HEARTLAND
New Zealand Limited

NZX Release

Heartland – Strategy Update

6 November 2015

Heartland New Zealand Limited (**Heartland**) (NZX: HNZ) advises its intention to amalgamate with its wholly-owned subsidiary, Heartland Bank Limited (**Heartland Bank**). Heartland also wishes to update the market in relation to the previously advised proposal for Heartland Bank to issue Tier 2 capital and for Heartland to subsequently return capital to shareholders.

Current Group Structure and Amalgamation Proposal

Heartland's current group structure is the product of the merger of three separate financial institutions in 2011, the corporatisation of what was then Heartland Building Society and a number of key business acquisitions (including most recently the Seniors Finance acquisition). This has resulted in an overly complex structure for a business of Heartland's size. For example, as a registered bank, Heartland Bank is required to have a separate board of directors, including additional independent directors, from its parent, Heartland. This results in duplication and complexity, which is only expected to increase as the group grows and choices need to be made as to where assets are held within the group.

The boards of Heartland and Heartland Bank have therefore reviewed the group structure with a view towards implementing a more efficient structure within which the group can best achieve its objectives and which provides transparency for its stakeholders. Accordingly, the boards of Heartland and Heartland Bank have determined to merge those companies by way of a short form amalgamation (**Amalgamation**). On Amalgamation, Heartland will continue as the amalgamated company (**Continuing Company**) but will change its name from "Heartland New Zealand Limited" to "Heartland Bank Limited". The Amalgamation will take effect on 31 December 2015 (**Effective Date**).

As a result of the Amalgamation, all of Heartland's businesses currently sitting outside of Heartland Bank will be brought into the banking group. The most significant of these businesses is the Australian reverse mortgage business, known as Heartland Seniors Finance. Other strategic investments, such as Heartland's shareholdings in Harmoney Corp Limited and Ora HQ Limited, as well as MARAC Insurance Limited, will also be brought into the banking group.

The Reserve Bank of New Zealand (**RBNZ**) is not required to consent to the Amalgamation, however we have notified them of it and are awaiting a formal response from them. Fitch has recently affirmed Heartland Bank's long term credit rating of BBB (outlook stable) and we do not believe that the Amalgamation will affect that rating.

No shareholder approvals are required to effect the Amalgamation. However, shareholders will be asked to vote on the appointment of directors to the new board of the Continuing Company (which will be comprised of existing directors of Heartland and Heartland Bank) and to amend the constitution of the Continuing Company to reflect the Amalgamation at the upcoming Annual Meeting. Further information on these resolutions will be provided in the Notice of Meeting to shareholders for the Annual Meeting.

Issue of Tier 2 Capital Instrument

Heartland advised the market on 18 August 2015 of its intention for Heartland Bank to issue a Tier 2 regulatory capital instrument (**Tier 2 Capital**) during the financial year as part of its capital management strategy, subject to market conditions remaining favourable.

Heartland's current intention is for the Continuing Company to proceed with the issue of Tier 2 Capital in April 2016. At this stage, the indicative issue amount is $50 million with up to $25 million of oversubscriptions. An issue of Tier 2 Capital would improve the Continuing Company's capital efficiency through diversification of the sources and types of capital funding, and would mean that the Continuing Company's capital structure is more closely aligned with that of other New Zealand registered banks.

No shareholder approvals would be required to effect the Tier 2 Capital issue, though further information will be provided in the Notice of Meeting to shareholders for the upcoming Annual Meeting.

Return of Capital

In the market announcement dated 18 August 2015, Heartland noted that a Tier 2 Capital issue could (in the absence of any other use) allow Heartland to return excess capital to shareholders by way of a share buyback.

Heartland confirms that, following the Amalgamation and the Tier 2 Capital issue, the Continuing Company will hold levels of regulatory capital in excess of that required by RBNZ and in excess of Heartland's own internal capital requirements (which provide for buffers above that required by RBNZ).

Whilst Heartland remains interested in acquiring Motor Trade Finances Limited, there is currently insufficient certainty as to whether an acquisition will proceed. In the absence of any other imminent value-creating investment opportunity, the board's current view is that the most appropriate use of the Continuing Company's excess capital is to return it to shareholders.

The exact amount of excess capital to be returned to shareholders would depend on the extent of oversubscriptions that may be received under the Tier 2 Capital issue and the business and economic factors present at the time the capital return was conducted. Accordingly, Heartland will seek shareholder approval at the upcoming Annual Meeting to return an amount of capital within a range of not less than $58 million (which equates to 10% of Heartland's average market capitalisation over the 20 trading days prior to this announcement) and not more than $100 million.

However, circumstances may arise whereby the return of capital may not proceed even if it is approved by shareholders. In summary, this would be if the Tier 2 Capital issue did not proceed (or did not complete successfully) or if the board identified an investment requirement or opportunity prior to the return of capital being undertaken (including an acquisition of Motor Trade Finances Limited), which leads the board to consider that a return of capital is no longer the most appropriate use of the Continuing Company's excess capital.

Method of Return of Capital

Heartland intends to conduct the return of capital by way of a Court-approved scheme of arrangement (**Arrangement**). Under the Arrangement, a proportion of each shareholder's shares would be cancelled and each shareholder would be given a cash payment in return for the cancellation of those shares. The board has determined that this would be the preferred method to return capital due to the certainty of timing and quantum of return which it would afford over other mechanisms. In addition, the Arrangement would be fair to all shareholders as it would ensure the capital is returned on a pro rata basis, leaving the relative voting and distribution rights of all shareholders unaffected, subject only to rounding.

Heartland will shortly file an application with the High Court of New Zealand seeking initial orders that, if granted, will allow the Arrangement to be voted on by shareholders at the Annual Meeting on 11 December 2015. Inland Revenue has confirmed that the Arrangement would not be a payment in lieu of a dividend.

Further information in relation to the Tier 2 Capital issue and the subsequent return of excess capital will be provided to shareholders in the Notice of Meeting.

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