

# HEARTLAND

New Zealand Limited

NZX Release

## Property Review Outcome and Updated Guidance YE 2013 and YE 2014

5 June 2013

Heartland New Zealand Limited (**Heartland**) (NZX:HNZ) has previously announced that it was undertaking a review of its strategy with respect to non-core legacy property assets. The purpose of the review was to assess the effectiveness of the existing strategy against current market conditions.

The existing strategy dates back to January 2011 when Heartland was first formed, and that strategy was a managed exit over a 5 year period beginning in January 2011. Real Estate Credit Limited (**RECL**)<sup>1</sup> was engaged to manage the non-core legacy property assets for that period, and RECL agreed to compensate the Heartland group for loss on those assets up to a limit of \$30m (these arrangements are set out in the RECL management agreement). Payment from RECL for any loss was to be made, for the most part, in 2016<sup>2</sup>.

The review that has been undertaken included considering:

- (i) whether a faster termination than that contemplated under RECL management would add more shareholder value, either by taking advantage of any changes in market circumstances or by reducing the amount of on-balance sheet property exposure; or
- (ii) whether a slower termination would in some cases be beneficial.

Following that review the Board has determined to adopt a change in strategy.

The change in strategy includes:

- Following a line by line review of the exit strategy for individual assets, a new or updated strategy for each asset in the non-core legacy property asset portfolio.
- Prepayment by RECL of the maximum compensation amount under the RECL management agreement (otherwise due in 2016), and termination of the RECL management arrangement.

### New strategy for assets

The non-core legacy property asset portfolio has a book value of \$139.0m as at 31 March 2013.

The assets in that portfolio are being divided into 3 classes, by reference to the new strategy which will apply. These asset classes are:

- *Performing*: These are loans or assets which are currently performing and will continue to be held (although real estate in this class would be sold if an attractive offer was received).

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<sup>1</sup> RECL is a subsidiary of Pyne Gould Corporation Limited, and is a third party unrelated to Heartland.

<sup>2</sup> The Heartland group has limited rights to early payment, and under those rights has received a total of approximately \$3.25m. The balance of compensation payable in 2016 is a maximum of approximately \$26.75m.

- *Acceleration*: These are loans and assets which will be exited within a 12-18 month timeline.
- *Extend*: These are loans which will be converted over time to real estate so that individual properties may be improved or positioned better for sale, and which will be held for up to 5 years.

The amounts contained in each asset class are considered commercially sensitive and will not be disclosed to avoid signalling intentions to potential buyers. Heartland does, however, expect that the majority of assets in the portfolio will be exited over the next 18 months, leaving only assets which are performing or which are being held for sale and in respect of which no further write-downs are anticipated.

As part of, and in order to facilitate this change in strategy, a one-off non-cash write-down in assets will be booked of \$18m pre-tax.

The write-down is required to:

- Meet discounts considered reasonable to exit loans and assets in the “Acceleration” class under a shorter timeframe than contemplated under the existing strategy.
- Cover risks and costs associated with holding assets in the “Extend” class over a longer timeframe. These risks are reasonable to anticipate over an extended workout period, but cannot be defined or ascribed with certainty.

The new strategy is considered preferable for the following reasons:

- (i) it creates the flexibility for Heartland to take advantage of market conditions to exit assets faster than possible under RECL management while, for certain assets, allowing for a longer timeframe to realise value where that is appropriate;
- (ii) although the change of strategy gives rise to a risk buffer via a write-down in assets, it should also mitigate the current negative market sentiment concerning the “property overhang”; and
- (iii) dismantling the RECL management agreement removes a legacy arrangement that does not fit with Heartland’s banking strategy.

The new strategy provides Heartland with greater flexibility to manage the property portfolio and to best balance an exit strategy with maximising shareholder value. While the cost is uncertain, recognising a write-down upfront removes the potential for property losses to detract from underlying earnings in the future and, if not realised, can be written back.

**Heartland is confident its earnings will now normalise, and no longer be impacted by the performance of the non-core legacy property assets.**

### **Prepayment and termination of RECL management agreement**

RECL is prepaying the maximum compensation amount under the RECL management agreement (being approximately \$26.75m) by immediately transferring to Heartland certain assets, including assets currently charged to secure the compensation payment. The assets being transferred are:

- (i) a Westpac bond due January 2016 with a face value of \$11m; and
- (ii) loans and property assets with a value equal to the balance of the maximum compensation amount.

Following termination of the RECL management agreement, future strategic and day-to-day management of the portfolio will take place in-house by Heartland.

Under the RECL management agreement, RECL was paid an up-front fee of \$11m in 2011. This fee was being amortised over the 5 year term of the arrangement. As the RECL management agreement is now being terminated and pre-paid, Heartland is required to write-off the non-amortised portion of this fee. This will result in a pre-tax cost (both non-cash and one-off) of approximately \$6m.

### **Effect on NPAT for current financial year (ending 30 June 2013)**

Without the fee write-off and second half write-down in assets, it is expected that the underlying net profit after tax (**NPAT**) for the current financial year (ending 30 June 2013) would have been approximately \$25m. This reflects positive progress in the areas of operating income, cost containment and core impairments and compares to earlier guidance in the range of \$21-\$24m.

As a result of the fee write-off and the write-down, Heartland expects NPAT for the current financial year to be approximately \$7m. This expected outcome means that Heartland is able to maintain profitability while absorbing these non-cash costs.

### **Dividend for FY2013**

The Chairman of Heartland, Bruce Irvine, advises that the \$24m pre-tax fee write-off and write-down, being non-cash items, will have no bearing on the Board's decision-making with respect to the final dividend.

### **NPAT for next financial year (ending 30 June 2014)**

As Heartland is confident its earnings will now normalise, and no longer be impacted by the performance of the non-core legacy property assets, Heartland's preliminary anticipation of NPAT for the next financial year (ending 30 June 2014) is \$34-\$37m. Further details and confirmation are expected to be made in August 2013, when Heartland announces its full year results for the financial year ending 30 June 2013.

This preliminary view of \$34-\$37m of NPAT for the next financial year reflects on-going reductions in cost of funds, lower impairments, cost reductions and asset growth in core assets in line with credit growth expectations.

### **Share Buy-Back Programme**

Heartland also proposes to put in place a share buy-back programme to allow it to manage its capital base should it deem it appropriate. All purchases under the programme will be on the NZX.

Further details (including the period during which the programme may operate and the maximum number of shares to be acquired) will be announced before the programme is implemented.

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For additional information contact:

Jeff Greenslade  
Chief Executive Officer  
Heartland New Zealand Limited  
+64 9 927 9149