

HEARTLAND

New Zealand Limited

NZX and Media Release

HEARTLAND FULL YEAR PROFIT OF \$6.9M IN LINE WITH EXPECTATION

26 August 2013

Heartland New Zealand Limited (**Heartland**) (NZX: HNZ) today announced a net profit after tax (**NPAT**) of \$6.9m for the full year ended 30 June 2013 in line with expectation. Managing Director Jeff Greenslade advised that underlying performance continues to improve during a period of significant strategic activity including Heartland being successful in achieving bank registration. The on-going growth of core assets, coupled with a continuing reduction in cost of funds, has positioned Heartland to deliver sustainable profitability in future years.

In addition, the measures taken with the non-core property asset portfolio (that is, the change in strategy described below) have removed the distraction of those assets and allow for a period of normalised results while this portfolio is managed down. Adjusted NPAT is \$24.4m (Adjusted NPAT is calculated by adding back one-off non-cash expenses incurred as a result of the change in strategy to the headline result). The original forecast NPAT guidance for 2013 was \$21-\$24m.

Achievements for the full year include:

- Bank registration achieved
- Dividend policy set, interim dividend paid, final dividend announced
- Investment grade credit rating affirmed
- Net Operating Income (**NOI**) and lending increased across the three core areas of Business, Rural and Consumer
- Implementation of new strategy for non-core legacy property asset portfolio
- RECL management agreement terminated

FINANCIAL PERFORMANCE¹

NPAT was \$6.9m for the full year ended 30 June 2013 (the **Current Reporting Period**); this is down \$16.7m from the \$23.6m for the previous corresponding full year ended 30 June 2012 (the **Previous Corresponding Reporting Period**) due to the write-downs in non-core property.

¹ This announcement is based on the 30 June 2013 audited consolidated financial statements of Heartland New Zealand Limited. For more detailed analysis and explanation please refer to the attached full year financial statements.

Net profit before tax (**NPBT**) was \$9.4m for the Current Reporting Period (down from \$20.3m NPBT for the Previous Corresponding Reporting Period).

Adjusted NPBT for the Current Reporting Period was \$33.7m an increase of \$13.4m over the Previous Corresponding Reporting Period illustrating the improvements in underlying business performance. Adjusted NPBT is calculated by excluding the one-off expenses of \$24.3m (pre-tax) incurred as a result of the change in strategy with respect to the non-core legacy property asset portfolio (which included termination of the management agreement with Real Estate Credit Limited (**RECL**) announced 5 June 2013) (**Change in Strategy**)².

Earnings Per Share was \$0.02 based on weighted average shares on issue.

Balance sheet³

Heartland's total assets increased by \$156.5m or 7% over the Current Reporting Period (from \$2.3bn at 30 June 2012 to \$2.5bn at 30 June 2013).

- There was a \$76.1m increase in the "core" business net finance receivables (Rural, Business and Consumer channels). However, due to a reduction in non-core assets of legacy Property and Retail Mortgages, net finance receivables reduced in total by \$67.9m (from \$2.1bn at 30 June 2012 to \$2.0bn at 30 June 2013).
- Cash and cash equivalents and Investments increased by \$225.5m (from \$114.0m at 30 June 2012 to \$339.5m at 30 June 2013) reflecting a change to holding higher levels of liquid assets to support ongoing liquidity targets.
- Borrowings, being largely retail deposits, increased by \$158.1m (from \$1.9bn at 30 June 2012 to \$2.1bn at 30 June 2013) funding asset growth.

Heartland's Net Tangible Assets (**NTA**) decreased by \$12.5m over the Current Reporting Period (from \$343.7m at 30 June 2012 to \$331.2m at 30 June 2013) due to the one-off non-cash write-down in property assets by \$18m (pre-tax) on the Change in Strategy. On a per share basis NTA was \$0.85 at 30 June 2013 compared to \$0.88 at 30 June 2012.

Net Operating Income

Net Operating Income (**NOI**) was \$106.9m for the Current Reporting Period, an increase of \$12m or 13% from the Previous Corresponding Reporting Period. The increase in NOI was attributable to lower cost of funds and improved product mix.

Costs

Operating costs were \$70.3m for the Current Reporting Period, an increase of \$4.8m from the Previous Corresponding Reporting Period. However, operating costs for the Current Reporting Period include \$6.1m of prepaid expenses written-off as a result of the Change in Strategy⁴. Adjusted operating costs (calculated by excluding expenses related to the Change in Strategy) were down \$1.5m (2%) from the Previous Corresponding Reporting Period.

² For details of the Change in Strategy, see Heartland's market announcement of 5 June 2013.

³ Heartland Trust and CBS Canterbury Charitable Trust were deconsolidated on 1 July 2012.

⁴ Specifically, the termination of the RECL management agreement as part of that Change in Strategy

The operating expense ratio was 66% for the Current Reporting Period, a reduction from 69% for the Previous Corresponding Reporting Period. The adjusted operating expense ratio (calculated by excluding the write-off of the expenses referred to above) was 60% for the Current Reporting Period.

Impairments and revaluations of investment properties

Impaired asset expense was \$22.5m for the Current Reporting Period, an increase of \$16.9m over the Previous Corresponding Reporting Period. This increase was primarily in the Non-Core Property division and included an impairment expense of \$12.9m made as part of the Change in Strategy⁵. Impairments remained low in the core areas of Rural, Business and Consumer lending.

As part of the Change in Strategy a \$5.1m fair value adjustment was also made against investment properties⁶.

Asset quality continues to improve with net impaired, restructured and past due loans over 90 days standing at \$49.0m or 2.4% of net finance receivables (**Net Impairment Ratio**) as at 30 June 2013; down from \$90.5m (or 4.4% of net finance receivables) as at 30 June 2012. The Non-Core Property book made up \$31.2m of the impaired, restructured and past due loans at 30 June 2013.

The Net Impairment Ratio on the core business (excluding the Non-Core Property book) was 0.9% as at 30 June 2013, compared to 1.3% as at 30 June 2012.

Funding and liquidity

Deposits increased from \$1.6bn at 30 June 2012 to \$1.8bn at 30 June 2013. This increase was driven by a positive customer reaction to the achievement of bank registration and subsequent product initiatives in retail deposit products of Heartland Bank Limited (**Heartland Bank**) (Heartland's principal operating subsidiary).

The liquidity of Heartland Bank was \$578.0m as at 30 June 2013, which consisted of cash, liquid assets and unutilised available funding lines. This included additional liquidity held pending the \$106m repayment of NZX Debt Market quoted bonds on 15 July 2013. The liquidity mix continues to evolve, with increased holdings of cash and liquid assets replacing unutilised or cancelled bank funding lines.

Investment grade rating reaffirmed

On 16 May 2013 Standard & Poor's affirmed Heartland Bank's investment grade credit rating of BBB- and as a result of its assessment of New Zealand's economic vulnerabilities changed the outlook to 'negative' from 'stable'.

⁵ As part of the one-off non-cash write down in property assets by \$18m (pre-tax) on the Change in Strategy

⁶ As part of the one-off non-cash write down in property assets by \$18m (pre-tax) on the Change in Strategy

BUSINESS PERFORMANCE – HEARTLAND’S CORE BUSINESS DIVISIONS

Business

Primarily driven by lower cost of funds, NOI increased to \$25.7m, up \$4.7m (22%) from the Previous Corresponding Reporting Period.

The business receivables book increased by \$8.9m to \$549.2m during the Current Reporting Period. Continued growth is expected in line with credit growth expectations.

Rural

NOI increased to \$22.9m, up \$3.7m (20%) from the Previous Corresponding Reporting Period. This was driven by the inclusion of a full twelve months earnings from the PWF book as well as lower cost of funds.

Largely due to the settlement of \$23.2m of recourse loans by PGG Wrightson Limited under a guarantee provided to Heartland Bank as part of the acquisition of PGG Wrightson Finance Limited, the rural receivables book contracted from \$478.6m to \$456.6m during the Current Reporting Period. Excluding these loans the Rural book increased slightly over the year despite the impact of the recent drought resulting in lower demand in livestock trading.

Retail & Consumer

Driven by lower cost of funds and growth in motor vehicle lending, NOI increased to \$50.2m, up \$5.1m (11%) from the Previous Corresponding Reporting Period.

The Retail & Consumer receivables book was flat over the Current Reporting Period with Motor Vehicle receivables growth of \$89.0m (14%) offset by an \$88.4m (27%) reduction in the residential mortgage book.

The reduction in the residential mortgage book reflects Heartland Bank’s strategy to focus on its core activities in Business, Rural and Household lending, replacing lower margin business with higher margin business which offer a better risk/return. As previously announced, Heartland Bank has entered into an exclusive arrangement with Kiwibank under which Heartland Bank customers can now access Kiwibank’s market leading residential mortgage products.

NON-CORE BUSINESS

Property

Total legacy Non-Core Property assets were \$107.4m at 30 June 2013, a reduction of \$52.7m (33%) from 30 June 2012. The Non-Core Property assets were made up of net receivables of \$49.1m and investment properties of \$58.3m.

The reduction included the impact of the one-off non-cash write down of \$18m (pre-tax) due to the Change in Strategy. The new strategy provides Heartland with greater flexibility to manage the portfolio and to best balance an exit strategy with maximising shareholder value. Heartland is now confident earnings will now normalise, and no longer be impacted by the performance of the non-core legacy property assets.

Investment properties held on balance sheet increased by \$2.8m during the Current Reporting Period. This increase was the result of additional assets received as part of the termination of the RECL management agreement, offset by the \$5.1m fair value adjustment made as part of the Change in Strategy.

Non-Core Property assets fell a further \$8.9m in July 2013 through realisations, subsequent to balance date pursuant to the Change in Strategy.

BANK REGISTRATION AND CORPORATISATION OF SUBSIDIARY

Heartland Bank became a registered bank on 17 December 2012, and converted to a company on 31 January 2013. The corporatisation process included a change in Heartland Bank's name from its previous name "Heartland Building Society" to its current name "Heartland Bank Limited".

FINAL DIVIDEND

The directors of Heartland have resolved to pay a final dividend for the full year ended 30 June 2013 of 2.5 cents per share. This dividend will be paid on 4 October 2013 to shareholders on Heartland's register as at 5.00pm on 20 September 2013 (the **Record Date**). This dividend will be fully imputed.

The Dividend Reinvestment Plan announced on 23 April 2013 (**DRP**) will be available, and a discount of 2.5% will apply (that is, the strike price under the **DRP** will be 97.5% of the volume weighted average sale price of Heartland shares over the 5 trading days following the Record Date)⁷. Participation in the **DRP** is entirely optional, and shareholders wishing to participate should make a participation election in one of the ways specified in the **DRP** offer document. The last date of receipt for a participation election from a shareholder who wishes to participate in the **DRP** is 20 September 2013.

BOARD COMPOSITION

As previously announced a number of changes have been made to the Boards of Heartland and Heartland Bank Limited (**Heartland Bank**). The changes have been promoted to increase the representation of broader shareholder interests on the Heartland Board, comply with standard Reserve Bank guidelines with respect to the number of independent directors of Heartland Bank and to extend the depth of banking experience of the Heartland Bank Board.

Progress to date has included the appointment of Greg Tomlinson to the Heartland Board, and the appointment of Richard Wilks and Nicola Greer as independent directors to the Heartland Bank Board.

In addition:

- the current Chairman of Heartland, Bruce Irvine, will resign from the Heartland Board but continue as Chairman of Heartland Bank.
- Geoffrey Ricketts will succeed Mr Irvine as the Chairman of Heartland.
- Christopher Mace and Gary Leech will continue as directors of Heartland (although resigning from the board of its subsidiary Heartland Bank to comply with standard Reserve Bank guidelines as to the percentage of independent directors on the Heartland Bank Board).

⁷ For the full details of the **DRP** and the Strike Price calculation, refer to Heartland's market announcement of 23 April 2013 which included the **DRP** offer document prepared as at 5 April 2013.

- Michael Jonas will become an Executive Director on the Heartland Bank Board.

These changes are expected to be completed on 27 August 2013.

NPAT FOR NEXT FINANCIAL YEAR (ENDING 30 JUNE 2014)

Heartland confirms its earlier forecast of NPAT for the next financial year (ending 30 June 2014) is \$34-\$37m.

The NPAT expectation for the next financial year reflects on-going reductions in cost of funds, lower impairments, continued focus on cost reductions and asset growth in core assets in line with credit growth expectations.

- Ends -

For further information, please contact:

Jeff Greenslade
Chief Executive Officer
Heartland New Zealand Limited
DDI 09 927 9149
M 021 563 593

Simon Owen
Chief Financial Officer
Heartland New Zealand Limited
DDI 09 927 9195
M 027 629 4602