The Treasury

South Canterbury Finance Limited Information Release

Release Document

April 2011

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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[6] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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

From: [1] @kordamentha.com]
Sent: Friday, 21 August 2009 12:39 p.m.
To: John Park; Craig Murphy
Cc: [1]
Subject: Apple
Attachments: 090820 realis.pdf; realisations.pdf; realisations with assumptions.pdf

John / Craig

Please refer to the attached and let us know if you have any queries.

regards

[1]

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Memo

KordaMentha

PRO51019

To:	**John Park & Craig Murphy, The Treasury**
From:	[1]
Date:	20 August 2009
Subject:	**South Canterbury Finance Ltd ("SCF")** **High-Level Potential Realisation Scenarios and Strategies**

1. Introduction

We understand that Treasury is considering alternative strategies for the Government's potential involvement with SCF.

You have asked for our very high-level comments on potential realisations if it ultimately transpires that SCF has to be wound-down, either through:

- an enforcement regime (e.g. Statutory Management or Receivership); or
- a managed wind-down process under the Government's ownership or control.

This memo does not consider the appropriateness of either option but we believe them both to be viable. Rather, as requested, this memo provides high-level comments on the realisations that might result.

This memo is provided subject to the terms and conditions of our engagement and the restrictions that are attached at Appendix A.

2. Asset Realisation Strategy

The strategy under either scenario would be based on the same fundamental principles, built around early categorisation of the company's assets:

1. Immediately saleable assets;
2. Assets that could be sold through a medium to longer-term strategy;
3. Assets that are unlikely to be saleable, which will require the establishment of appropriate systems and processes (at both a management and governance level) to manage the assets over the longer-term.

Based on the information that is currently available, we believe that the assets would broadly be separated as follows:

Category 1 Immediately Saleable (i.e. 6 months to 1 year)	Category 2 Saleable Medium to Longer Term (i.e. 1 to 2 years)	Category 3 Unlikely to be Sold / Hold (i.e. 2 years +)
Plant & Equipment book	Dairy Holdings equity	Impaired loans (esp. Property)
Consumer book	SI Farms equity	Large tranche of business loans
Listed Investments	Better portion of remaining loans	Rural loans
Helicopters (NZ)	Property assets	
	Scales Corporation	

- Category 1 assets should (at face value) be saleable but we suspect only a major institution could raise the funds required to purchase the Plant & Equipment book.

The second two categories are likely to be significantly affected by market conditions:

- Timing is likely to be critical, for the sale of the farm assets in particular. It is possible that a rushed sale of the farming assets could cause the companies' lenders to react to protect their position, which might erode equity value.
- We assume that it would be possible to implement a risk grading system so the better loans within the Business and Property goods can be identified. That portion (which we assume to be 40%) is included in Category 2 and the balance (which we assume to be the illiquid portion of the book) in Category 3. 40% is a very high level estimate as SCF's systems do not enable us to identify what can be included in this tranche.
- It is not possible to determine whether the Category 3 assets will best be realised over the longer-term, or if economic conditions and credit availability change such that:
  - Further impairment arises; or
  - Other financiers change their attitude toward the type of borrower within this category, creating refinancing opportunities that do not currently exits; or
  - The borrowers are able to repay through trading profits.

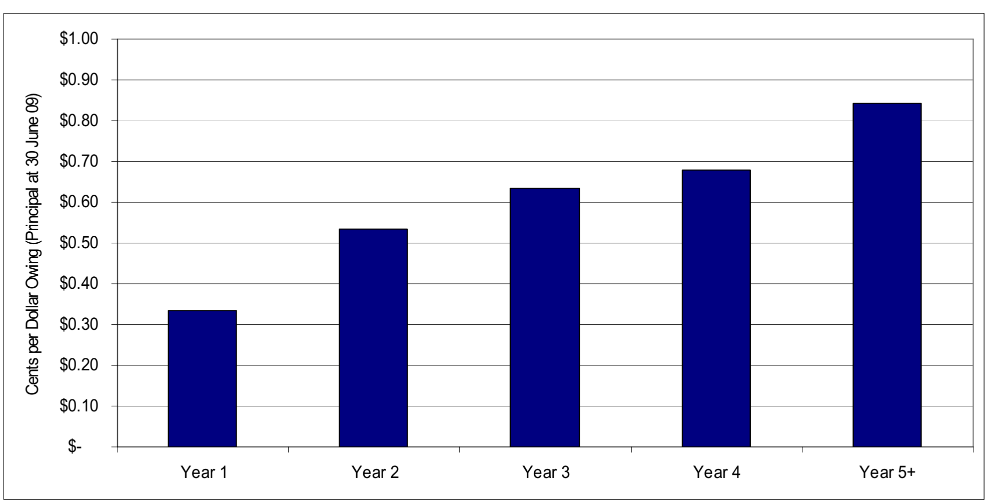
3. Potential Realisation Scenarios

To provide an estimate of potential realisations it has been necessary to adopt very high-level assumptions around:

- Realisation timeframes for each category of asset. It is extremely difficult to undertake this projection for the Category 3 assets.
- Realisation values for each category of asset, which we have generally calculated as a discount against the book value of each asset.

3.1 Favourable (Improved) Market Conditions

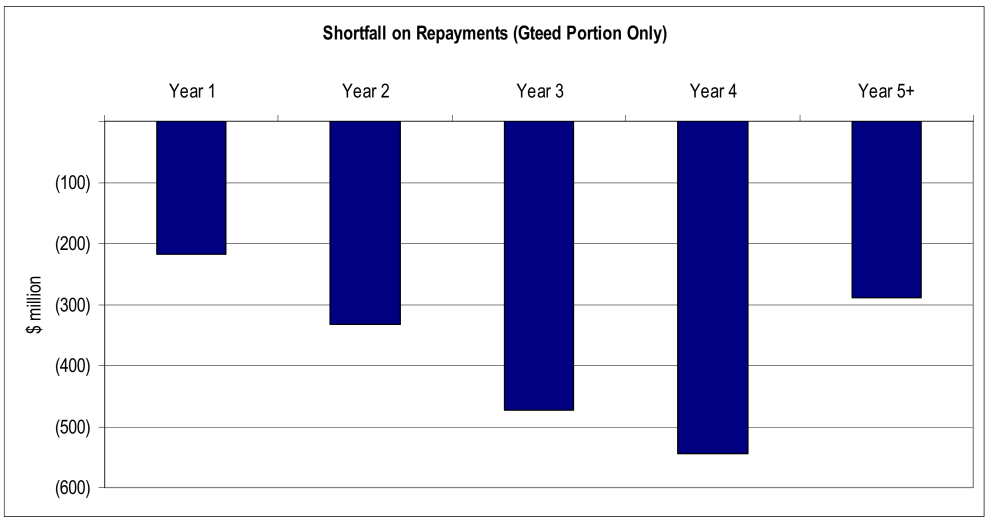
The assumptions we adopted forecast total realisations under improved market conditions of around 84% at the face value of principal outstanding on 30 June 2009 (i.e. excluding allowances for "the time value of money" and future interest that may accrue on debt):



This should be considered a high-end scenario, assuming that SCF were provided with the time required to:

- Work with the lenders to realise value from the equity held in the farming assets;
- Establish processes to identify the better performing tranches of the loans book and obtain a reasonable set of data on loan performance that a purchaser would recognise;
- Work-out the impaired, at risk and illiquid loans. This is a critical assumption, as it represents approximately 40% of total realisations.

The cumulative mismatch between the guaranteed liabilities and projected recoveries peaks under this scenario at approx. $550 million in year four:



We have not allowed for realisation costs (refer comments below).

3.2 *Short-term realisation*

- A short-term realisation strategy would most likely see assets being sold in unfavourable market conditions.
- The key issues will therefore be:
  - Whether buyers exist for the assets;
  - The availability of funding for purchasers; and
  - The impact that sales may consequently have on realisation values.
- It is very difficult to estimate what realisations might be available in such conditions but we can make high-level assessments of potential discounts against our above estimates:
  - **Category 1**:
    - Likely to remain saleable.
    - Shorter realisation timeframes may lead to discounts, perhaps in the order of 10% to 15%.

- **Category 2**:
  - Sales would have to shift from a two to three year horizon into a six to 12 month window.
  - Value may be lost in the farming assets, as those entities' lenders could seek to maintain their position by taking a sale process out of SCF's hands.
    - The lenders would likely be concerned not only with the impact that a short sale process might have on these assets but also with the impact that a wholesale sale of a large number of farms might have on the market.
  - The *Better Loan Tranches* may also trade at a discount, perhaps up to 30% to 40% as there may be insufficient time to establish a seasoned loan set with reasonable metrics.
  - We suspect that it would be very difficult to compress a sales process for Scales Corp, given the complications with its capital structure.
- **Category 3**:
  - These assets would be significantly affected by a shortening of the sales process.
  - It may be extremely difficult to find any buyers for the assets, due to their metrics.
  - If a buyer could be find, we suspect that the discount would be very steep. We would expect that realisations might range between 10% and 20% of book value, at best.
  - It seems highly possible that large portion of these assets might not be sold at all.
- Under this scenario, there would be no future interest accrual that under other circumstances may potentially enhance recoveries.

4. Operating Strategy

- The Company would have to be restructured to focus on recovery / realisation rather than origination. Senior management positions are likely to be disestablished or reorganised.
- It is best to retain as many of the existing staff as possible, so there institutional knowledge remains available. In an enforcement scenario, we would not expect the Receiver / Statutory Manager to replace existing administrative staff with his own resources.
- Governance arrangements would have to change under either scenario:
  - Enforcement: the Receiver / Statutory Manager would provide strategic direction and oversight.
  - Managed Wind-down: new directors (who would likely require an indemnity from the Government) would provide strategic direction and oversight.
- We would not expect the cost differential between a managed wind-down and an enforcement scenario to be significant in comparison to the company's liabilities and potential recoveries.

It is apparent that the characteristics of a large portion of SCF's assets are such that they do not lend themselves to short-term realisation. Accordingly, any strategy relying on a short-term liquidation of the Company's asset base will likely lead to transactions occurring at significant discounts to the assets' book values. Consequently, the resulting return will be materially different to the optimal outcome that is discussed at section 3.1 above. It is however very difficult to quantify what the return will be under these conditions.

We trust that this memo provides a helpful overview of potential scenarios but please do not hesitate to contact us if you have any queries.

Appendix A

- This summary, which has been prepared for the Treasury, has been undertaken pursuant to the scope of work that is contained in the Agreement for Inspection & Related Services entered into between KordaMentha and the Crown.
- This memo is not intended for general circulation, nor is it to be reproduced or used for any purpose other than that outlined above without our written permission in each specific instance. We do not assume any responsibility or liability for any losses occasioned to any party as a result of the circulation, publication, reproduction or use of this report contrary to the provisions of this paragraph.
- In preparing this report we have relied on information provided to us by the Company. We have not carried out any form of due diligence or audit on that information. The information provided to us included forecasts of future revenues and expenditures, profits and cash flow that were prepared by the Company. We have also necessarily relied on very high-level assumptions to generate projections. Forecasts and projections by their very nature are uncertain, and some assumptions inevitably will not materialise. Therefore the actual results achieved may vary significantly from those in the forecasts.
- We reserve the right (but will be under no obligation) to review this memo and if we consider it necessary to revise the memo in light of any information existing at the date of this memo which becomes known to us after that date.

$ million based on 30 June 2009	Net BV	Year 1	Year 2	Year 3	Year 4	Year 5+	Total
Cash (assume 20 Aug bal)	[3]						
Category 1 - Immediately Saleable							
Plant & Equipment (Face Finance)							
Consumer							
Other Assets							
Helicopters NZ Realisation (inc. leases)							
Category 1 - Immediately Saleable							
Category 2 - Saleable Med to Longer-Te							
Dairy Holdings							
SI Farms							
Other Assets							
Better Loan Tranches (assume 40%)							
Scales Corp (SCF & Southbury)							
Category 2 - Saleable Med to L-T							
Category 3 - Hold							
Impaired							
At Risk							
Property Loans (6 yrs, tail remains)							
Business Loans (10 yrs, tail remains)							
Rural Loans (10 yrs, tail remains)							
Other Assets							
Category 3 - Hold							
Gross Cashflow	2,066	684	411	207	93	334	1,729
Potential Interest Accrual		*34*	*29*	*25*	*21*	*17*	*126*
1st Ranking Liabilities							
Deposits		(526)	(316)	(159)	(71)	(257)	(1,329)
Bonds		(117)	(70)	(35)	(16)	(57)	(295)
USPP		(42)	(25)	(13)	(6)	(20)	(105)
Total		(684)	(411)	(207)	(93)	(334)	(1,729)
Government Position							
Guaranteed		(614)	(369)	(186)	(83)	(300)	(1,552)
Not Guaranteed		(70)	(42)	(21)	(10)	(34)	(177)
Total		(684)	(411)	(207)	(93)	(334)	(1,729)
Guaranteed		$ 0.33	$ 0.20	$ 0.10	$ 0.05	$ 0.16	$ 0.84
Guaranteed cumulative		$ 0.33	$ 0.53	$ 0.63	$ 0.68	$ 0.84	
Lag on Scheduled Repayments							
Scheduled Repayment Due		867	518	347	258	62	2,051
Surplus / (Shortfall) cumulative		(183)	(289)	(429)	(594)	(322)	(322)
Lag on Gteed Portion (estimated)							
Scheduled Repayment Due (estimated)		832	485	326	154	45	1,841
Surplus / (Shortfall) cumulative		(218)	(333)	(473)	(544)	(289)	

Balance of document withheld: [3]