HEARTLAND
New Zealand Limited

NZX Release

ACQUISITION AND FINANCIAL FORECASTS

14 February 2014

SUMMARY

Acquisition

Heartland New Zealand Limited ("Heartland") (NZX: HNZ) advises that it has entered into a Sale and Purchase Agreement with Seniors Money International Limited ("SMI") for the acquisition of its New Zealand and Australian Home Equity Release mortgage businesses. The consideration for the acquisition is NZ$87 million. The Sale and Purchase Agreement is subject to a number of conditions being satisfied prior to settlement on 1 April 2014, including SMI obtaining shareholder approval to proceed with the transaction. See the full release for further details of the acquisition.

Capital Raising

Heartland is raising NZ$20 million to partially fund the acquisition. The capital raising comprises a NZ$15 million equity placement and a NZ$5 million share purchase plan. Under the share purchase plan, each Heartland shareholder with an address in New Zealand on the register at 5pm on 27 February 2014 will be eligible to invest up to $15,000 in new Heartland shares. Further details of the placement and share purchase plan are included in the full release and the attachment to this announcement.

Forecast

Heartland will shortly be releasing its results for the first half of FY2014. Net profit after tax is expected to be around $16.5 million and in line with the forecast full year outcome of $34-$37 million for FY2014. Heartland's forecast for FY2015 is yet to be finalised and more detailed financials will be available sometime following settlement of the acquisition. Taking all relevant factors into consideration including acquisition and integration costs expected to be incurred in FY2015, the underlying business, together with the contribution from the acquisition, is likely to produce a full year result for FY2015 of between $42-44 million of net profit after tax. See the full release for further details of Heartland's forecast financial information.

FULL RELEASE

Heartland New Zealand Limited ("HNZ" or "Heartland") (NZX: HNZ) advises that it has entered into a Sale and Purchase Agreement ("SPA") with Seniors Money International Limited ("SMI") for the acquisition of SMI's New Zealand and Australian Home Equity Release ("HER") mortgage businesses. SMI is majority owned by Quadrant Private Equity, together with a number of minority shareholders (together, the "Vendor").

This acquisition provides Heartland Bank Limited ("Heartland Bank") with the product capability to meet the needs of the 65+ demographic which is a growing demographic and is typified by those with the majority of their personal wealth tied up in their primary residential dwelling. The acquisition advances Heartland's ongoing strategy of pursuing niches within the Household, Business and Rural sectors where it can obtain a market leading position.

The consideration for the acquisition is NZ$87 million and under the SPA, HNZ will acquire the Sentinel New Zealand ("Sentinel") and the Australian Seniors Finance businesses, including their respective mortgage portfolios with an aggregate asset value of approximately NZ$760 million[1] and their operational infrastructure and funding arrangements.

HNZ intends to hold the Australian business separately outside Heartland Bank but the New Zealand business will be migrated into Heartland Bank over time.

Heartland has been researching the HER product over the last 12 months and has visited and studied the markets in USA, Canada, UK and Australia. Heartland has gained an understanding of the HER product and has rigorously tested its fit with Heartland's strategy. The HER product offers significant growth opportunities supported by demographic and population fundamentals.

The chance to purchase SMI's New Zealand and Australian businesses arose during Heartland's strategic evaluation of the HER product, giving Heartland the opportunity to fast-track entry into strong and established market positions. Following due diligence it was confirmed that SMI's processes and underwriting standards are consistent with best practice. Key staff, both in New Zealand and Australia, (with experience in the HER market since 2003) will be retained. In addition, prior to this announcement, Heartland has approved risk parameters for the HER product and the training of a dedicated distribution team has commenced.

Acquisition Details

SMI will establish a new subsidiary ("New Sentinel"), to which all of the assets, liabilities and operational infrastructure of the current Sentinel operating companies will be transferred, immediately prior to the acquisition taking place.

A newly incorporated, wholly owned subsidiary of HNZ, Heartland HER Holdings Limited ("HHHL") will acquire all of the shares in New Sentinel. The Australian business assets will be acquired by way of HHHL acquiring all of the shares in the current Australian operating company (Australian Seniors Finance Pty Limited ("ASF")).

The consideration for the acquisition is NZ$87 million.

The SPA is conditional on the following having taken place prior to settlement on 1 April 2014:

- The shareholders of SMI approving the transaction. (The board of SMI supports the transaction and will be recommending the transaction to its shareholders).
- The purchaser agreeing funding arrangements with Commonwealth Bank of Australia ("CBA") in relation to the acquisition.
- The purchaser being satisfied that there is no change in circumstances such that the purchaser ceases to be satisfied (acting reasonably) that the acquisition and related arrangements will not be adverse to Heartland Bank's status as a registered bank.
- The purchaser being satisfied that there is no change in circumstances such that the purchaser ceases to be satisfied (acting reasonably) that the acquisition and related arrangements will not be adverse to Heartland Bank's credit rating.
- The vendors agreeing funding arrangements in relation to its retained businesses.
- None of the purchaser's or the vendors' cancellation rights arising and not being waived on or prior to settlement.
- Completion of the transfer of all of the assets, liabilities and operational infrastructure of the current Sentinel operating companies to New Sentinel.

[1] Includes NZ$30.5 million of HER loans purchased by Heartland Bank in December 2013

Overview of the Acquired Business

Sentinel is the No. 1 HER mortgage provider in New Zealand, with an approximately 80% market share. ASF is the largest non-bank HER mortgage provider in Australia, with approximately 20% of that market. Both the Sentinel and ASF portfolios are seasoned and diversified, having been established in 2003 and 2004 respectively and consisting of approximately 4,050 and 4,250 individual loans respectively. Over the three years prior to the GFC (March 2005 to March 2008), the Sentinel HER loan portfolio increased by NZ$269 million (an average of ~NZ$90 million p.a.), whilst the ASF HER loan portfolio increased by NZ$364 million (an average of NZ$121 million p.a.).

The weighted average loan to value ratio ("LVR") of the New Zealand HER loan portfolio is approximately 32.7%, while the weighted average LVR of the Australian portfolio is approximately 31.8%.

At origination, borrowing capacity is determined with reference to the age of the youngest borrower. A borrower aged 60 years of age can initially borrow up to an LVR of 15% with this rising 1% for each additional year of age (up to a maximum of 45%). SMI's LVR/Age table is derived using internal and external mortality and mobility experience and ratified by specialist actuaries.

The experience of Sentinel and ASF is that, on average, approximately 10-11% of the existing HER loan balance is repaid per annum, which is broadly in line with experiences in mature overseas markets (e.g. the United States) and as the HER mortgage portfolios are seasoned such repayments produce an attractive cash flow.

Acquisition Funding

The acquisition consideration of NZ$87 million is being funded by Heartland:

- To the extent of $48.3 million, in cash. Heartland is conducting a capital raising of $20 million (details below) to partially fund the $48.3 million cash component and will fund the balance with existing cash on its balance sheet; and
- By issuing $38.7 million of shares to the Vendor at a price of $0.90 each. All shares issued to the Vendor are subject to a minimum 12 month lock-up escrow arrangement.

CBA, SMI's existing primary banker, has agreed to continue to provide committed facilities to Sentinel and ASF to fund the portfolios for a term of five and a half years on similar terms to those that are in place today.

Strategic Drivers – Home Equity Release Loans[2]

HER loans allow seniors (an often asset rich but income poor demographic) to access the equity in their homes. Seniors must be a minimum age (60+), live in their own home, and have equity in it. The important distinction between an HER loan and a conventional mortgage is that there are no principal or interest payments required while the borrower occupies the property, meaning that qualifying borrowers can access this finance type without having a regular source of income.

The borrower's entitlement to occupy the residence is not affected if the value of the loan reaches a point where it exceeds the value of the property - the borrower is entitled to occupy the property for as long as the borrower wishes. The product offered includes a "No Negative Equity Guarantee" which means that the borrower (or their estate) will never be required to repay more than the value of the property.

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[2] Statistics in this section are sourced from: Statistics New Zealand, Australian Bureau of Statistics, New Zealand Treasury, Australian Treasury, Department of Families, Housing, Community Services and Indigenous Affairs (Australia), The Smith Institute, Key Retirement Solutions, HOMEQ company filings, Reverse Mortgages Report to Congress (US)

This product is an ideal response to demographic and economic realities - an ageing population with much of its wealth invested in real estate. The ability to monetise these assets without the need to sell and exit the family home or to demonstrate external sources of debt servicing allows those aged 60+ to remain independent and to age with dignity in their own homes.

Currently, approximately 635,000 New Zealanders are aged 65 years or older. This is forecast to grow to 1.1 million in 2031. New Zealanders have a significant amount of wealth tied up in their homes, with the value of housing stock currently standing at over NZ$700 billion (this compares to the current NZX50 securities index aggregate capitalisation of approximately NZ$54 billion). Approximately 82% of New Zealanders aged 65+ own their own home, with 92% of these homes being owned mortgage free. Amongst property owners aged 65 to 74, property accounts for 85% of their total net wealth, whilst for property owners aged 75+ the figure is 88%. Approximately 22% of total net wealth held by New Zealanders is held by the 65+ age group.

Furthermore, the median income of New Zealanders aged 65+ is just NZ$20,200. Government superannuation accounts for 57% of the average income of those aged 65+.

The statistics are similar in Australia, with the number of Australians aged 65 years or over forecast to increase from 3.3 million today to more than 5.8 million in 2031. The value of the housing stock in Australia is approximately A$4.5 trillion (this compares to the ASX securities index aggregate capitalisation of A$1.4 trillion).

Approximately 83% of Australians aged 65+ own their own home, with 93% of these homes being owned mortgage free. Approximately 70% of the wealth of Australian's aged 65+ is held in property assets. The mean household income of Australian couples aged 65+ is approximately A$34,100 with government pensions accounting for 61% of this income. The mean household income for single Australians aged 65+ is approximately A$27,300 with government pensions accounting for 76% of this income.

In the United States, the Federal Government supports the HER product, via the Home Equity Conversion Mortgage ("HECM"), an HER loan designed by the Department of Housing and Urban Development and insured by the Federal Housing Administration. In total 740,000 loans have been originated (valued at US$166 billion) under the HECM program since it began in 1990, with about 582,000 loans still outstanding (valued at US$136 billion). Over 90% of HER loans in the United States are written under the HECM program. The programme provides significant social benefits by allowing seniors to age in their homes, promoting independence and dignity. Research by the National Reverse Mortgage Lenders Association[3] shows that the cost to seniors of 'ageing in place' is less than a third of the cost of nursing home care. The HECM HER loan is currently available to homeowners aged 62 years and older.

In Canada, HOMEQ is the only national provider of HER mortgages and effectively has a monopoly position in that market. Prior to being privatised in 2012, HOMEQ had an HER mortgage portfolio with aggregate assets of approximately CAD$1.3 billion. HOMEQ has been in operation since 1986.

In the United Kingdom, the market is dominated by a small number of large providers. Most of the major lenders are members of the Equity Release Council, the industry body for the equity release sector. This body has drawn up a voluntary code of practice for equity release products which puts in place safeguards and guarantees for consumers. Since the formation of the Equity Release Council's predecessor (Safe Home Income Plans) in 1990, the market has grown from £30 million to approximately £1 billion today.

Acquisition Consistent with Heartland's Strategy

Heartland's strategy is to participate in specialist niches where it is capable of achieving a leading position, as opposed to the more generalist product areas dominated by the major banks (e.g. conventional

[3] www.nrmlaonline.org

residential mortgages). Heartland's competitive advantage in these markets arises through specialist product features and knowledge reflected in the skills of Heartland's people and the positioning of its distribution channels. Heartland currently occupies leading market positions in invoice financing, livestock financing and motor vehicle financing.

The acquisition of the HER capability fits with Heartland's strategic objectives:

- Within the target "Households" banking sector but with compelling fundamentals aligned to an ageing population – in fact, the 60+ demographic is already Heartland's largest and most important customer group, being its depositors;
- Specialist product – Sentinel and ASF are Australasia's only specialist provider of HER Loans and the market is relatively less contested than mainstream banking markets;
- Number 1 market positions;
- Experienced staff and seasoned existing processes in both jurisdictions together with the ability to leverage both the existing distribution platforms and relationships and those of Heartland within New Zealand;
- Sustainable earnings and growth; and
- Longer asset duration to balance Heartland's largely short dated asset profile.

The intention remains to confine the activities of Heartland Bank to New Zealand. The Australian business will remain under HNZ outside the bank, funded exclusively by CBA in A$.

Expanding into Australia was not an immediate objective of HNZ and the opportunity to do so arose from this acquisition, but HNZ is very pleased with the opportunity and sees a range of benefits arising from the Australian business:

- ASF is established with a strong market position and is self-sustaining in terms of processes;
- The key risk components are the same as for New Zealand and are well understood;
- ASF is well led, with a strong culture of best practice compliance and underwriting standards, and has been operating successfully since 2004;
- It is self-funding under the CBA facility; and
- Diversification into the larger and, at times, stronger Australian market is considered beneficial.

Operational Management
Heartland will acquire the existing expertise and operational infrastructure of Sentinel / ASF. Both entities have established efficient processing platforms. Heartland will introduce increased governance and oversight consistent with bank standards. Existing underwriting standards meet with best industry practice and Heartland will build on this and may in certain areas adopt an even more granular approach with respect to geographic risk profiling.

Product strategy and team management will come under the overall management of Chris Flood, Head of Retail, who has been responsible, amongst other things, for Heartland's successful motor vehicle finance and deposit strategies.

New Zealand Business
Sentinel is the number one HER mortgage provider in New Zealand, with an approximately 80% market share. As at 31 December 2013 the New Zealand business had approximately NZ$340 million[4] of HER loan assets with a weighted average LVR of approximately 32.7%.

[4] Includes NZ$30.5 million of HER loans purchased by Heartland Bank in December 2013

Attempts to develop the product in New Zealand have been sporadic and, especially since the GFC cashflow constraints and the absence of a major sponsor, growth has been limited. Notwithstanding this, there is significant unsatisfied demand for this product (635,000 New Zealanders are aged 65+). Heartland intends to make HER loans a core product in New Zealand and has identified a number of strategic affinities with this acquisition:

- HER loans provide access to the Household sector which is one of Heartland's targeted sectors;
- Unlike conventional residential mortgages, which Heartland does not regard as core, the market is less contestable and Heartland will be acquiring a leading market position from which it can grow;
- Margins are better than those available from conventional residential mortgages and the risks as measured by loss rates are reasonably similar, based on both actuarial analysis and research into other jurisdictions such as the USA and Canada; and
- This product will provide additional options to better meet the needs of a growing number of heartland New Zealanders in terms of how they manage their retirement.

Sentinel will report into Chris Flood, Head of Retail, and it is intended to migrate the Sentinel HER loans into Heartland Bank over time.

Australian Business
The Australian business will be held by HHHL, a wholly owned subsidiary of HNZ, and will remain outside the banking group. It is an established business that has been in operation since 2004, with an established market position and is self-supporting with respect to its processes and day to day operations.

ASF is the largest non-bank HER mortgage provider in Australia, with approximately 20% of that market. As at 31 December 2013 it had HER loan assets of approximately A$380 million with a weighted LVR of approximately 31.8%.

ASF will report to the HHHL Board comprised of:

Geoff Ricketts (Chair)
Greg Tomlinson
Jeff Greenslade
Michael Jonas
Chris Flood
Australian Director – TBA

Geoff Ricketts, the current chair of HNZ, has extensive experience with Australian businesses. He was recently chair of Lion Nathan, recently a director of Australian company Spotless Group and is a current director of Suncorp Group (ASX listed banking and insurance group). HNZ, through the board, will be directly responsible for the risk framework and, following extensive analysis by external advisors, is comfortable that the existing book and underwriting guidelines meet proper prudential standards. HNZ intends to grow this business.

Capital Raising
As noted above, HNZ is raising NZ$20 million to partially fund the acquisition. The capital raising comprises a NZ$15 million equity placement and a NZ$5 million share purchase plan.

Placement
HNZ has this morning successfully received commitments from a range of existing and new investors to subscribe for new HNZ shares in a NZ$15 million equity placement ("Placement"). Pursuant to the Placement, 17,045,455 new shares will be issued at $0.88 each ("Placement Issue Price"), a 1.12% discount to HNZ's closing share price on the NZX yesterday, with allotment and settlement to take place on Tuesday 18 February 2014.

Share Purchase Plan
Under the Share Purchase Plan ("SPP"), each HNZ shareholder with an address in New Zealand on the register at 5pm on Thursday 27 February 2014 will be eligible to invest up to $15,000 in new HNZ shares. HNZ is seeking to raise NZ$5 million under the SPP. The SPP has been fully underwritten by First NZ Capital Securities Limited. The minimum application amount is $2,500. Eligible shareholders will apply for a dollar amount of shares rather than a certain number of shares. The number of shares to be issued to each eligible shareholder will be the dollar amount of shares applied for (adjusted for any scaling) divided by the issue price. If this produces a fractional number, the number of shares allotted to that eligible shareholder will be rounded up to the nearest whole number.

The issue price for the SPP will be the lower of:

- a 2.5% discount to the average end of day market price of Heartland shares over the 5 day trading period from Thursday 13 March 2014 to Wednesday 19 March 2014;[5]and
- the Placement Issue Price, reduced by the amount per share of any cash dividend declared by HNZ with an ex date falling prior to the allotment of shares under the SPP.

The key dates for the SPP are as follows: [5]

- Ex-date for SPP entitlements: Tuesday 25 February2014
- Record Date for SPP entitlements: Thursday 27 February 2014
- Opening Date of SPP: Friday 28 February 2014
- Closing Date of SPP: Tuesday 18 March 2014
- SPP pricing period: Thursday 13 March 2014 to Wednesday 19 March 2014
- SPP price announced: Thursday 20 March 2014
- Allotment Date under SPP: Tuesday 25 March 2014

Forecast
The purchase price for the acquisition is $87 million. Heartland expects the acquisition will be earnings per share and return on equity accretive. The acquisition is expected to generate $8-9 million of net profit after tax in its first full year following integration. However, FY2015 performance will be impacted to some extent by amortisation of acquisition costs and costs associated with integration into the Heartland group, expected to be around $2 million (post tax).

HNZ will shortly be releasing its results for the first half of FY2014. Net profit after tax is expected to be around $16.5 million and in line with the forecast full year outcome of $34-$37 million for FY2014.

HNZ's forecast for FY2015 is yet to be finalised and more detailed financials will be available sometime following settlement of the acquisition. However, HNZ's underlying net profit after tax for FY2015 (i.e. excluding the contribution from the acquisition) is expected to grow by approximately 5% from FY2014's result. Taking all relevant factors into consideration including acquisition and integration costs expected to be incurred in FY2015, the underlying business, together with the contribution from the acquisition, is likely to produce a full year result for FY2015 of between $42-44 million of net profit after tax.

Heartland believes that the timing is right for Home Equity Release products and is confident that it will offer strong and sustainable growth potential in the future.

- Ends -

[5] Subject to the NZX Main Board Listing Rules, HNZ reserves the right to alter the key dates. If HNZ elects to extend the Closing Date for the SPP, the period over which the issue price is determined will be the 5 day trading period up to and including the extended Closing Date.

For further information please contact:

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