

25 October 2022

Heartland Group Holdings Ltd (HGH)



The company will hold its Annual Shareholders Meeting at **2.00pm Tuesday 8 November 2022.**

It will be a virtual only meeting. You can 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. Later, 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.

The Group has over 130,000 customers with deposits of \$3.6 billion. As at 30 June 2022, its lending comprises Reverse Mortgages (\$1.95 billion), Business Finance (\$1.40 billion), Motor Finance (\$1.38 billion), Rural Finance (\$689.1 million), Personal Lending (\$64.9m) and residential mortgages (\$281.9m).

StockCo Australia was acquired by the company in April 2022 for A\$154.4 million. StockCo Australia is a provider of specialist livestock finance for cattle and sheep farmers across Australia. Most recently, in October 2022, the company announced it had signed a share purchase agreement to purchase Melbourne-based Challenger Bank for AU\$36 million, subject to approvals. It intends to transfer its existing Australian businesses to sit in or under Challenger Bank.

Current Strategy

Heartland's vision is *"to create sustainable growth and differentiation through best or only products delivered through scalable digital platforms."*

Delivery is through 'business as usual' growth, frictionless service at the lowest cost, expansion within Australia and growth by acquisition.

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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

Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	G	See below.
Director share ownership	G	Directors are not required to own shares.
Executive Remuneration	A	See below.
Golden parachutes/handshakes	A	Not disclosed if these or similar payments are made.
Director Independence	G	A majority of Directors are independent.
Board Composition	G	See below.
Director Tenure	A	See below.
ASM Format	R	See below.
Independent Advice for the Board	A	See below.

Directors Fees: Generally good disclosure. The disclosure in the annual report that “*Heartland’s policy is to pay directors’ fees in cash*” implies no share-based payments or other benefits to directors. The table of payments made to directors disclosed shows that no special exertion benefits were paid.

We note that HGH is proposing an increase in the Director Fee Pool at this year’s shareholder meeting. The [Notice of Meeting](#) (NoM) is clear that the intention of the fee pool increase is to allow for an increase of one director on the Heartland Bank Board and to allow for the increased remuneration applicable for Geoff Summerhayes, Heartland’s Australian-based director.

No increases are planned for other directors (although the NoM also states that the director fee pool is able “*to be divided amongst the non-executive directors as the Board may from time-to-time determine.*”

The Board has taken independent advice in relation to Geoff Summerhayes level of remuneration to support the increase. NZSA believes a summary of this advice should have been disclosed to the market.

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.

There is reasonable disclosure around the STI, although the measure groups used to determine the overall outcome of 89% are not disclosed. The maximum STI awarded is equivalent to 100% of fixed remuneration.

The LTI award for FY22 is disclosed as a ‘face value’ of \$2.5m of performance rights – however, there is no disclosure of the performance conditions that result in vesting. We note the long-term nature of the vesting period, at between 4-5 years.

This represents a significant weighting towards long-term CEO incentive – a position preferred by NZSA to ensure alignment with the long-term interests of shareholders. However, we note the disclosures imply an incentive regime up to 3.5x greater (approx.) than fixed remuneration.

Golden parachutes/handshakes: In the interests of transparency, NZSA believes there should be explicit disclosure around the severance terms associated with the CEO, including whether specific termination payments are offered.

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.

We note that the company does not participate in the IoD's "Future Directors Programme" (or similar). NZSA feels that given the status of Heartland within the NZX-listed community, it would provide an effective experience for emerging directors. We do note, however, that the company offers its own leadership development programme through the "Rangatahi Shadow Board" as a means of developing emerging capability. The programme offers both executive and board exposure.

The nature of the company's boards (both HGH and Heartland Bank) indicate 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.

We note that Heartland has appointment dates in either 2018 (4 directors) or 2021 (2 directors). The 2018 appointments are likely to have resulted from the restructuring of Heartland Bank into Heartland Group at that time. When this is taken into account, both Geoff Ricketts (Chair) and Jeff Greenslade (CEO) have served on the Board since 2010.

Given the criticality of both individuals to Heartland's success, NZSA would appreciate a clear disclosure of how the company intends to manage succession in a manner that reduces risk for shareholders and maintains historic strong performance.

ASM Format: NZSA prefers 'hybrid' ASM's (i.e., physical, and virtual) as a way of promoting shareholder engagement while maximising participation. The company is holding a virtual only meeting citing concerns around Covid 19. We note most NZX companies have reverted to hybrid meetings.

We appreciate that HGH sought advice from NZSA in planning their virtual only meeting, at a time when Covid restrictions were still in place. With the benefit of hindsight, NZSA should have advised HGH to plan for a hybrid meeting, remove the 'physical' element if there were Covid safety concerns.

Independent Advice for the Board: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities.

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.

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	A	See below.

Audit Rotation: Whilst the company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules, it does not disclose if the Audit Firm is rotated at 10 years.

Notwithstanding auditor tenure, NZSA also expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm to improve transparency for investors.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure.
Political donations	A	Not disclosed if donations were made.

Political Donations: NZSA policy is that companies should not make donations to political parties. We expect disclosure to this effect, even if none have been made.

Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	G	Good disclosure.
Capital Raise process	A	See below.
Takeover or Scheme	n/a	n/a if no takeover

Capital Raise process: During the year the company raised \$200 million by way of a Placement and Share Purchase Plan. NZSA prefers that companies respect existing shareholders by first offering a renounceable rights issue so they can either maintain their proportionality or derive some value from the sale of rights before utilising other raising methods.

Heartland's share price fell from \$2.34 to \$1.66 (as of 5th October 2022) over the last 12 months – a 29% decline. This compares unfavourably with the NZX 50 which declined by 17% in the same period. The capitalisation of HGH is \$984m placing it 32nd out of 130 companies on the NZX by size and makes it a large company.

Metric	2020	2021	2022	Change
Interest Income	\$347m	\$328m	\$342m	4%
Net Interest Income	\$217m	\$234m	\$250m	7%
Interest Margin	62%	71%	73%	3%
NPAT	\$72.0m	\$87.0m	\$95.1m	9%
EPS ¹	\$0.124	\$0.149	\$0.16	8%
PE Ratio	10	16	10	
Capitalisation	\$738m	\$1,371m	\$984m	-28%
Current Ratio	n/a	n/a	n/a	n/a
Debt Equity	6.60	6.45	7.77	20%
Operating CF ²	\$45.9m	\$26.9m	\$30.0m	12%
NTA Per Share ¹	\$1.08	\$1.18	\$0.99	-16%
Dividend Per Share ¹	\$0.097	\$0.11	\$.11	n/c

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 a stellar year, but HGH was not immune to broader market PE contraction, and this contributed to a falling share price whilst posting rising revenue and profits.

Interest Income was up by 4% on 2021 and as interest rates rise, this should also continue to rise. Net interest income was up by a further 7%, driven by an increase in interest margin from 71% to 73%.

This enabled HGH to deliver NPAT of \$95.1m, an increase of 9% on the prior year. Last year HGH forecasted that they expected NPAT to be in the range of \$93m to \$96m.

In an [update to market](#) provided on the 13th October, HGH expects NPAT for the financial year ending 30 June 2023 to be within the guidance range of \$109 million to \$114 million, excluding any impacts of fair value changes on equity investments held and excluding the impact of de-designation of derivatives (a non- cash accounting item).

This would be an improvement on this year's already impressive profit.

HGH currently trades on a PE of 10.

The debt equity ratio increased slightly to 7.77 and this may seem high but for the industry that HGH operates in, high debt equity ratios are the norm.

HGH have NTA of \$0.99 per share, a decline of 16% on 2021. The shares trade at a 67% premium to NTA indicating the market expects continuing good performance and dividends.

The company paid a steady fully imputed dividend of \$0.11 cents per share for FY2022.

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.

We note this format is usual practice amongst finance and/or banking organisations.

Resolutions

1. To re-elect Geoffrey Ricketts as an Independent Director.

Geoffrey Ricketts was appointed to the Heartland Bank Board 30 September 2010. His past roles include directorships of Suncorp Group New Zealand, Todd Corporation, Spotless Group, Oceania & Eastern Limited and Lion Nathan, as well as numerous other private companies. His current roles include Mercury Capital Limited and Oceania and Eastern Group. He was formerly a commercial lawyer and partner at Russell McVeagh.

We note if he is re-elected, he will have served 15 years at the end of that term. Whilst we will support his re-election, we will expect this to be his last term. We consider it critical for shareholders that a succession management plan is communicated to provide assurance of Heartland's ongoing performance.

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

2. To re-elect Jeff Greenslade as a Non-Independent Director.

Jeff Greenslade was appointed to the Board 30 September 2010 and is the CEO. He joined Heartland in 2009 as Chief Executive Officer of Marac Finance Limited – one of the four New Zealand entities that merged in 2011 to become what is now known as Heartland. He 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. From February 2006 until February 2008, he spent time on the board of UDC Finance Limited. He has also held a number of senior positions in the Institutional and Capital Markets areas of The National Bank of New Zealand and its subsidiary, Southpac.

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

3. To increase the Directors Fee Pool.

The board is proposing to increase the Directors free Pool from NZ\$1,200,000 to NZ\$1,600,000 or AUD\$1,400,000 (whichever is the greater amount from time to time), an increase of NZ\$400,000 (33%). The current Fee Pool was approved by shareholders in 2016. The Board has set out the reasons it is seeking an increase in the Notice of Meeting.

As noted in our commentary above, we recognise that only one existing director, Geoff Summerhayes, will benefit from the increased fee pool. However, given the Australian-based benchmarks associated with this director, we would expect disclosure of a summary of independent benchmarking to support the proposal.

We discussed this with Heartland Group. They re-iterated the disclosure in the Notice of Meeting, in that appropriate benchmarking had occurred, supported by advice from a respected Australian human services consultancy. Comparators had included a range of ASX-listed small-cap financial services firms and larger banking providers. It became apparent that while the Board had gone through due process in establishing an appropriate fee level for Mr. Summerhayes, there was never a 'final report' created that could be publicly issued.

Given context, we will vote undirected proxies **IN FAVOUR** of this resolution.

However, we are disappointed with the level of disclosure in this case. An effective 'business case' for director fee increases is just as relevant for shareholders as it is for the Board. Given Heartland's credibility amongst investors, NZSA would have expected better.

4. Ratification of Placement.

This related to the capital raising in August 2022 and allows the company to restore the Listing Rules limit on raising no more than 15% of new capital without shareholder approval in a 12-month period. Full details are set out in the Notice of Meeting.

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

5. Ratification of Share Purchase Plan.

As with Resolution 4 this relates to the capital raising in August 2022. Full details are set out in the Notice of Meeting.

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

6. 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 Sunday 6 November 2022.**

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

The Team at NZSA