The Treasury

South Canterbury Finance Limited Information Release

Release Document

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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.

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South Canterbury Finance Limited

Response to KordaMentha Report

September 2009

South Canterbury Finance

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1. Executive Summary

There are a range of material statements and conclusions contained in the KordaMentha report that give a misleading and overly pessimistic impression as to South Canterbury Finance's current financial position.

- This response details South Canterbury Finance's ("SCF" or the "Company") initial response to KordaMentha's ("KM") report dated 4 September 2009.
- KM was appointed to undertake an analysis of SCF pursuant to agreed terms of reference with the Treasury: cf. terms of engagement.
  - it is important to note that KM was instructed to review particular loans on a "forced seller" basis;
  - accordingly, in following these instructions, KM has adopted very conservative valuations for these assets;
  - assessing these loans on a going concern basis would result in considerable upside; and
  - a "forced sale" approach is inconsistent with that of NZ GAAP and the auditors, and we would expect audited provisions to be less than those described by KM. E&Y peer review.
- The KM report highlights liquidity as an immediate concern and misinterprets the low recent reinvestment rates as a signal that SCF has lost the confidence of the capital markets:
  - this view contrasts strongly with that of our advisor Forsyth Barr who consider that any apparent liquidity issues can be addressed and remedied once SCF's amended prospectus is registered:
    - Forsyth Barr has raised in excess of $350 million for SCF over the past 3 years and has lead managed 7 of the 14 listed debt issues in 2009 YTD;
  - SCF's low recent reinvestment rates primarily reflect two considerations:
    - the Company does not currently have a valid Prospectus/Investment Statement, effectively precluding the Company from raising debenture capital; and ✓
    - SCF's debenture rates are currently 1.50 - 1.75% below market rates for similar Crown Guaranteed investments.
  - in Forsyth Barr's view, liquidity issues can be readily addressed by SCF raising its offered rates to market (or slightly above market) levels:
    - [3]

1. Executive Summary (cont'd)

  - with the benefit of the existing Crown Guarantee, Forsyth Barr is confident that SCF will be able to successfully access the debenture and debt capital markets within the guarantee period.
- KM also notes that SCF would not be compliant with RBNZ's draft NBDT policies (in its current draft form):
  - the reality is that it is unlikely that any finance company who seeks funds from the public currently satisfies the RBNZ draft NBDT capital adequacy requirements (which we note, are still under review); and

    Same as many other entities?
  - as a consequence, if the RBNZ draft NBDT rules were implemented in their current form, there would not be a NBDT sector in New Zealand; however
  - the strategy currently being implemented by SCF and its advisors (refer Section 10) will enable SCF to emerge as a downsized, more focussed business which will potentially comply with the NBDT regime by 30 June 2011 (if that regime was enacted in its current form).
- With an adverse view on liquidity and capital adequacy, this has influenced KM's views on the level of appropriate provisioning:
  - consistent with its instructions, KM's analysis reflects the view that SCF's liquidity issues will not allow it to manage its loan book appropriately and rollover its advances and will be required to "forced sale" the underlying assets/security.
- Other factors which contribute to KM's view that a higher level of provisioning is required include:
  - the relatively short timeframe in which KM has had to make its desktop assessment, and KM's preference to rely upon its own subjective and unsubstantiated valuations rather than independent recognised valuations:
    - in our view, this methodology reflects KM's orientation as receivers/liquidators, rather than finance company specialists;
    - KM spent only limited time with senior SCF executives in its evaluation process; and
    - there also appears to have been a lack of information on KM's behalf;
  - KM acknowledges the uncertainty surrounding the provisioning, and reduced many of its preliminary estimates.
- To substantiate and validate our view, we review a selection of those loans which KM assert require a significant level of additional provisioning and we provide robust information which supports SCF's views on specific provisioning:
  - we also note a degree of ambiguity and vagueness in relation to KM's collective provisioning; and
  - this information supports SCF's view that the increased provisioning suggested by KM is overly excessive.

1. Executive Summary (cont'd)

- KM's references to the loan portfolio and loan management systems and process are inaccurate in a number of respects:
  - its report materially overstates SCF's exposure to specific sectors and specific geographical locations; and
  - many of KM's statements are simply incorrect.
- KM make reference to the appointment of Forsyth Barr and Harmos Horton Lusk as advisors to Southbury/SCF and the fact that they are not clear what strategy Southbury's advisors will pursue (notwithstanding an explanation by Allan Hubbard, Chairman of SCF and director and major shareholder of Southbury):
  - we confirm that Southbury does have a clear strategy and this has been previously enunciated to both the Treasury and the Trustee;
  - we briefly outline this strategy in section 11 of this document and would be pleased to discuss this in more detail; and
  - Southbury's advisors were not contacted prior to KM finalising its report so there was no opportunity for clarification and confirming how this strategy appropriately addresses the key issues identified in its report.
- We do not believe KM has focused on SCF as a going concern and has largely ignored the sustainability of SCF's ongoing business:
  - notwithstanding current market conditions, a reduction in the size of SCF's loan book, and the need to hold excess liquidity, the Company is currently forecasting a NPBT for the year to 30 June 2010 of $21.4 million;
  - putting aside the potential cost of the new Crown Guarantee, profitability is anticipated to increase further in 2011 with SCF forecasting NPBT of $33.8 million.
- The owners of SCF, principally AJ and MJ Hubbard, have via Southbury Group Limited and in a personal capacity, provided a significant amount of support to SCF over the last 12 - 18 months:
  - have acquired problem assets, injected quality assets into SCF, and provided other "make-whole" agreements to the Company;
  - remain committed to the continued success and recapitalisation of SCF.
- For all of the reasons outlined above, it is critical that the KM report is recognised as an opinion on the position of SCF in the event of failure (in accordance with instructions) as opposed to the status of the Company as a going concern.

2. SCF's Liquidity

With the existing Crown Guarantee, South Canterbury Finance has the ability to readily access the retail market for additional liquidity within the guarantee period.

- The KM report highlights liquidity as an immediate concern:
  - the report states the low recent reinvestment rates *"supports the assumption that there are other factors driving investors decisions, as opposed to their decision being solely focused on the protection that the Crown Guarantee provides"*;
  - KM do not provide any analysis to support its contention that SCF's reinvestment rates are low relative to the reinvestment rates of other companies in the finance sector.
- In Forsyth Barr's experience, the relatively low reinvestment rates merely reflect the low interest rates offered by SCF, relative to its competitors, combined with (more recently) the lack of a registered prospectus:
  - note that SCF's 1 year rate of 5.50% is currently 1.50% below the 7.00% rate currently being offered by MARAC (the only other BB+ Negative Outlook issuer in the sector);
  - SCF's 1 year rate at 5.50% is also materially below the approximate 7.00% yield on its equivalent 1 year listed security (SCF030); and
  - as all investments covered by the Crown Guarantee are effectively "perfect substitutes", it is understandable that investor monies tend to gravitate towards the higher offered rate.
- Forsyth Barr believe that SCF can readily address any liquidity issues by offering a more appropriate interest rate for a term covered by the Crown Guarantee once its prospectus is registered:
  - Forsyth Barr is well qualified to provide this guidance, having raised $225 million for SCF and PGW Finance across two Crown Guaranteed offers in late 2008/early 2009.
- The Company is currently in negotiations with USPP investors subsequent to the Company's rating downgrade on 13 August 2009:
  - under the terms of the USPP investors are able to seek repayment on or around 30 November;
  - current discussions are based on amortising the repayment of the USPP over a 3 ½ year period;
  - whether or not the USPP is restructured, the debenture/retail bond programme remains a viable refinancing mechanism.

2. SCF's Liquidity (cont'd)

- The key issue facing SCF in relation to liquidity is the fact that its does not presently have a valid prospectus to raise debenture capital from the public:
  - this is the biggest issue facing the Company at the moment and, if it is not addressed soon, it has the potential to significantly undermine the sustainability of the business; and
  - it will also be extremely difficult for the Company to raise additional equity capital and for Southbury to implement its proposed equity raising plan.
- The Company's inability to access the public markets for additional debenture capital will also impact the Company's ability to successfully renegotiate with its US PP investors.

3. Provisioning

Korda Mentha are specialists in receiverships and, in operating within its terms of reference, have adopted what the Company considers as an overly aggressive position on provisioning.

- KM was instructed to undertake a desktop valuation based on a "forced seller" basis for the material impaired, related party and non-cash flow assets:
  - accordingly, KM has adopted very conservative valuations for these loans, and there would be considerable upside if these assets are progressively realised in an orderly manner (consistent with SCF being a going concern).
- In addition, the higher potential provisions presented by KM in its report should be viewed with caution given the high degree of uncertainty, which KM itself acknowledge, by the language used by KM in its report:
  - *"aggregate provisioning is extremely sensitive to the collective provision";*
  - "*under different scenarios impairment provisions could have totalled...*"; and
  - KM's collective estimates are effectively caveated by the inclusion of the word "*(say)*".
- KM suggests that under a scenario (i.e. not necessarily the most likely scenario) impairment provisions could (i.e. not would) have been $75 - 110 million higher, as shown below:

($m)	SCF	KM Low	KM High
Specific	80	139	139
Collective - at risk (say)	19	10	40
Collective - unimpaired (say)		25	30
Total	**99**	**174**	**209**

3. Provisioning (cont'd)

- We present in the following pages clear and objective evidence that a significant proportion of KM's proposed increase in specific and collective provisions have little merit, are overstated or are inaccurate.
- SCF also stresses that KM's conclusions should be considered in the context of its specific instructions to undertake desktop valuations of particular assets on a "forced seller" basis:
  - KM is familiar with administering receiverships and liquidations under "forced sale" circumstances;
  - KM has had less than two months to form its desktop view, whilst SCF's proposed provisioning reflects years of experience in the industry and with the particular borrowers, and is supported by independent valuations.
- As a desktop exercise, KM's provisions are not based on a detailed understanding of the asset in question (i.e. pursuant to a site visit or security inspection) or the client's ability to repay and the borrower's previous history.

4. Specific Provisioning

The analysis and evidence below demonstrates that KM's proposed specific provisioning is overly aggressive.

- We have reviewed KM's schedule of specific provisions as per schedule H of its report:
  - our primary focus has been on the 12 loans below which feature some of the largest discrepancies.
- These loans are outlined below, along with SCF's & KM's provision and the amount in dispute:

Borrower	Loan Value	SCF Provision	KM Provision	Amount in Dispute
[3]		$2.03m	$11.99m	$9.96m
		-	$5.00m	$5.00m
		-	$3.50m	$3.50m
		$2.50m	$5.00m	$2.50m
		-	$2.00m	$2.00m
		$1.00m	$2.00m	$1.00m
		-	$0.75m	$0.75m
		-	$1.20m	$1.20m
		-	$0.50m	$0.50m
		-	$0.54m	$0.54m
		$1.00m	$2.20m	$1.20m
		-	$5.50m	$5.50m
		$6.53m	**$40.18m**	**$33.65m**

- As shown, the potential differences in the 12 loans selected above total approximately $34 million, or 70% of the total difference between SCF's and KM's specific provisions (excluding Australia and Southbury, and adjusted for revised SCF provisions as above):
  - a detailed description of each loan is included as Appendix 1.

4. Specific Provisioning (cont'd)

- The nature of the differences can be summarised as follows:
  - in accordance with its terms of reference, many of KM's valuations are at "forced sale" values:
    - SCF is confident that a gradual sell down over the next 18 months to 2 years will result in loans being realised at SCF values;
  - in many cases (Bream Tail, Glen Echo, Henderson) KM have ignored robust independent valuations from registered recognised valuers (often due to its terms of reference);
  - we also note that recent developments with some loans [3] have meant that previous provisioning is no longer appropriate;
  - in other cases, KM acknowledges that its provision may be reduced/released in the very near term following updated information:
    - in most of these cases, KM has already reduced its preliminary estimates;
    - SCF believes that this demonstrates the uncertainty and subjectivity of KM's estimates.
- In addition to the 12 loans above, we also briefly review a further seven loans below which KM consider require an additional $10.4 million of provisions:
  - for the reasons outlined below SCF is confident that the $3.3 million provision is adequate.

Borrower	Loan Value	SCF	KM	Diff.	Reason
[3]		$0.4m	$1.3m	$0.9m	Total security value $2m. Valuation of farm $3-3.2m. Rabo 1st at $1.8m (Rabo 3rd mortgage (behind SCF)). In addition first mort on forestry and lifestyle block valued at $0.87m plus collateral assets (now sold) of $130k.
		$1.5m	$2.5m	$1.0m	Accountant - driven by need to avoid bankruptcy. Arrangements made on sell down.
		-	$0.4m	$0.4m	S&P agreement executed with Sea Sheppard.
		$0.5m	$1.3m	$0.8m	Sales progressing better than expected.
		$0.5m	$1.0m	$0.5m	Blenheim property sold and now restructured.
		$0.4m	$3.4m	$3.1m	Workout currently selling underway. Additional second mortgage and first charge taken.
		-	$0.5m	$0.5m	Asset sales progressing well in Levin district.
		$3.3m	$10.4m	$7.1m	

5. Specific Southbury Provisions

The KM report proposes to effectively write-down the value of SCF's loans to Southbury shareholders to zero.

- KM has proposed a provision of $20 million against a total of five loans to Southbury shareholders:
  - this represents a write-down of approximately 97% of the loans to[3] (who collectively hold approximately 13% of Southbury); and
  - a write-down of this magnitude effectively implies that Southbury's ordinary shares are worthless.
- Based on Southbury's provisional consolidated balance sheet as at 30 June 2009, Southbury has a net asset value of approximately $150 million or $15 per share:
  - given the shareholder loans are secured over the shares, the value of the shares, based on the provisional book value of Southbury (and its subsidiaries) as at 30 June 2009 approximates the $ value of the Southbury loans; and
  - it is therefore difficult to reconcile how these loans can be deemed to be impaired based on Southbury's current financial position.
- Some of this lending contains guarantees from borrower:
  - recapitalisation proposed is likely to provide liquidity in these shareholdings.
- We also note that KM's assessment also contains an element of circularity:
  - as the level of provisioning in SCF against these loans increases, the value of the security of the Southbury loans also reduces and hence there is a need for additional provisioning.

6. Collective Provisions

KM's recommendations on collective provisioning lack substantiation and are well above comparable loan books.

- The KM report recommends a significantly increased collective provision:
  - the basis of this calculation appears vague and arbitrary, with KM itself acknowledging that *"it is difficult to assess what the collective provision on the portion of the book that we consider to be at risk"*.
  - in addition, we note that KM caveats its estimates by adding the term "*(say)*".
- KM adopts a "mid-point" estimate of $43 million, based on a low estimate of 3% and a high point of 40%:
  - little or no evidence is provided to support this basis of calculation.
- In particular, we question the appropriateness of using a specific provisioning ratio of 40% as the high point for a collective provisioning purpose:
  - specific provisions relate to particular loans where impairment has been identified, inherently different from a collective approach;
    - SCF's loss history across its portfolio has historically been very low;
  - the 40% reference point in turn reflects KM's view on specific provisions:
    - using the Company's provisions, this benchmark would be significantly lower;
  - also, property makes up a significant proportion of these specific provisions, and this sector has attracted larger impairments than other sectors.
- We also question 3% as the low point:
  - **[3]**
  - as stated by KM, the overall provisioning is extremely sensitive to the collective provision.
- In summary, we believe that it is inappropriate to adopt any increase in collective provisioning without additional evidence to the contrary.

7. SCF's Dairy Assets

SCF's dairy assets are high quality dairying operations and are well positioned to benefit from the recovery underway in the dairy industry.

- KM makes a number of assertions regarding the value of SCF's 33% shareholding in Dairy Holdings Limited ("DHL") and the lack of liquidity for such assets.
- The last two months have seen a strong rebound in dairy commodity prices and sentiment in the sector:
  - after dropping to a low of US$2,290/tonne in June, the weighted average USD dairy commodity price has increased substantially, especially in recent weeks, to US$3,520/tonne in early September.
- The following fundamental factors have contributed to the rebound in prices:
  - significant gains in the price of wholemilk powder;
  - low domestic stock and production levels; and
  - strong demand from India for fat-based dairy products.
- On Friday 10 September 2009, Fonterra announced that it expects to make a further announcement as to the likely dairy payout over the next few weeks:
  - SCF believes that, based on the recent dairy price recovery, an increased payout is becoming increasingly likely.
- Based on the recent recovery in dairy commodity prices, investor interest in the sector has rebounded:
  - SCF recently received an expression of interest for its 33% shareholding in DHL for in excess of its current carrying value;
  - Olam International's recent cornerstone shareholding in NZ Farming Systems Uruguay (arguably an inferior asset) and interest in PGG Wrightson is further evidence of growing offshore interest in the sector; and
  - references in the KM report to the failure of the second largest shareholder in DHL to sell its stake in the company relate more to the price sought by the vendor at that time and the existence of pre-emptive rights complicating the sale process, rather than lack of interest in the shareholding.
- DHL has invested heavily over the recent years and is ideally placed to reap the cost and operating efficiencies from this investment.
- Forsyth Barr is advising SCF and Southbury on sale and restructuring options for the dairy assets, including a potential IPO.

8. Board and Governance

SCF is currently in the process of implementing significant changes to the structure and composition of the Board and management.

- Mr Allan Hubbard is aware that he needs to implement significant changes to both the composition and structure of the SCF Board (and Southbury's):
  - this has been clearly communicated to the Treasury and the Trustee;
  - this process has commenced with the recent resignations of Stuart Nattrass and Bob White.
- SCF is committed to introducing 3 - 4 new independent directors to the Board of SCF by 30 November 2009:
  - Southbury is in discussions with several potential board appointments who have the requisite skills, profile and independence;
  - it is likely that these individuals will be appointed initially in an advisory capacity by 30 September 2009 prior to being appointed formally as part of Southbury's proposed restructuring and recapitalisation process (refer Section 11); and
  - this will enable potential directors to familiarise themselves with Southbury and/or SCF and also contribute to improving SCF's governance and systems.
- It is Mr Hubbard's intention to step down as Chairman of the Board of SCF once these new appointments are finalised to enable an independent Chairperson:
  - it is likely that 2 - 3 new board members will be added to the Southbury Board as part of the pre-IPO capital raising process.
- SCF is also aware that it needs to strengthen and broaden its management team:
  - the Company has recently employed an additional senior executive and is actively seeking to recruit additional senior management personnel including a General Manager, Business in September 2009.
- A full restructure of the SCF group has been completed:
  - these changes have focussed on business risk and new credit control regime, together with centralisation of the back office functions.
- SCF proposes to appropriately reference these changes in the structure and composition of the Board and management in the Draft Memorandum of Amendments to the prospectus.

9. Management and Systems

KM is incorrect/inaccurate in several of its assertions on SCF's management structure and systems:

KM Position	SCF Position
▸ No regular independent oversight to ensure that policies and procedures are being followed	▸ [1] (previously National Operations Manager) performs an internal audit on a quarterly/as-required basis to ensure policies and procedures are being followed ▸ The National Operations Manager has no involvement in loan origination or loan management
▸ No rigid separation between origination and credit/risk approval	▸ There is rigid separation between loan origination and credit risk approval for all loans greater that $250k (representing approximately 90 - 95% of the loan portfolio)
▸ Lack of a risk grading framework makes it difficult to assess loan portfolio in its entirety and prohibits an overview of credit quality ▸ Appears to influence the very conservative assumptions adopted by KM in relation to the level of provisioning	▸ SCF developed a risk grade model in 2008 and all loans are risk graded. All data was loaded effectively by 31 March 2009 ▸ The risk grade model accounts for: ▪ security type ▪ LVR ▪ industry type ▪ location ▪ loan performance history (i.e. arrears) ▪ financial performance ▪ borrower's history ▪ management experience ▸ Model was developed in conjunction with [1] (formerly S&P) ▸ Data is derived from Sovereign database and updated daily

9. Management and Systems (continued)

KM Position	SCF Position
Company's system does not record whether or not GSAs are first or subsequent ranking	SCF does record whether or not a GSA is first or second ranking and can analyse the book on that basis
Consumer book has been in its current configuration for only three years Book is not very seasoned	Consumer book has been part of SCF for 83 years, and is well seasoned SCF has quality data and understands the variables within the consumer book very well
General account conduct commentary suggests a general lack of full compliance but contains ambiguous references such as: ▪ *"in many instances"*; ▪ *"a number of instances"*; and ▪ *"often limited"*	Commentary not specific enough to be meaningful Specific numbers/percentages required to add credibility to the statements Generalisations at present
Generally a very low level of consideration of exit strategies in regard to loan origination	Almost without exception there was an exit strategy for the loans when they were originated The general deterioration in the market has meant that some origination exit strategies are no longer viable and other strategies have to be considered (frequently with limited options)

SCF is disappointed with these inaccuracies and the misleading impression given by its contents.

SCF acknowledges its systems and processes can be improved and has restructured accordingly.

10. Summary of Financial Statements

Balance Sheet as at 30 June 2009 ($m)			
Assets		**Liabilities**	
Cash and Receivables	123.3		
Investment Assets	276.5		
Receivables	15.4	Creditors	21.4
Taxation	53.5	Borrowings	2,079.3
Advances	1,630.9	**Total Liabilities**	**2,100.7**
Prop. Plant & Equipment	124.6		
Shares in Associated Co's	87.5	**Total Equity**	**211.1**
Total Assets	**2,311.8**	**Total Liabilities Plus Equity**	**2,311.8**

Source: SCF's full year preliminary result announcement to the NZX (28 Aug 2009).

Profit & Loss ($m)	30 June 2010	30 June 2011
Total Loan Interest Income	187.4	167.0
Total Lease Income	6.4	2.5
Total Fee Income	3.7	4.2
Total Other Income	15.8	25.2
Total Income	**213.4**	**198.9**
Total Interest Expense	(143.0)	(121.0)
Total Bad Debt Expenses	(14.2)	(10.8)
Depreciation	(5.9)	(5.4)
Total Other Expenses	(29.0)	(27.9)
Total Expenses	**(192.0)**	**(165.1)**
Net Profit Before Tax	**21.4**	**33.8**

11. Capital Raising Strategy

Southbury (SCF's 100% owner) is in the process of implementing a robust and sustainable long term funding solution for SCF.

- An overview of the proposed recapitalisation is as follows:
  - the immediate injection of $40 - 75 million of new ordinary equity into SCF following a private placement within Southbury:
    - placement is likely to be in two tranches (reflecting investor preferences) but with all proceeds injected as ordinary equity into SCF;
  - the subsequent injection of $75 - 100 million of new ordinary equity into SCF by means of an IPO of a new company ("Southbury Corporation"):
    - the IPO capital raising is expected to be underwritten to a minimum of $50 million (an early underwriting commitment is in discussion);
  - the conversion of SCF's existing $120 million perpetual preference shares into fully paid ordinary equity in SCF as part of the IPO:
    - assuming 75% conversion, this will result in a further $90 million of ordinary share capital in SCF ($30 million remains as PPS in SCF).
- This proposed recapitalisation will provide a $115 - 175 million equity cash injection and $205 - 265 million of new ordinary equity capital into SCF which will successfully recapitalise SCF on a sustainable basis:
  - in addition, further discussions continue with an investor who may inject a further $25 - 50 million of additional capital into Southbury.
- The IPO and listing of Southbury Corporation on the NZX (currently intended prior to 31 December 2009) will also provide a bona fide arms-length equity funding solution for SCF:
  - provide a transparent and liquid market in the equity of the group;
  - add the additional overlay of the NZX's listing rule and continuous disclosure requirements in respect of equity of the group;
  - provide the group with ongoing access transparent to the NZX listed capital markets; and
  - establishes SCF into a viable long-term vehicle.

11. Capital Raising Strategy (Cont'd)

- The private placement process has commenced and is expected to be completed by late September 2009:
  - a terms sheet has been agreed with Allan Hubbard and potential investors have been identified and contacted;
  - this investor group will likely include a small group of high profile wealthy individuals with demonstrable wealth and business acumen;
  - Forsyth Barr is engaged as Arranger and Lead Manager to the private placement and IPO, and Harmos Horton Lusk are assisting Southbury as legal advisors.
- The IPO will involve the establishment of Southbury Corporation Limited ("Southbury Corporation") which will hold Southbury Group Limited's ("Southbury") existing shareholdings in the following subsidiaries:
  - SCF (100%);
  - Helicopters NZ Limited ("HNZ") (100%); and
  - Scales Corporation Limited ("Scales") (86%).
- The IPO will seek to raise $75 - 100 million of new equity capital in Southbury Corporation with the proceeds to be injected into SCF as new ordinary equity:
  - Allan Hubbard has an exceptionally strong market reputation and has a very loyal and strong investor following; and
  - Forsyth Barr will be Lead Manager, Organising Participant and Underwriter to the IPO of shares in Southbury Corporation.
- The IPO will also include an exchange offer for SCF's perpetual preference shareholders to exchange its preference shares in SCF into ordinary shares in Southbury Corporation:
  - the proceeds of the exchange offer would then effectively be reinvested as fully paid ordinary equity in SCF; and
  - Forsyth Barr has a significant volume of clients invested in SCF's preference shares (circa $50 million) and is confident that the exchange offer will be well supported by these investors.
- A key part of the equity plan is a restructuring of the management and board structure of SCF and Southbury Corporation.3
- In addition to the sale of non-core investments SCF will also seek to reduce the size of its loan book from $1.7 billion to $1.3 billion:
  - together with the institutions discussed above this will reduce SCF's risk weighted capital adequacy requirements under both Basel II and the proposed NBDT regime.

11. Capital Raising Strategy (Cont'd)

- The new equity raised by the private placement and IPO introduces cash into the Company assisting with liquidity.
- SCF is also committed to implementing a range of initiatives which will substantially enhance its risk weighted capital position and business focus. These include:
  - a significant reduction in the level of SCF's non-core assets including:
    - the sale or restructuring of its shareholdings in Dairy Holdings and South Island Farms (collectively circa $140 million) by way of private sale or IPO;
    - the restructuring and effective sale of its interests in Helicopters Nominees (circa $69 million); and
    - the sale or recapitalisation of up to $75 million of additional non-core assets (primarily listed bonds and equities).
  - a material reduction in the level of SCF's related party loans:
    - since 30 June 2009, related party lending has been reduced by in excess of $50 million;
    - the Company is realistically targeting to reduce related party loans by up to $50 - 75 million by 30 June 2010;
  - a prohibition on any further property development lending.

NZIFRS vs. KM

Prospectus

30/9. Audit timing.

✓ Capital Raising timing

✓ Situation with USPP holders

Sec Comm → continuous disclosure

→ allotting securities

Appendix A:

A1. [3]

Loan Value: $11.99m

SCF Provision: $2.03m

KM Provision: $11.99m (i.e. fully provisioned)

SCF Position

- July 09 registered reputable valuation received from Jones Lang Lasalle of $24m:
  - BNZ 1st mortgage at $14m leaves $8 - 10m for SCF (after allowing for transaction costs, interest).
- BNZ have agreed to let SCF take a first charge over 2.45m OSI shares valued at approximately $1.6m (value endorsed by recent capital raising involving Pioneer and K1W1).
- SCF is currently in discussions in relation to additional security for the loan on all Birnie's assets.
- BNZ is stable if interest continues to be paid.

KM Position

- KM seems to have not accepted the JLL valuation on the basis that it does not reflect market reality and the only sale in the development over the past 18 months was to a related party.
  - note that, in contrast to KM's implication that the related party transaction supplies an inflated sales price, JLL states that the sale was effectively conducted at a "wholesale" price, and notes that the sale would appear to be at the lower end of the range for quality coastal lifestyle blocks.
- KM also disputes the value of the OSI shares.

Summary

- KM has taken a contrary view to JLL as valuers, and does not state the basis for its amount of provisioning.
- SCF believes that the provision is overstated by $10m, particularly given the potential for additional security and a current registered valuation.
- SCF currently seeking additional security over all group assets and is in discussions with BNZ on sell down.
- KM has viewed the property as if BNZ was forced selling[3] at BNZ debt levels.

A2. [3] [redacted]

Loan Value: $31.46m

SCF Provision: -

KM Provision: $5.00m

SCF Position

- First mortgage position in relation to [3] [redacted] in Christchurch:
  - asset intended to be sold in next two years.
- SCF has valuations of $35 - 40m, with the last registered valuation in Feb 08 at $35.7m.
- SCF notes that cash flows based on [3] [redacted] show EBITDA of $2.4m for the coming year once completed:
  - [3] [redacted]
- Borrower has been incentivised to repay $2m per year in principal.
- Sound cash flow business – added potential over next two years.
- Additional collateral security on (1) [3] [redacted] – Last valuation July 2008: $9.6m prior BNZ of $7.5m (currently in receivership); (2) [3] [redacted] first mortgage $1.5m.

KM Position

- KM states that market has moved since Feb 08, but notes the <u>considerable uncertainty</u> in determining this movement and future movements:
  - KM states that "it is <u>impossible to know</u> what the market will do between now and 2011, but we have recommended a provision based on a <u>potential movement</u> in value since the latest valuation".

Summary

- Cash flow business still yet to reach potential.
- Good product well located.
- Fully completed – no additional development cost.
- KM provision would suggest recovery of just $26.5m compared with $35.7m valuation and despite good performance of [3] [redacted]
- SCF will manage the loan and asset rather than "forced sale" the asset.

A3. [3]

Loan Value: $15.10m

SCF Provision: -

KM Provision: $3.50m

SCF Position

- [3] is a well sought after 13,000 stock property and is readily saleable as a farming operation.
- Valuations of security for loan total $17.1m, including land, stock and personal guarantees (supported by collateral security ie land):
  - supports no provision; and
  - note interest is being paid monthly from various robust sources.
- An Auckland investor injected $3m last year to assist with the completion of the development (following full due diligence):
  - strengthened asset value and saleability.

KM Position

- KM takes issue with the collateral valuation, arguing that it is inadequate and needs to be revalued based on being a farm, not a potential subdivision, on the basis that it will be a forced sale:
  - KM appears to be disregarding value of stock ($2.6m) and PG ($0.6m) in its provision (have requested further information on PG value).

Summary

- KM does not appear to have taken into account the value of stock and the personal guarantees.
- The land valuations above are based on farm values (i.e., no development value) by two highly regarded Southland registered valuers.
- SCF believes that the security valuations support no provision.
- Despite this KM assumes recovery of just $11.6m in a "forced sale" outcome.

A4. [3]

Loan Value: $14.59m

SCF Provision: $2.50m

KM Provision: $5.00m

SCF Position	KM Position
▸ Provisions depend on execution of significant[3] contract. ▸ SCF understands contract is in the process of being executed.	▸ KM has agreed that a provision is not required once the contract with Exxon is signed. ▸ KM just awaiting a copy of the signed contract and release provision.

Summary

- Provision to be released following receipt of signed contract.
- Signed documentation to be in place by 30 September 2009.

A5.

Loan Value: $41.00m

SCF Provision: -

KM Provision: $2.00m

SCF Position

- Security consists of [3] [redacted] in NZ ($30.5m less prior charge to HSBC of $18.8m) and Fiji assets.
- [3] [redacted] also "pledged", value $3 - 5m.
- Deducting this security from the loan value results in $24 - 26m of residual exposure.
- Provision dependent on Fiji valuations being greater than $24 - 26m:
  - have valuations totalling $31m, but 18 months old;
  - updated CBRE valuations should be available shortly, which will give more robust guidance as to value.

KM Position

- KM acknowledge that SCF are working on new valuations.
- KM concerned with the illiquidity of the Fiji assets.

Summary

- Incorporating the [3] [redacted] as security, "breakeven point" for Fiji valuations is $24 - 26m.
- [3] [redacted] property currently being marketed as one unit, with interested parties at $25 – 30m.
- If these valuations come out at or above this, no provision required.

A6. [3]

Loan Value: $6.39m

SCF Provision: $1.00m

KM Provision: $2.00m

SCF Position	KM Position
▸ Subsequent to the KM provision, the borrower has offered additional security reducing the provision to $0.5 - 1.0m.	▸ As a result of the additional security, KM reduced its provision to $2m: • KM acknowledges that the situation may develop over the next month to make SCF's $0.5 - 1.0m assessment appropriate.

Summary

- SCF has provided an additional $2m to borrower (supported by another $3m by a third party on a subordinated basis).
- New funding has enhanced SCF's security position by $1.3m.
- KM provision already reduced, and may be reduced further over next month.

- Subsequent to KM review, borrower pledged additional security.

A7. [3]

Loan Value: $5.63m

SCF Provision: -

KM Provision: $0.75m

SCF Position	KM Position
▶ LVR 72%, equity in business of $3.8m, exceptional property in very saleable blocks. ▶ Located near Hastings/Napier. ▶ Key supplier to Mr Apple (Scales) and likely that Mr Apple would purchase all properties in need to run under the Mr Apple operation. ▶ Interest Cover 8/09 1.47x, EBITDA $2.2m.	▶ KM believes that the position is reliant on current years trading, not yet known: ▪ note KM has agreed that it may be reasonable to reduce provision if trading is acceptable, and would recommend that this be done on this basis; ▪ KM has already reduced provision from $2m to $0.750m.

Summary
▶ SCF believes that KM's view is not supported by the above, as demonstrated by the reduction in provision, and believes that no provision is required.

A8. [3]

Loan Value: $1.60m

SCF Provision: -

KM Provision: $1.20m

SCF Position	KM Position
▸ Loan fully serviced from next year from $4.55 dairy pay out. ▸ Cash flow positive. ▸ Potential for $5/kg dairy payout 2009/2010. ▸ An important share milker of DHL, milking over 2,000 cows and being one of its top producers. ▸ Potential assistance from DHL if required.	▸ KM assessment estimates recoverable value of $7m, ASB debt of $6.7m, hence provision: ▪ recognises potential for business to be cashflow positive over season but needs to be demonstrated; ▪ provision adjusted to $1.2m, to be reviewed at end of season.

Summary

- Given positive cash flow and servicing of loan, provisioning is not required.
- KM view to be reviewed at end of season.
- Regarded as being in the top 10% of sharemilkers in NZ

A9. [3]

Loan Value: $11.68m

SCF Provision: -

KM Provision: $0.50m

SCF Position	KM Position
▸ Security over two farms and stock far in excess of $14m: ▪ Lamb finishing property (well located), $6m (valued on the basis of $850 per stock unit) ▪ Stock finishing property, $6m (valued on the basis of $428 per stock unit) ▪ Additional security over all stock and plant on both properties valued at $2.3m ▸ SCF breakeven at $474 per SU → very unlikely low. ▸ $2m equity currently in Taihape operation on realistic values.	▸ KM valuation $10 - 12m, no basis given: ▪ KM notes that provision has been reduced to $0.5m, and agrees provision should be released if performance returns to an acceptable level this year.

Summary

- Land and stock valuations support no provision, KM has already reduced its estimates, and acknowledges potential for provision to be released.

A10.[3]

Loan Value: $1.36m

SCF Provision: -

KM Provision: $0.54m

SCF Position	KM Position
▸ Loan supported by floor plan ($400k), guarantee from previous owner ($400k), business premises ($675k), 2nd mortgage on home ($200k + equity) and other assets (stocks, debtors, plant, $705k). ▸ Business has been struggling but have never missed a payment and is entering its busy season (spring and summer). ▸ SCF believes no provision required as security cover adequate.	▸ KM acknowledges floor plan coverage, but has concerns on other security given lack of information, and trading results: ▪ has indicated they are happy to reconsider above provision on the evidence of further information requested.

Summary

- No provision required, to forward additional information to KM.

A11. [3]

Loan Value: $1.07m

SCF Provision: $1.00m

KM Provision: $2.20m

SCF Position	KM Position
▸ Current balance $1.067m. ▸ Property sold to [3]	▸ KM reduced previous provision by $0.5m, being the mid-point of the value range for [3]

Summary
▸ Maximum provision of 1.1m needed only to cover balance outstanding.

A12.[3]

Loan Value: $41.60m

SCF Provision: -

KM Provision: $5.50m

SCF Position	KM Position
▸ Well located hotel in central Auckland with significant demand prior to RWC2011. ▸ Refurbishment 70% complete and under budget, on track for completion Dec 09. ▸ Valuation on file at $72m (dated 20/8/08). ▸ Recent going concern value of $77.5m (dated 27 Aug 09). Point of sale (Sep 2010) valuation of $82.5m. ▸ Prior charges of $27.4m. ▸ 3 - 4 interested purchasers with sales process to be re-ignited on completion of refurbishment.	▸ No rationale / evidence provided for provision.

Summary

- KM have requested no evidence of valuations or monthly trading reports.
- No basis to provision.