The Treasury

South Canterbury Finance Limited Information Release

Release Document

April 2011

www.treasury.govt.nz/publications/informationreleases/scf

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.

South Canterbury Finance (SCF)

Purpose

The purpose of this note is to ensure we are all on the same page in regard to the current and potential future issues facing SCF.

Liquidity

SCF is under significant liquidity pressure:

- Cash reserve have fallen from $148m as at 30 June 2009 to @$80m as at 13 August 2009
- Liquidity pressures have been exacerbated by the Trustees decision (at the instigation of the Company's Office) to withhold all new / rollover deposits in a separate trust account
- SCF is also realising the liquid investment assets (as distinct from cash) they hold.
- As at 30 June 2009, SCF held $112m of listed shares and bonds and we are advised they have subsequently sold @$25m to support their liquidity position.

By close of business today (18 August), Korda Mentha will receive an updated and reconciled set of liquidity projections for the Company.

The expectation remains that SCF will face an initial liquidity issue over September / October:

- The timeframe will shorten in the event that new / rollover deposits continue to held by the Trustee
- A decision by the US Private Placement note holders to call for repayment would crystallize the liquidity issue at the time repayment was due

The possible sale of Helicopters New Zealand (HNZ) by Southbury would offer some relief, resulting in up to $100 million in additional liquidity. We are advised that Southbury has received an offer for HNZ but the status of the offer and timeframe for completion are uncertain. Three to six months would be a positive but realistic time line for completion.

The view is that the HNZ sale would merely delay the inevitable at this stage without a substantive wider solution.

Provisioning

Korda Mentha have reached a view on the level of provisioning (on a going concern basis) required by SCF as at 30 June 2009.

The effect on SCF would be to effectively wipe out the current equity of $234m if:

- The existing tax asset of $48m were eliminated on the basis that the company is unlikely to be in a position to use that asset
- Impairments on equity / other investment assets e.g. Dairy Holdings shares were also recognised

We expect SCF to increase provisioning above the level originally they originally suggested, but to remain below the levels proposed by KM. In particular, SCF may seek to limit provisioning to a level consistent with maintaining at least $170m in equity in order to avoid potential covenant breaches.

Actual equity may be able to fall as low as $120m for Trust Deed purposes in the event the Trustee determines that the likelihood of a $50m injection from external sources is sufficiently certain.

The above is dependent on SCF's auditors agreeing to the level and adequacy of provisioning proposed by SCF, and their view being peer reviewed.

Capital Requirements

Capital requirements for SCF will depend on a number of factors:

- Actual minimums agreed with the Trustee under the new NBDT prudential regime, subject to the minimum requirement of 8% relating to rated issuers under the regulations
- The timeframe for transition to compliance with the new regime
- The level of provisioning as at 30 June 2009 together with any additional provisioning that may be required post 30 June 2009
- Changes to the composition of SCF balance sheet

As a result of historical transactions between SCF and Southbury (designed to protect SCF from the effects of impairment charges), a number of problem loans have effectively been "swapped" for investment assets.

The effective of those transactions has been to significantly increase the capital requirements going forward:

- SCF holds $325m of equity and other investment assets that equate to @14% of total assets
- On a risk weighted basis (which in turn drives capital requirements), those same assets account for 28% of SCF's total risk weighted assets
- In terms of capital requirements, those same assets require $146m of capital at a 10% capital adequacy ratio (@$117m at 8% capital adequacy), equivalent to at least 50% of SCF's current equity

In a similar, although less dramatic vein, the nature of SCF's lending business means that is also relatively capital hungry:

- The majority (>65%) of SCFR lending is risk weighted at 200% or higher
- Those same 65% of loans by value account for 74% of the total capital directly required to support SCF's lending business

Recapitalisation

An essential ingredient in any recapitalisation of SCF will be a significant restructure of the balance sheet.

Initial analysis suggests that based on 30 June 2009 data and assuming provisioning / impairment charges wipes out the current equity in the business:

- At a 10% capital adequacy requirement, SCF would need in the order of $580m in new capital / $460m at 8%

- Selling the $325m non-core investment assets noted above would reduce the requirement by around 25% to $430m at10% capital adequacy / $345m at 8% capital adequacy
- Sale of those assets would also significantly improve SCF's short / medium term liquidity and funding profile

As noted below, Southbury may be able to contribute directly to downsizing the SCF balance to the extent that it proceeds to successfully realise sales of either or both of its two major investments (Helicopters NZ and Scales Corporation) and in turn use those funds to purchase some of SCF's non core investment assets.

Potential Company Perspective

The above is a context for considering the Company's view of the world:

- They have a possible $150m in new equity, albeit staged over 2009 / 2010
- A possible / probable sale of Helicopters before the end of December which could generate:
    - @$100m in cash flow
- Depending on further asset sales eg Scales, the above process could be repeated

Assuming SCF manages to:

- get through 30 June 2009 with $170m of equity
- sell Helicopters and Scales for $90m each
- access $150m of new equity

it would then have:

- @$340m in equity
- Reduced its risk weighted balance sheet by ~$960m
- Added $330 million in liquidity (assuming deposit levels remain unchanged) or $205m in liquidity after repaying the USPP

Continued sales of its holdings of list bonds and shares would further supplement liquidity / reduce funding requirements as well as contributing to shrinking its risk weighted balance sheet.

Under the above "optimistic" scenario, SCF could well consider they are on track for compliance with the capital requirements NBDT regime (at 8% minimum capital adequacy they would only be $45m short).

Appendix 1

SCF Risk Weighted Balance Sheet

SCF		Assets		Risk Weighted Assets	Risk Weight		Capital Requirements by line @10% Capital Adequacy (Tier 1)	% of Total Capital Requirement
Assets								
Loans								
Agriculture	$	346.65		693.3	200%	$	69.33	12%
Property Investment	$	85.44		106.8	125%	$	10.68	2%
Property Development	$	305.40		458.1	150%	$	45.81	8%
	$	42.53		127.6	300%	$	12.76	2%
Commercial	$	127.08		152.5	120%	$	15.25	3%
	$	464.75		929.5	200%	$	92.95	16%
Consumer	$	78.00		78	100%	$	7.80	1%
Other	$	263.35		526.7	200%	$	52.67	9%
Sub-total	$	1,713.21	$	3,072.50		$	307.25	53%
Liquidity								
Liquid Assets		158.5		31.7	20%	$	3.17	1%
Other Assets								
Trade Receivables	$	14.54	$	50.90	350%	$	5.09	1%
Operating Leases	$	8.06	$	14.10	175%	$	1.41	0%
Fixed Assets	$	139.71	$	489.00	350%	$	48.90	8%
All Other Assets	$	194.60	$	681.10	350%	$	68.11	12%
Equity Investments	$	129.95	$	779.70	600%	$	77.97	14%
Sub-total	$	486.86	$	2,014.80		$	201.48	35%
Operational Risk			$	656.49		$	65.65	11%
Total Assets / Risk Weighted Assets	$	2,358.57	$	5,775.49		$	577.55	
Capital Requirement								
8%			$	462.04				
10%			$	577.55				

SCF Assets with RBNZ NBDT risk weight >200%

SCF

		Assets		Risk Weighted Assets	Risk Weight	% of Total Loans	% of Risk Weighted Loans
Assets							
Loans							
Agriculture	$	346.65	$	693.30	200%	20%	23%
Commercial	$	464.75	$	929.50	200%	27%	30%
Other	$	263.35	$	526.70	200%	15%	17%
Sub-total	$	1,074.75	$	2,149.50	200%	63%	70%
						% of Total Assets	% of Risk Weighted Assets
Other Assets							
Fixed Assets	$	139.71	$	489.00	350%	6%	10%
All Other Assets	$	194.60	$	681.10	350%	8%	13%
Equity Investments	$	129.95	$	779.70	600%	6%	15%
Sub-total	$	464.26	$	1,949.80	420%	20%	38%
Total	$	1,539.01	$	4,099.30	266%		
Total Loans	$	1,713.21	$	3,072.50	179%		
Total Assets / Risk Weighted Assets (excl Operational Risk)	$	2,358.57	$	5,119.00	217%		
Total (Selected Assets) as % of Total / Risk Weighted Assets		65%		80%			