. In 2014, Heritage achieved the following accolades.

- Heritage won Canstar Blue's Challenger Bank Award for the Most Satisfied Customers for the second time in three years.
- Canstar Cannex awarded us best customer-owned bank at the Queensland First Home Buyer State Awards for the second year in a row.
- Heritage won numerous awards at Money Magazine's Best of the Best for its credit card products.

TABLE 2

| | 31 December 2014 | 30 June 2014 |
|------------------------------------|------------------|------------------|
| Total consolidated assets | \$8.322 billion | \$ 8.519 billion |
| Retained profits | \$388.98 million | \$372.89 million |
| Capital adequacy ratio | 12.07% | 13.33% |
| Liquidity ratio | 19.31% | 22.23% |
| Mortgage loan arrears over 30 days | 0.41% | 0.39% |

* Roy Morgan Research, Consumer Banking in Queensland, Main Financial Institution (MFI) Satisfaction, December 2014

- Heritage was "Highly Commended" for two products in the Low Rate Credit Card Category at the MOZO Experts Choice Awards.
- Heritage was selected in the Top 5 for Bank Accounts, Debit Cards and Mutual Bank at the 2014 MOZO People's Choice Awards.
- At the Australian Human Resources Awards, Heritage won the award for Recommended Employer <1000 and was a finalist for Best Health and Wellbeing Strategy.
- Heritage was announced as the winner for Human Resource Management and Employer of Choice at the Australian Business Awards ABA 100 for the fourth year in a row (formerly 'Recommended Employer').

STRATEGIC INVESTMENT IN DIGITAL CAPABILITIES

Heritage has always focused on providing customers with the best banking experience possible, through the combination of our products, pricing and service. Heritage has further sharpened its focus on the customer experience in 2014 with a number of key initiatives, including launching a five-year Digital Blueprint to map out Heritage's

strategic priorities for investment in technology initiatives. The rapid advance of digital technology is revolutionising our industry by fundamentally changing the way people do their banking. Transactions are now overwhelmingly taking place on-line, and increasingly via mobile devices. Customers want to transact from whatever device they have, from wherever they are, at whatever time they want. The Digital Blueprint sets out Heritage's response to this trend, covering not only upgrades to our online and mobile banking services, but also to our core banking system, our financial management system, our data analytics and our cross-channel integration. We are also recruiting additional staff to enhance our skills and expertise in these areas.

CASH BY OPTUS PARTNERSHIP

Australian telco Optus launched its new Cash by Optus contactless payment app in November 2014 following a two-year development collaboration with Heritage and Visa. Cash by Optus allows people to use their smartphone to pay for goods and services instead of using cash or plastic debit and credit cards. The product uses Near Field Communication (NFC) and Visa payWave technology to replace cash purchases below \$100. This means customers can pay

for small purchases like lunch, petrol and groceries using their smartphones at any of the hundreds of thousands of retailers that accept Visa payWave. Heritage is responsible for the banking aspect of Cash by Optus, drawing on our extensive experience in this area. We are recognised for our ability to deliver creative and effective payment solutions for corporate partners, particularly in the area of prepaid transactions. That has led to partnerships with major Australian companies such as Qantas, Australia Post, and now Optus. The launch of Cash by Optus now also establishes Heritage as a leader in mobile payments. Our specialist expertise in this emerging area of payments reinforces our position as an enabler of innovative new services that the customers of leading Australian companies are seeking.



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