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.

South Canterbury Finance Limited
Crown Position

October 2009

FORSYTH BARR
Investment Banking

South Canterbury Finance

1. Crown's Position

By our estimates, the Crown is currently exposed to a potential funding obligation of circa $1.8 billion to SCF eligible depositors under the existing Retail Deposit Guarantee Scheme. In addition, if the guarantee was triggered, it is exposed to a potential liquidation loss of $280 – 670 million based on an assumed 80 – 60% receivership pay-out.

- If South Canterbury Finance ("SCF") defaults on its payment obligations then based on KordaMentha's 8 July 2009 numbers the Crown's payment obligations under the Retail Deposit Guarantee is summarised below:

Crown Guarantee Payment Obligation		
	(NZ$m)	
Debentures	1,549	
Listed Bonds	350	
Unsecured	30	
	1,929	
Less Non-Eligible	88	
	1,841	93%
US PP	137	7%
	1,978	

- Based on a total book of $2,092 million at 8 July 2009 and assuming a 60 – 80% realisation range under a receivership scenario the potential economic value loss to the Crown under the guarantee is:

Realisation Range	Crown Loss (NZ$m)	US PP Loss (NZ$m)
60%	672.0	49.1
80%	284.0	20.0

1. Crown's Position (Cont'd)

- In addition, given the size of SCF's book and the concentration of its loan exposures and securities in the South Island, there are significant potential contagion impacts associated with SCF being placed into receivership:
  - the flow on impact for other lenders and finance companies such as [3] Allied Nationwide etc will be significant and could potentially trigger additional Crown exposure under the Retail Deposit Guarantee;
  - the receivership of SCF may also constitute a "force majeure" event [3]
    - this has the potential to further destabilise the finance [3] sectors of the economy.

2. Recommended Support to SCF

We propose that the Crown provide liquidity support to SCF of up to $50 million and extend the term of the existing guarantee to SCF for a further 12 months.

- The indicative terms of the liquidity support facility would be as follows:
  - maximum amount: $50 million;
  - availability: ability to drawdown if cash reduces to below $50 million;
  - repayment date: 30 June 2010;
  - interest rate: to government stock rate plus 120 bp.
- The introduction of new equity into Southbury Corporation Limited (and SCF) will require the Crown to extend the Retail Deposit Guarantee to SCF for a further 12 months to 12 October 2011:
  - recommend that the proposed 120bp guarantee fee be waived (or substantially rebated) provided SCF reduces the size of the Crown's exposure under the guarantee by:
    - a minimum of $200 million in the year ending 30 June 2010; and
    - a further $200 million in the year ending 30 June 2011.
- The extension and provision of the Crown guarantee on these terms will substantially enhance the financial profile of SCF over the restructuring period:
  - this will significantly increase the attractiveness of the SCF equity "story" and broaden the potential investor audience for a capital raising by its parent Southbury Corporation Limited ("SCL");
  - new equity, governance, etc will reduce the Crown's risk of SCF failure;
  - increase the potential quantum of IPO capital introduced into SCL and SCF which will reduce the likelihood that the Crown guarantee will be triggered.

3. Assessment of Costs / Benefits

Our preliminary assessment of the costs and benefits to the Crown of providing the recommended support to SCF is as follows.

Costs:

- The costs of providing the liquidity support is minimal if the recapitalisation of SCF is successful as the Crown is earning an economic rate of return on its investment:
  - in a receivership scenario assuming a 60 - 80%, pay-out ratio the Crown's potential loss would further increase by $10 - 20 million.
- Assuming an average loan book of $1.5 billion in FY2011, the loss of the proposed 120bp guarantee fee is $18 million on an annual basis.

Benefits:

- The targeted $150 million of new equity to be introduced into SCF will increase SCF's equity to circa $350 million on an average book of circa $1.75 billion in FY2010 (i.e. circa 20%).
- Avoids/defers a $1.8 billion pay-out under the guarantee which equates to an annualised saving of $108 million per annum at a 6.0% interest rate.
- Avoids/defers the Crown incurring a $284 - 672 million potential economic loss now based on an assumed 80 - 60% recovery rate.
- Based on SCF's current forecasts, the Crown's potential liability under the guarantee reduces by circa $400 million over the next two years.
- Avoids/defers what could be a significant contagion impact on the finance and agri-business.