New Zealand Shareholders Association Inc.

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26 October 2023

HEARTLAND GROUP

Heartland Group Holdings Ltd (HGH)

The company will hold its Annual Shareholders Meeting at **2.00pm Thursday 9 November 2023.**

The location is **Te Pae Christchurch Convention Centre, 188 Oxford Terrace, Christchurch.**

You can also join the meeting online here.

Company Overview

The company first listed on the NZX in February 2011 and the ASX in 2018. It has a long history dating back to 1875 as the Ashburton Permanent Building & Investment Society. Heartland came together through the merger of Southern Cross Building Society, CBS Canterbury, MARAC Finance and PGG Wrightson Finance. In 2014, it also acquired Australian Seniors Finance.

In New Zealand, the Group operates Heartland Bank. In Australia, it operates leading reverse mortgage business Heartland Finance, and livestock financier StockCo Australia. It is currently in the process of acquiring Challenger Bank in Australia.

In March, Geoff Ricketts, who had served on the Board since 2011 and as Chair from 2013, passed away. Former Deputy Chair Greg Tomlinson has been appointed Chair.

Current Strategy

Heartland's vision is sustainable growth through differentiation based on a 'best or only' product strategy, delivered through scalable digital platforms. This is underpinned by three strategic pillars: Business as Usual Growth, Frictionless Service at the Lowest Cost and Expansion in Australia.

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Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

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Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	A	See below.
Director share ownership	G	Directors are not required to own shares.
Executive Remuneration	A	See below.
Golden parachutes/handshakes	A	See below.
Director Independence	G	A majority of Directors are independent.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid meeting
Independent Advice for the Board and Risk Management	A	See below.

Directors Fees: Not disclosed if retirement benefits are offered (a position not favoured by NZSA) or if special exertion payments are made. It appears Directors do not receive share options, but this is not explicitly stated.

Executive Remuneration: The CEO is paid a base salary and a short-term incentive (STI), both in cash, and a long-term incentive (LTI) by way of performance share rights.

NZSA encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure 'groups'), weightings, targets, and the level of achievement versus target for each component associated with any awards.

The maximum STI is 100% of the base salary with the actual achieved for the year being 90%. The measures and weightings are not disclosed.

The LTI award for FY23 is not disclosed as the grant had not yet been made when the Annual Report was written. The performance criteria are not disclosed.

The CEO's salary as a multiple of the employee average is 10.41 times (FY2022: 11.08 times), and his total remuneration as a multiple of the employee average is 19.22 times (FY2022: 23.17 times).

Golden parachutes/handshakes: In the interests of transparency, NZSA believes there should be explicit disclosure around the key terms associated with the CEO's employment contract.

Board Composition: The Annual Report does not include a skills matrix that attributes skill sets to individual Directors to demonstrate how they contribute to the governance of the company. Directors' other governance roles are not disclosed in the Annual Report.

We note the Chair, Greg Tomlinson, is a non-independent director, by virtue of his related 9.76% shareholding. Both NZSA and the NZX Code recommend the Chair is an Independent Director. We appreciate that Tomlinson took on the role of Chair under difficult circumstances. We would welcome further disclosure as to his future intentions.

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We note that the company offers its own leadership development programme through the "Rangatahi Advisory Board" as a means of developing emerging Director capability amongst employees under 35 years of age. The programme offers both executive and board exposure.

The nature of the company's boards (both HGH and Heartland Bank) indicates a commitment to thought, experiential and social diversity, with relevant experience for Heartland.

Director Tenure: NZSA looks for evidence of ongoing succession or 'staggered' appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

Three Directors were appointed in 2018 and two in 2021. The 2018 appointments are likely to have resulted from the restructuring of Heartland Bank into Heartland Group at that time. There will need to be some thought given to rotation to ensure an orderly transfer of institutional knowledge.

Independent Advice for the Board & Risk Management: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

The Board Charter clearly states that Directors are able to seek independent advice to support their decision-making (with the permission of the Chair). The Annual Report notes that the internal audit function, reporting directly to the Board, has unfettered access to information required to support its activities. It is not clear if other assurance roles have unfettered access to the Board.

The company offers good disclosure of financial risks and health and safety risks. Given the nature of Heartland's business, many of the financial risks and mitigations disclosed are the same as core operational risks. There is limited disclosure of strategic risks and mitigations.

As noted above, the Annual Report describes the Internal Audit governance and management process. Internal Audit also manage the broader operational and compliance risk management function within Heartland.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure.
Audit rotation	G	See below.

Audit Rotation: The company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules. We note in December 2022 PwC replaced KPMG as Auditor.

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Environmental Sustainability

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment
Approach	A
Sustainability Governance	A
Strategy and Impacts	A
Risk and Opportunity	R
Metrics and Targets	A
Assurance	R

Overall approach: Heartland Group Holdings has produced Sustainability Reporting since 2019. The Group is designated as a climate reporting entity under the mandatory climate-related disclosure standards, but have chosen not to act as an 'early adopter'. NZSA would expect further assurance around the Group's progress towards meeting the requirements of the climate-related disclosure regime.

NZSA also looks for evidence of a wider consideration of environmentally-relates risks and opportunities (ie, beyond climate change) and their impact on the company's strategy.

Sustainability Governance: In the absence of a skills matrix, it is difficult to assess the specific capability requirement on Heartland Group's Board. However, they do disclose the Board's expectation to establish a Sustainability Committee.

Strategy and Impact: Heartland reflect a 'work in progress' by noting that they are currently undertaking scenario analysis to better understand the resilience of their business strategy in light of possible climate-related risks, but provide no further disclosure. They do disclose a number of examples of capital investment to support mitigations.

Risk and Opportunity: Heartland Group Holdings does not disclose any environmental-related risks, opportunities or mitigation strategies.

Metrics and Targets: While Heartland report their Scope 1 & 2 GHG emissions have reduced compared to their 2019 baseline, they do not provide nominal data. They do disclose a few environmental targets, one of them being to set long-term GHG targets.

Assurance: Heartland Group disclose that their emissions data is unaudited. NZSA expects limited assurance of emissions data (in line with CRD requirements) and a review of other environmental disclosure statements.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

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Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure.
Political donations	G	No donations were made.

Financial & Performance

Policy Theme	Assessment	Notes
Capital Management	A	A SPP was completed at $1.80. NZSA prefers an entitlement-based form of capital raise. Good disclosure around dividend policy and rationale.
Takeover or Scheme	n/a	*n/a if no takeover*

Heartland's share price rose from $1.63 to $1.71 (as of 17th October 2022) over the last 12 months – a 5% increase. This compares favourably with the NZX 50 which rose by 4% in the same period. The capitalisation of HGH is circa $1.1b placing it 30th out of 128 companies on the NZX by size and makes it a large company.

Metric	2020	2021	2022	2023	Change
Interest Income	$347m	$328m	$342m	$573m	54%
Net Interest Income	$217m	$234m	$250m	$282m	13%
Interest Margin	62%	71%	73%	53%	-27%
NPAT	$72.0m	$87.0m	$95.1m	$95.9m	1%
EPS[1]	$0.124	$0.149	$0.16	$0.135	-16%
PE Ratio	10	16	10	13	
Capitalisation	$738m	$1,371m	$984m	$1.2b	26%
Current Ratio	n/a	n/a	n/a	n/a	n/a
Debt Equity	6.60	6.45	7.77	6.51	-16%
Operating CF[2]	$45.9m	$26.9m	$30.0m	-$31.8m	n/a
NTA Per Share[1]	$1.08	$1.18	$0.99	$1.12	13%
Dividend Per Share[1]	$0.097	$0.11	$.11	$0.115	5%

[1] *per share figures based off actual shares at balance date (not weighted average)*

[2] *Net Operating cashflows before changes in operating assets and liabilities*

Heartland Bank had another stellar year in what could be construed as a difficult trading environment, with rising interest rates and falling market confidence.

Notwithstanding these conditions, HGH's share price rose and managed to slightly beat the broader index. *Interest Income* was up 54% on 2022 to $528m as interest rates rises took full effect. Net interest income was however only up 13% to $282, as the rising cost of deposits meant the interest margin declined to 53%.

This enabled HGH to deliver *NPAT* of $95.9m, a slight increase on last year. Underlying NPAT (excluding movements in value of equity investments and derivatives) was within the guidance provided on 13th October 2022, of a range between $109 million to $114 million.

An investor presentation was released in conjunction with their annual results and on page 35 they provided some outlook where *"Heartland expects NPAT for FY2024 to be within the guidance range of $116 million to $122 million excluding any impacts of fair value changes on equity investments held, the impact of the de-designation of derivatives, and any costs related to the acquisition of Challenger Bank, which remains subject to RBNZ and APRA approval...*" In addition, they state an ambition to double NPAT within the next 5 years.

Although NPAT remained static, HGH had issued 116.8m new shares during the year, and this led to an elevated *PE* of 13.

The *debt equity* ratio decreased from 7.77 to 6.51 and this may seem high - however, for the industry that HGH operates in, high debt equity ratios are the norm.

HGH have *NTA* of $1.12 per share, an increase of 13% on last year. The shares trade at a 53% premium to NTA indicating the market expects continuing good performance and dividends.

The company paid increased fully imputed dividends of $0.115 cents per share for FY2023.

We note that the Balance Sheet may be difficult to assess for investors not accustomed to reviewing finance or banking industry accounts. The traditional breakdown of Current Assets (ie, readily 'liquid') and Current Liabilities (due on demand or within 12 months) is not shown on the Balance Sheet, although there is strong disclosure of the nature of each item in the notes to the accounts. Investors should use their judgement or take appropriate advice around assessing relevant liquidity and funding metrics for Heartland.

Harrogate Trustee Limited (which is owned by Greg Tomlinson) is the largest holder with a 9.76% stake.

Resolutions

1. To re-elect Greg Tomlinson as a Non-Independent Directors.

Greg Tomlinson was appointed to the Board in October 2018 and is the Chair. He is currently a Director of a number of companies including Oceania Healthcare Limited, Tomlinson Group Investments Limited, and Indevin Group Limited. He has a beneficial interest in Heartland shares held by Harrogate Trustee Limited, which is currently Heartland's largest shareholder.

We will vote undirected proxies **IN FAVOUR** of this resolution.

2. To increase the Directors Fee Pool from NZ$1,600,000 or AU$1,400,000 (whichever is the greater amount from time to time) to NZ$2,400,000 or AU$2,200,000 (whichever is the greater amount from time to time), an increase of NZ$800,000 or AU$800,000 (33% and 57% respectively).

The current Fee Pool was approved by shareholders at the 2018 ASM. The Notice of Meeting notes the Consumer Price Index has increased 21.3% since that time. The Board is also seeking an increase in respect of the acquisition of Challenger Bank and the growth and increased complexity of the company over that time.

The Board has commissioned an independent Report from EY and a copy of the Report is attached to the Notice of Meeting. The Report includes appropriate comparator data.

We note that the company proposes a Chair Fee of NZ$175,000 as recommended by EY however it proposes a Directors Fee of NZ$120,000 compared to the EY recommendation of NZ$105,000. Whilst EY recommends Committee Chairs Fees of NZ$15,000 the company is proposing Fees of NZ$20,000.

The Notice of Meeting also includes the proposed Board Fees for Challenger Bank (around AU$550,000), and that an additional three non-executive independent Directors will be appointed to the Board of Challenger Bank by Heartland on completion of the acquisition. The underlying increase to HGH director fees is therefore limited to AU/NZ$250,000.

We will vote undirected proxies **IN FAVOUR** of this resolution.

3. That the Board is authorised to fix the auditor's remuneration for the coming year.

This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

Proxies

You can vote online or appoint a proxy at https://vote.linkmarketservices.com/HGH/

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **2.00pm Tuesday 7 November 2023.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA