

The Treasury

South Canterbury Finance Limited Information Release

Release Document

April 2011

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Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:


- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [2] 9(2)(b)(i) - to protect trade secrets
- [3] 9(2)(b)(ii) - to avoid unreasonable prejudice to the commercial position of the person who supplied the information or who is the subject of the information
- [4] 9(2)(ba) - to protect information that is subject to an obligation of confidence, or that was or could be provided under legal compulsion, where making the information available would be likely to prejudice the supply of similar information and it is in the public interest for that information to continue to be supplied
- [5] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [6] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [7] 9(2)(h) - to maintain legal professional privilege
- [8] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, an [8] appearing where information has been withheld in a release document refers to section 9(2)(i).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Date: 8 July 2009

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South Canterbury Finance Limited Ratings Review

Executive Summary

Standard and Poor's placed South Canterbury Finance Limited ("SCF") 'BBB-' credit rating on CreditWatch yesterday (old rating BBB-), which means that there is a 50% chance that a rating downgrade may occur in the next three months.

Korda Mentha is currently undertaking and inspection of SCF on behalf of Treasury.

No action is further proposed to be taken until reporting is received from Korda Mentha, apart from increased monitoring around SCF's liquidity position.

Standard and Poor's Announcement

Standard and Poor's placed South Canterbury Finance Limited ("SCF") 'BBB-' and 'A-3' credit ratings on CreditWatch on the 7th of July 2009.

Placing SCF on CreditWatch is in reaction to:

1. SCF's announcement of a NZ\$37.000m loss for fiscal 2009, which in turn was due to NZ\$58.000m in provisioning across SCF's property book;
2. SCF's decision to purchase the DHL shares¹ has increased its risk profile, weakened its liquidity and increased related-party exposures, which have moderated SCF's capitalisation; and
3. The ratings trigger on SCF's US\$100.000m USPP compounds the liquidity concerns as this provides a mechanism for funders to withdraw their support.

Although not outlined above, a Standard and Poor's rating down grade would also result in cross defaults under both the Trust Deed (in SCF's view) and the Group's standby funding lines, which could trigger the Crown Guarantee.

A CreditWatch negative listing implies a 50% chance of a rating downgrade over the next three months. The ratings may be lowered by one or more notches should SCF fail to address pressures concerning its liquidity, capital adequacy position (stemming from related-party exposures) and rising credit costs.

¹ This transaction is outlined as an attachment.

Guidance has been given by Standard and Poor's on issues SCF is required to address to maintain a BBB- rating. This guidance is outlined below:

1. SCF needs to be able to maintain a liquidity level that will support its ability to repay the U.S. private-placement issue and maintain its daily operations;
2. SCF needs to negotiate or eliminate the rating trigger from the U.S. private-placement facility;
3. SCF's underwriting agreement with its major shareholder needs to be executed;
4. SCF needs to considerably reduce or eliminate its related-party exposures;
5. SCF needs to considerably reduce its property development loan portfolio, and cleanse its property investment loan portfolio; and
6. Allan Hubbard, will need to remain steadfast in his ability and willingness to support SCF.

Some positive comments were made by Standard and Poor's in regard to SCF, these included:

1. SCF's sound business profile and geographic diversity, underpins the company's market position as one of the largest domestically owned finance companies in New Zealand;
2. The broad geographic coverage of SCF's operations underpins its very good local market presence, and overall competitive position in the finance company sector; and
3. SCF's track record of profitability, excluding fiscal 2009, also supports the rating. At year ended June 2009, SCF had total assets of approximately NZ\$2.300b, making it a significant player in the New Zealand finance company market.

Way Forward

The key issues that Standard and Poor's have highlighted in regard to SCF have been highlighted through Treasury's monitoring and management of SCF, which is why Korda Mentha is currently undertaking and inspection of SCF on behalf of Treasury ([3]) – prime banker - also has concerns, and has an inspection of SCF underway).

All of these issues outlined by Standard and Poor's are being investigated by Korda Mentha² in addition to the related party transaction. No action is proposed to be taken until reporting is received from Korda Mentha, apart from increased monitoring around SCF's liquidity position.

The Agreement for Inspection and Related Services was executed by Korda Mentha on the 2nd of July, and they had their initial meeting with SCF in Timaru on the 6th of July 2009.

We will receive updates from Korda Mentha on a weekly³ basis (and ad hoc as material information comes to hand) from now on. We expect an initial report from Korda Mentha in approximately two weeks, and a final report in four weeks.

The table over the page outlines the critical dates over the next three and a half months that we are aware of.

² An outline of the Korda Mentha scope is attached as an appendix.

³ The first update is attached as an appendix.

Date	Week	Issue
7 July 2009	0	Ratings review published, BBB- negative watch.
14 July 2009	1	
21 July 2009	2	Initial Korda Mentha report expected
28 July 2009	3	
4 August 2009	4	Final Korda Mentha report expected
11 August 2009	5	
18 August 2009	6	
25 August 2009	7	
1 September 2009	8	
8 September 2009	9	
15 September 2009	10	
22 September 2009	11	
29 September 2009	12	Standard and Poor's rating announcement expected. A downgrade would trigger an event of review under the USPP, Banking and (in SCF's view) the trust deed covenants, which may lead to a Guarantee breach.
6 October 2009	13	
13 October 2009	14	
20 October 2009	15	
27 October 2009	16	
3 November 2009	17	This would be the last week of the USPP "event of review period" which lasts for six weeks. Lenders would now be entitled to call for repayment of circa US100million owing to them unless agreed otherwise.

ATTACHMENT

Scope of Inspection

General Business Practices;

Prepare a company profile of SCF, its shareholders, key staff, directors and related parties.

Prepare a company profile of SCF's corporate metrics over the past three years in six-monthly intervals.

Review SCF in respect to it's:

1. Asset write strategy;
2. Funding strategy;
3. Trust Deed;
4. The effect of the proposed regulatory changes proposed by the RBNZ, both pre and post the Restructure;
5. The business model of SCF; and
6. The governance model of SCF.

Outline what steps are being taken to reorganise SCF to improve its liquidity and financial stability.

Credit Quality;

We would like you to undertake a due diligence style review of those material assets that (and sample the balance of the book):

1. Are impaired, past due, in arrears by more than 60 days or otherwise at risk;
2. Are related party lending; and
3. Do not "cash flow".

Review the arrears, past due and impaired assets and provisioning across the portfolios: and

Market Position;

Given the large loan book of SCF, and the level of new lending that SCF has historically undertaken is there any sector, or geography that will be significantly affected if SCF was to shrink their loan book and or stop lending.

Liquidity;

The general liquidity position of SCF should be reviewed, with investigation and analysis centred around:

1. SCF's current liability profile (maturity profile, amounts raised, interest rates etc);
2. SCF's current asset profile (maturity profile, concentration risk etc);
3. An outline of the depositor mix (number of depositors, quantum invested etc);
4. The level of parent support available; and
5. A full analysis of funding facilities held by SCF should be conducted.

Proposed Restructure of Southbury Group Limited and SCF (the "Restructure");

SCF have engaged the services of an independent expert in regard to a Restructure of Southbury Group Limited and SCF.

It is expected that the reporting on SCF will include a full analysis of the proposed Restructure in regard to its effect on SCF.

Reasonable steps should be undertaken to ensure the accuracy of any information gained from the independent expert.

Update from Korda Mentha

On Tuesday, 7 July 2009 we received an update from Grant Graham from Korda Mentha in regard to their visit to SCF on Monday the 6th of July 2009.

A key message was outlined in the Korda Mentha update as to the potential effect of a S+P downgrade, Korda Mentha's comment were:

1. Korda Mentha haven't yet been able to review any documentation relating to the issue, but SCF advised that an event of review under the terms of the US Private Placement will arise if the S+P rating falls below BBB-;
2. Korda Mentha understand that the event of review period lasts for six weeks and at the end of that period those lenders will be entitled to call for repayment of circa US100million owing to them unless they agree otherwise;
3. Korda Mentha also understands this will cause cross defaults under both the Trust Deed (in SCF's view) and the Group's standby funding lines. Korda Mentha are attempting to access relevant documentation as a matter of urgency: and
4. Korda Mentha understands that the S+P announcement was expected last night and must now be imminent.

Treasury will get a more formal update as to the information received by Korda Mentha, as they do seem to have covered off the key "trip up" events.

Related Party Transaction

On Wednesday, 24 June 2009 we received the draft Independent Expert Opinion prepared by Bevan Wallace of Morgan Wallace Limited for the Crown and the associated Report prepared for South Canterbury Finance pursuant to requirements under the Crown Deed of Guarantee in respect of a related party transaction, being the acquisition of shares in Dairy Holding Limited ("DHL").

Our understanding of the transaction is that on or about the 30th of June 2009 SCF is to undertake a related party transaction (the "Transaction") with its ultimate parent Southbury Group Limited ("SGL"). The brief details of the Transaction are outlined below;

1. SCF is to enter into a transaction to purchase SGL's interest in DHL, being 33.59% of the ordinary share capital in DHL (537,370 shares):
2. Under the Transaction, SCF is to pay \$75,732,967 for SGL's interest in DHL which is to be settled by \$40,000,000 of shares (being 40 million shares in SCF) and \$35,732,967 in cash:
3. As SCF and SGL are related parties, and the Transaction is greater than 1% of SCF assets, under clause 6.2 (b) of the Deed Treasury is to approve an independent expert who is to prepare a report confirming the Transaction is on an arms' length basis before the Transaction can proceed: and
4. Treasury is not required to consent to the transaction.

On Monday, 29 June 2009, Treasury received the final Independent Expert Opinion prepared by Bevan Wallace of Morgan Wallace Limited for the Crown and the associated Report prepared for South Canterbury Finance pursuant to requirements under the Crown Deed of Guarantee in respect of a related party transaction, being the acquisition of shares in DHL. We provided SCF with an acknowledgment letter of the Expert Opinion and associated report.