

Half-Yearly Report

For the period ended 31 December 2013



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 2013. The financial statements for the period have been reviewed by our external auditors. Key performance measures are set out in Table 1.

- Our underlying profit performance held up well in an extremely competitive environment. At the same time we increased our capital adequacy ratios and invested in growing our staff numbers.
- The \$24.520 million pre-tax profit was down 12.1% on the \$27.887 million in the same period the previous year. However, the previous period's result included a significant gain made on the sale of Visa shares. Excluding that amount, the pre-tax profit was down just 1.6%.
- Profit after tax was \$17.929 million, down 8.3% on the corresponding period in the previous year. Again, excluding the Visa share gain from the previous year's result, profit after tax actually rose 2.6%.
- Those profit results were recorded in a six-month period in which we added 13 extra positions to our staffing levels, a further investment in our ability to provide customers with service excellence.

- Heritage continues to champion its *People first* philosophy which focuses on providing customers with the best possible rates, products and services. This is reflected in the fact that Heritage aims to ensure that its retail banking offering remains consistently better value than the big banks and many other financial institutions.
- Loan approvals totalled \$657 million in the period, down 18.4% on the amount achieved in the same period in 2012. This was a factor of both the continuing fierce competition in the marketplace and also our desire to soften asset growth to strengthen our capital ratio position. Pleasingly, loan approvals rebounded well towards the end of 2013 and have continued to track well in early 2014, reflecting our determination to offer pricing that is extremely competitive.
- Retail deposit growth remained solid at \$256 million in the six months to 31 December 2013.

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

- Heritage continues to face the ongoing issue of balancing the need for profits to boost retained earnings and capital, while

also providing customers with attractively priced products and services. With prudential requirements tightening in the post-GFC environment, the pressure on this balance is likely to grow.

- This pressure is reflected in our total consolidated assets, which decreased 1.6% from \$8.507 billion to \$8.369 billion in the six months to 31 December 2013. This in part reflects the desire to grow our capital ratio, as per the increasing prudential requirements. We also chose to early mature \$400 million in Government Guaranteed debt in this period. This assisted in increasing margin without adversely impacting our customers, and contributed to the slight reduction in assets.
- We lifted our Tier 1 capital ratio from 11.07% as at 30 June 2013 to 11.69% as at 31 December 2013. The total capital ratio increased from 12.81% to 13.37%. Similarly, our liquidity ratio increased from 20.31% to 21.51% in the same period.
- Heritage also maintained our net interest margin income at the same level during this period, reflecting our aim of balancing our need to grow retained earnings against our goal of providing great value to customers.

TABLE 1

	Six months to 31 December 2013	Six months to 31 December 2012	Increase (Decrease)
	\$ million	\$ million	%
Profit before tax	24.52	27.89	-12.1
Profit after tax	17.93	19.56	-8.3
Loan approvals	657.00	804.94	-18.4
Retail deposit growth	256.20	303.52	-15.6

- Importantly, Heritage recorded a significant increase in non-interest income in the six months to 31 December 2013. This was the result of a number of factors, including the benefits of our involvement in a number of new ventures in the pre-paid cards area. Growing non-interest income is a key aim moving forward.
- Heritage's rate of mortgage loan arrears over 30 days was just 0.33% at 31 December 2013. Heritage is extremely proud of this achievement, which is around one third of the industry average. This 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 late 2013. These independent assessments of Heritage's quality and resilience speak volumes about our long-term sustained financial, risk management and operational outcomes.

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 \$49.3 million a year better off through banking with Heritage rather than the big four banks (on average) at December 2013.* Our customers gained a \$34.3 million benefit through better rates and fees on our deposit products, particularly through our extremely competitive term deposit rates, and a \$15.0 million benefit because of better interest rates and fees on our lending products.

The overall member benefit figure was \$15.5 million higher than for the corresponding period to December 2012, which illustrates just how strongly Heritage continues to deliver great value for customers.

These benefits are shared by all our customers.

EXTERNAL RECOGNITION

Importantly, external recognition validates our success in delivering a great customer experience. In 2013, Heritage achieved the following accolades

- Canstar awarded us best customer-owned bank at the QLD First Home Buyer State Awards.
- Heritage won Money Magazine's Cheapest Business Credit Card and placed second for Cheapest Credit Card from a bank.
- Heritage received two 5-star ratings from Canstar for our credit card and business cheque products.
- Heritage was the recipient of four awards at the 2013 Australian Home Loan Awards.
- Heritage won the Recommended Employer in the Australian Business Awards for the third year in a row.
- Heritage won the award for Best Employee Value Proposition at the Australian Human Resources Institute national awards.
- Heritage was selected in the Top 3 Best Mutual Bank, Top 3 Home Loans Provider and Top 3 Saving Account Provider awards at the 2013 Mozo People's Choice Awards.

TABLE 2

	31 December 2013	30 June 2013
Total consolidated assets	\$8.369 billion	\$8.507 billion
Retained profits	\$349 million	\$330 million
Capital adequacy ratio	13.37%	12.81%
Liquidity ratio	21.51%	20.31%
Mortgage loan arrears	0.33%	0.31%

*as at December 2013

COMMUNITY BANKING BENEFITS

Community is one of Heritage's core values and is lived by the organisation, as well as the individuals who work here. Our community focus is another way we translate the mutual philosophy into practice. Heritage operates seven community branches across southern Queensland, which are joint ventures between Heritage and local investors. Heritage established the community branches in areas which were being abandoned by other banks, to ensure local residents had access to a full banking service in their local area. One function of the community branches is to return a share of the profits they make to the community via grants to worthwhile local events, organisations and charities. In 2013, Heritage hit the milestone of \$26 million that the community branches have returned to their local communities via funding grants, wages, rents and payments for other goods and services.

FOCUS ON CUSTOMER EXPERIENCE

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 2013 with a number of key initiatives, including:

- Establishing a new Customer Experience Committee, which draws together

representatives from across the organisation to identify areas where we can improve our service to customers. The Committee reviews all feedback received from customers and actively seeks out ideas on how to enhance our services.

- Setting up a new Business Process Management Team. This team will review all our key processes to identify simpler and easier ways to do things for our customers.
- Reviewing our personal loans process and product to make it simpler for customers to apply for a loan.
- Developing a new distribution strategy for the future, which looks at each of our distribution channels and how to maximise customer benefits from them in the years to come.
- Reviewing our current intranet and setting out a roadmap for improvement that will enhance staff members' ability to meet customer needs.

QANTAS CASH CARD

Heritage Bank continues to forge new opportunities based on our nationally recognised expertise in the pre-paid card sector, this time through a partnership with iconic Australian airline Qantas. Heritage is the issuer for a new style of Qantas Frequent Flyer membership card that now has in-built pre-paid card functionality. Qantas call this new functionality "Qantas Cash" and launched the new-style card in August 2013.

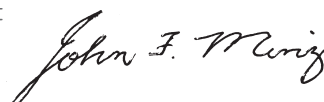
OPTUS PARTNERSHIP

In December 2012, Heritage announced an exciting collaboration with Australia telecommunications giant Optus and global payments firm Visa to develop a product that enables people to use their smartphone as a virtual wallet, paying for day-to-day purchases with a swipe of the phone. Trials and further development are underway with a view to a commercial launch later in 2014. Heritage is contributing its prepaid card expertise to the project. The contactless payment system will allow customers to use their smartphones to "wave and go" to pay for day to day purchase transactions such as buying coffee, petrol, grocery items and movie tickets at hundreds of thousands of retailers nationally and internationally where Visa payWave is accepted.

The collaboration with Optus and Visa holds exciting prospects for Heritage. Our traditional strength in payment systems has now positioned us to be a major player in the disruptive innovation in mobile payments. This provides funding, non-interest income and brand benefits.



KERRY J. BETROS
Chairman



John F Minz
Chief Executive Officer

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