

Heartland Group

Valuation Remains Incongruous

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UNDERPERFORM

Heartland Group Holdings (HGH) provided a brief trading update at its Annual General Meeting (AGM), reiterating its FY21 NPAT guidance of NZ\$83m–NZ\$85m and estimating NPAT to be tracking around NZ\$30m for the first four months of FY21. We increase our FY21 NPAT forecast to NZ\$65m, raising group loan receivables from 6.4% to 9.7% in light of stronger than expected motor loan receivable growth. Our FY21 NPAT estimate is lower than guidance due to 1) taking a more cautious view on impairments; in contrast management expects to see no adverse impairment impacts as a result of COVID-19, 2) we see risk of loan receivable growth softening in 2H21 given the group's 0.8% loan growth in 2H20, and 3) we expect to see continued net interest margin (NIM) compression across the business, corroborated by comments made by the RBNZ in its recent monetary policy statement. We do recognise there is upside risk to numbers in a bull case economic scenario. Considering HGH's risk profile, the level of macroeconomic uncertainty remaining, exposure to unsecured loans through Harmony and the ongoing elevated expenditure related to 'digital' we retain our UNDERPERFORM rating.

NZX Code	HGH	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.45	NPAT* (NZ\$m)	69.9	64.7	73.4	81.9	PE	12.0	13.2	11.8	10.8
Target price	NZ\$1.41	EPS* (NZc)	12.1	11.0	12.3	13.5	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS growth* (%)	-4.8	-9.2	11.7	9.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	576.7m	DPS (NZc)	7.0	5.0	8.0	8.5	Price / NTA	1.3	1.3	1.2	1.0
Market cap	NZ\$836m	Imputation (%)	100	100	100	100	Cash div yld (%)	4.8	3.4	5.5	5.9
Avg daily turnover	587.9k (NZ\$759k)	*Based on normalised profits					Gross div yld (%)	6.7	4.8	7.7	8.1

What's changed?

- **Earnings:** FY21E NPAT increase from NZ\$61.9m to NZ\$64.7m
- **Target price:** Small increase from NZ\$1.35 to NZ\$1.41

RBNZ latest monetary policy statement suggestive of further NIM compression for smaller banks

The RBNZ's Financial Stability Report released 25 November 2020, corroborates our view that a prolonged period of stimulatory monetary policy is likely in its current form to create a number of headwinds for HGH. This is further underpinned by 1) sustained ultra-low interest rates which will likely continue to apply pressure to HGH's NIM (Net Interest Margin) through reduced retail interest rates, 2) HGH not participating in the RBNZ's Funding for Lending Program (FLP) – expected to be implemented early December 2020, and 3) competitors (the big four NZ banks) receiving funding at the OCR, decreasing the average funding cost of the NZ banking industry and further widening the funding gap between HGH and competitors. In its Financial Stability Report, the RBNZ stated 'Banks with high proportions of funding from retail sources, including most of the smaller banks in New Zealand, would see greater NIM compression as their funding costs would not fall by as much as the interest rates they would be able to earn on their assets'.

NIM reflective of risk profile

The RBNZ dashboard reports HGH's NIM to be 4.5% against peer banks ANZ (1.9%), BNZ (2.0%), ASB (2.1%) and Westpac (1.9%). We view the implication of a higher risk loan book to translate into higher impairment expenses. However, for HGH this may roll into FY22 and beyond if HGH's 'Extend' product is used to re-finance non-performing loans during FY21. We consider our FY21 forecast impairment ratio of 0.71% to be conservative given HGH's FY20 ratio of 0.64%.

Heartland Group Holdings (HGH)

Priced as at 30 Nov 2020 (NZ\$)						1.45						
12-month target price (NZ\$)*						1.41	Spot valuations (NZ\$)					
Expected share price return						-2.8%	1. R-g/C-g vs P/BV					1.35
Net dividend yield						4.3%	2. n/a					n/a
Estimated 12-month return						1.6%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						n/a	Total firm value					n/a
Equity beta						n/a	(Net debt)/cash					n/a
WACC						n/a	Less: Capitalised operating leases					n/a
Terminal growth						n/a	Value of equity					n/a
Profit and Loss Account (NZ\$m)						Valuation Ratios						
	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E	
Interest income	330.0	346.8	371.1	397.8	418.5	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a	
Net interest income	194.3	216.7	227.4	241.0	254.0	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a	
Other income	11.7	16.6	17.5	18.3	19.0	PE (x)	11.4	12.0	13.2	11.8	10.8	
Net operating income	206.1	233.2	244.9	259.3	273.0	Price/NTA (x)	1.4	1.3	1.3	1.2	1.0	
Operating and other expenses	80.0	97.6	109.9	114.0	118.3	Free cash flow yield (%)	n/a	n/a	n/a	n/a	n/a	
Impairment expenses	20.7	29.4	36.0	33.4	30.3	Net dividend yield (%)	6.9	4.8	3.4	5.5	5.9	
Depreciation and Amortisation	5.8	9.2	9.9	10.8	11.6	Gross dividend yield (%)	9.6	6.7	4.8	7.7	8.1	
Tax	27.9	27.2	24.4	27.7	30.9	Capital Structure						
Normalised NPAT	71.7	69.9	64.7	73.4	81.9	Interest cover EBIT (x)	n/a	n/a	n/a	n/a	n/a	
Abnormals/other	1.9	2.1	0	0	0	Interest cover EBITDA (x)	n/a	n/a	n/a	n/a	n/a	
Reported NPAT	73.6	72.0	64.7	73.4	81.9	Net debt/ND+E (%)	n/a	n/a	n/a	n/a	n/a	
Normalised EPS (cps)	12.7	12.1	11.0	12.3	13.5	Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a	
DPS (cps)	10.0	7.0	5.0	8.0	8.5	Key Ratios						
Growth Rates							2019A	2020A	2021E	2022E	2023E	
Net interest income (%)	6.7	5.1	7.0	7.2	5.2	Return on assets (%)	3.0	2.7	2.2	2.4	2.5	
Net operating income (%)	4.7	13.2	5.0	5.9	5.3	Return on equity (%)	11.0	10.5	9.1	9.5	9.4	
Normalised NPAT (%)	6.2	-2.5	-7.4	13.4	11.6	Return on funds employed (%)	n/a	n/a	n/a	n/a	n/a	
Normalised EPS (%)	1.5	-4.8	-9.2	11.7	9.5	EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a	
Ordinary DPS (%)	11.1	-30.0	-28.6	60.0	6.3	EBIT margin (%)	n/a	n/a	n/a	n/a	n/a	
Cash Flow (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
EBITDA	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	n/a	n/a	n/a	n/a	n/a	
Working capital change	n/a	n/a	n/a	n/a	n/a	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a	
Interest & tax paid	n/a	n/a	n/a	n/a	n/a	Imputation (%)	100	100	100	100	100	
Other	n/a	n/a	n/a	n/a	n/a	Pay-out ratio (%)	79	58	45	65	63	
Operating cash flow	n/a	n/a	n/a	n/a	n/a	Capital						
Capital expenditure	n/a	n/a	n/a	n/a	n/a	Tier 1 Capital (NZ\$m)	529	531	571	615	661	
(Acquisitions)/divestments	n/a	n/a	n/a	n/a	n/a	Total Capital (NZ\$m)	529	531	571	615	661	
Other	n/a	n/a	n/a	n/a	n/a	RWA (NZ\$m)	3921	4191	4486	4631	4834	
Funding available/(required)	n/a	n/a	n/a	n/a	n/a	CET1 Ratio	13.5%	12.7%	12.7%	13.3%	13.7%	
Dividends paid	n/a	n/a	n/a	n/a	n/a	Total Capital Ratio	13.5%	12.7%	12.7%	13.3%	13.7%	
Equity raised/(returned)	n/a	n/a	n/a	n/a	n/a	Key indicators						
(Increase)/decrease in net debt	n/a	n/a	n/a	n/a	n/a	Net Interest Margin	4.2%	4.4%	4.2%	4.2%	4.1%	
Balance Sheet (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
Cash & cash equivalents	74.5	147.2	147.7	148.2	148.7	Cost to Income Ratio	41.6%	45.8%	48.9%	48.1%	47.6%	
Receivables	4,349.8	4,583.8	5,007.7	5,306.1	5,656.8	Impairment Expense Ratio	0.47%	0.64%	0.71%	0.62%	0.53%	
Intangibles	71.9	72.8	74.7	75.5	75.4	Divisional NII (NZ\$m)						
Right of use asset	0	18.4	16.2	14.3	12.6	Motor	54.7	57.0	63.8	70.5	73.3	
Other assets	432.8	496.0	513.0	529.4	545.1	NZ Reverse Mortgages	20.7	20.1	21.8	23.7	25.6	
Total funds employed	4,929.0	5,318.1	5,759.3	6,073.4	6,438.6	Australia Reverse Mortgages	22.3	30.1	33.1	36.8	41.6	
Deposits	3,153.7	3,264.2	3,584.8	3,685.1	3,841.3	Personal Consumer	14.6	18.4	18.4	18.3	18.7	
Other borrowings	0	0	0	0	0	Business	52.9	58.0	58.4	60.1	62.8	
Other liabilities	1,099.7	1,354.0	1,456.4	1,568.3	1,679.7	Rural	30.4	29.7	28.5	27.8	28.1	
Shareholder's funds	675.7	700.0	718.1	820.0	917.6							
Minority interests	0	0	0	0	0							
Total funding sources	4,929.0	5,318.1	5,759.3	6,073.4	6,438.6							

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

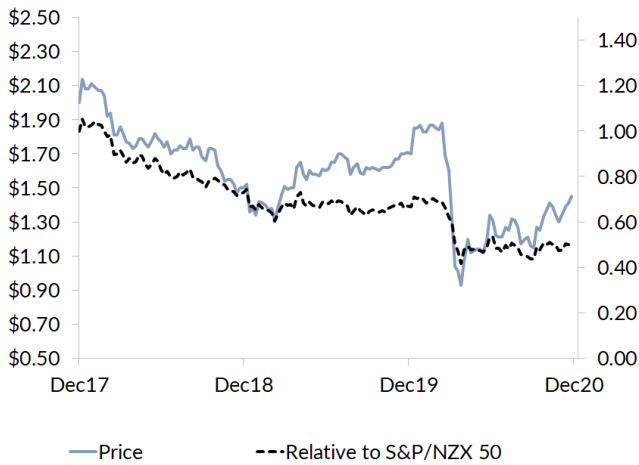
Changes to forecasts

We make small changes to our forecasts for years FY21E–FY23E. We increase receivables for HGH's Motor Division to +15% having grown +0.2% at 2H20 and decrease business lending from +6.0% to +3.0% in light of commentary regarding receivables and repayments. We also note there is risk of softening demand and vehicle supply chain issues dampening growth for the motor book in 2H21. While motor receivables and Intermediated lending saw positive growth for the first four months of FY21, management commentary suggests that growth and repayments of Relationship Lending, Open4Business and Harmony have been less encouraging. Both the New Zealand and Australian reverse mortgage receivable growth are in line with our expectations.

Figure 1. Changes to forecasts FY21E–FY23E

(NZ\$m)	FY21E			FY22E			FY23E		
	Old	New	% change	Old	New	% change	Old	New	% change
Net interest income	222.7	227.4	2.1%	236.5	241.0	1.9%	253.3	254.0	0.3%
NIM	4.2%	4.2%	0.0%	4.2%	4.2%	0.0%	4.2%	4.1%	0.0%
PBT	85.2	89.1	4.5%	96.5	101.0	4.7%	111.4	112.8	1.2%
NPAT	61.9	64.7	4.5%	70.0	73.4	4.7%	80.9	81.9	1.2%
EPS (cent)	0.11	0.11	4.5%	0.12	0.12	4.7%	0.13	0.13	1.2%
DPS (cent)	0.05	0.05	0.0%	0.08	0.08	0.0%	0.09	0.09	0.0%

Source: Forsyth Barr analysis

Figure 2. Price performance


Source: Forsyth Barr analysis

Figure 3. Substantial shareholders

Shareholder	Latest Holding
Harrogate Trustee	9.8%

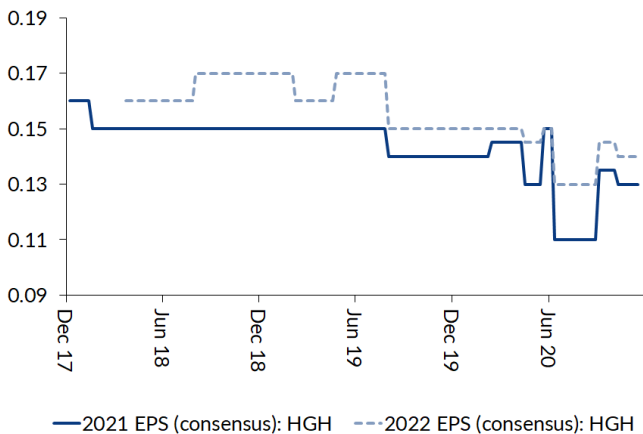
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

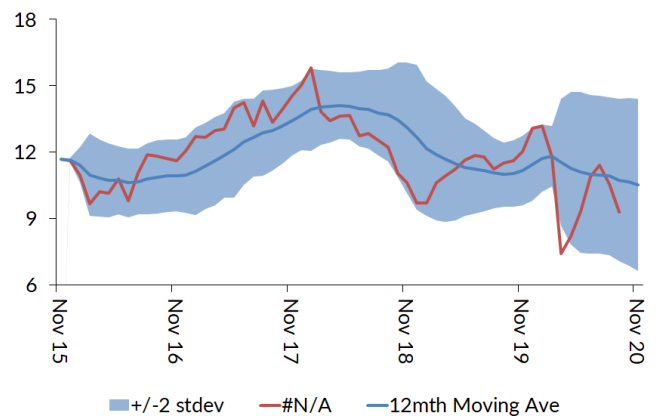
Company (metrics re-weighted to reflect HGH's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Heartland Group Holdings	HGH NZ	NZ\$1.45	NZ\$836	13.2x	11.8x	n/a	n/a	n/a	n/a	5.5%
AUST AND NZ BANKING GROUP	ANZ AT	A\$23.25	A\$66,039	15.5x	13.2x	n/a	n/a	n/a	n/a	4.9%
BENDIGO AND ADELAIDE BANK	BEN AT	A\$9.12	A\$4,841	15.8x	13.3x	n/a	n/a	n/a	n/a	4.4%
BANK OF QUEENSLAND	BOQ AT	A\$7.89	A\$3,586	18.6x	14.2x	n/a	n/a	n/a	n/a	4.6%
COMMONWEALTH BANK OF AUSTRAL	CBA AT	A\$81.09	A\$143,861	19.9x	18.2x	n/a	n/a	n/a	n/a	4.0%
NATIONAL AUSTRALIA BANK	NAB AT	A\$23.48	A\$77,256	19.3x	14.7x	n/a	n/a	n/a	n/a	4.6%
WESTPAC BANKING CORP	WBC AT	A\$20.61	A\$74,437	18.9x	13.3x	n/a	n/a	n/a	n/a	5.0%
Compco Average:				18.0x	14.5x	n/a	n/a	n/a	n/a	4.6%
HGH Relative:				-27%	-18%	n/a	n/a	n/a	n/a	20%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (HGH) companies fiscal year end

Figure 5. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 6. One year forward PE (x)


Source: Forsyth Barr analysis

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