

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.

Southbury Group Restructure and South Canterbury Finance Recapitalisation

September 2009



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1. Proposed Equity Plan

This proposal outlines a robust and sustainable long term funding solution for South Canterbury Finance Limited (“SCF”) utilising the strength of Southbury Group (SCF’s 100% owner).

- ▶ An overview of the proposal is as follows:
 - the immediate injection of \$20-40 million of new ordinary share capital into SCF following a private placement by a subsidiary of Southbury Group;
 - the subsequent injection of \$75-100 million of new ordinary share capital 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;
 - the conversion of SCF’s existing \$120 million perpetual preference shares into fully paid ordinary share capital of SCF as part of the IPO:
 - assuming a 75% conversion rate, this will result in a further \$90 million of ordinary share capital in SCF.
- ▶ This proposed equity plan will provide a \$95-140 million equity cash injection and \$185-230 million of new ordinary equity capital into SCF which will successfully recapitalise SCF on a sustainable basis.
- ▶ The IPO and listing of Southbury Corporation on the NZX 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 on the group;
 - provide the group with ongoing access transparent to the NZX listed capital markets; and
 - establishes SCF into a viable long-term vehicle.
- ▶ The private placement process has commenced and is expected to be completed by mid-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 has been appointed Arranger and Lead Manager to the private placement and IPO, and Harnos Horton Lusk are assisting Southbury as legal advisors.

1. Proposed Equity Plan (Cont'd)

- ▶ 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 their 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 number of client invested in SCF's preference shares (circa \$50 million) and are 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:
 - this will involve the establishment of an Interim Advisory Board and the eventual appointment of a new independent chairman and new independent directors to both SCF and Southbury Corporation; and
 - while Allan Hubbard would step down as chairman of SCF, he would remain a director and his integrity and reputation would engender a high degree of support from the market;
 - the new chairman and directors would be introduced to strengthen governance and enhance market confidence.
- ▶ Forsyth Barr is confident that investor interest in SCF as part of the broader Southbury Corporation group of companies would be well received and supported by the market.
- ▶ This view is underpinned by Forsyth Barr's position as the leading provider of debt and equity finance to SCF:
 - raised in excess of \$500 million in equity and share capital from the market for SCF over the last 5 years; and
 - been the largest provider of debenture funding to SCF over many years.

2. SCF – Other Proposal Initiatives

- ▶ As part of this proposed equity plan, SCF would also implement the following initiatives as part of its restructuring plan:
 - enhance its management team with the introduction of additional finance and lending personnel;
 - implement new and improved operating processes using:
 - new loan origination;
 - credit approvals;
 - loan management; and
 - loan impairment review;
 - progressively reduce the size of its lending book, focussing in particular on:
 - further realisation of non-core assets; and
 - ongoing reduction in related party loans;
 - replace SCF's existing auditor with a new "Big Four" audit firm.

3. SCF – Key Issues Addressed

The proposed restructuring of the Southbury Group and recapitalisation of SCF addresses a number of key issues.

KEY ISSUES AND PROPOSED RESPONSE		
Short Term Capital (\$20-\$40m)	✓	<ul style="list-style-type: none"> ▪ \$20-\$40m injection of new equity into SCF. ▪ Process underway and expected to be completed by mid-late September 2009. ▪ Avoid any potential breaches in SCF's Trust Deed. ▪ Provides independent equity capital and support for the restructuring.
Medium Term Capital (\$75-\$100m)	✓	<ul style="list-style-type: none"> ▪ IPO of Southbury Corporation to raise additional \$75-100m new ordinary equity. ▪ IPO enables SCF to lever off the value and earnings of Southbury's other subsidiaries, HNZ and Scales. ▪ Underwritten to a minimum of \$50m by Forsyth Barr Group.
SCF Capital Restructuring (\$90m)	✓	<ul style="list-style-type: none"> ▪ \$120m of Tier 2 preference shares ("PPS") in SCF's capital structure is not optimal. ▪ PPS holders offered option to exchange into ordinary shares in Southbury Corporation as part of IPO. ▪ Anticipate a high level of investor support (>75%).
Access to Ongoing Capital	✓	<ul style="list-style-type: none"> ▪ IPO of Southbury Corporation will likely introduce in excess of 5,000 new shareholders. ▪ Listing will provide ongoing access to new capital from a wide and diverse shareholder base. ▪ Enhance SCF's access to equity and debt capital on a ongoing basis. ▪ Transforms SCF into a viable transparent long-term entity.
Governance and Management	✓	<ul style="list-style-type: none"> ▪ Appointment of new independent Chairman. ▪ Appointment of new independent directors with relevant skills and market credibility. ▪ Appointment of additional senior management to the business.
US Private Placement	✓	<ul style="list-style-type: none"> ▪ Investor ability to put bonds at face value plus accrued interest on 30 November 2009. ▪ Crown assistance will address any immediate liquidity issue associated with repayment of these funds.

3. SCF – Key Issues Addressed (Cont'd)

KEY ISSUES AND PROPOSED RESPONSE (Cont'd)		
Ongoing Liquidity	✓	<ul style="list-style-type: none"> ▪ SCF existing debenture rollover rates at circa 50% are comparable to other finance companies [3] ▪ Confirmation of Government Guarantee will provide opportunity to launch \$125-150m listed bond to investors to address short-term liquidity.
Non-core Assets	✓	<ul style="list-style-type: none"> ▪ SCF has sold \$30m of non-core assets (principally listed bonds) post 30 June 2009. ▪ Up to \$300m of other non-core assets have been identified which can be potentially realised in next 12-18 months. ▪ This will likely include an IPO of Dairy Holdings Limited and South Island Farms which have a combined book value of \$143m. ▪ Reduces size of SCF's overall book and capital requirements.
Related Party Lending	✓	<ul style="list-style-type: none"> ▪ Related party loans have reduced by approximately \$40m since 30 June 2009. ▪ SCF is focused on reducing related party loans by in excess of another \$40m by 30 June 2010.
Management Team and Lending Practices	✓	<ul style="list-style-type: none"> ▪ SCF is committed to strengthening both its senior management and branch management team. ▪ Includes further enhancement of lending practises and loan management.

4. SCF – Current Position

On 28 August 2009 SCF made its NZX preliminary announcement declaring an unaudited net loss after tax for the year to 30 June 2009 of \$69 million.

Financial profile of SCF (\$m)	
As at 30 June 2008	
Ordinary Equity	133
PPS	120
Total Equity	253
Year to 30 June 2009	
Net loss after tax	(68)
Minority Interests	1
Fair Value Adjustments	(2)
Ordinary Shares Issued	60
PPS Dividends	(8)
Ordinary Dividends	(24)
Movements in Equity	(41)
As at 30 June 2009	
Ordinary Equity	92
PPS	120
Total Equity	212

- ▶ On 3 July 2009, SCF announced an anticipated \$58 million of impairments and net loss before tax of approximately \$37 million for the full year to 30 June 2009:
 - however, based on an extensive review of its book by management, SCF's auditors and independent advisors, SCF increased the impaired asset charge up to \$106 million, taking its net loss after tax to \$68 million; and
 - SCF's total equity as at 30 June 2009 was \$212 million.
- ▶ On 13 August 2009, Standard & Poor's ("S&P") downgraded SCF (and MARAC) to BB+ negative outlook (from BBB-). The implications of this downgrade are that:
 - USPP investors have the right to put \$125 million of bonds back to SCF on 30 November 2009;
 - the put right is individual to each investor and SCF is currently in discussion with investors via the US private placement arranger (BNZ).
- ▶ SCF also breached an interest cover ratio in relation to its syndicated banking facility (BNZ/CBA). This facility is currently undrawn and has been terminated.

5. Private Placement – Current Status

Forsyth Barr is in the process of undertaking a private placement of Mandatory Exchangeable Bonds via Southbury Group to provide \$20-\$40 million of ordinary equity in SCF.

- ▶ An overview of the key terms of the Mandatory Exchangeable Bonds is set out below.

Issuer	Helicopters NZ Limited (“HNZ”).
Instrument	Mandatory Exchangeable Bond (“MEB”).
Offer Size	NZ\$20m plus up to NZ\$20m in oversubscriptions.
Purpose	The net proceeds of the offer will enable Southbury Group to subscribe for new fully paid ordinary shares in SCF.
Ranking	Subordinated to senior lenders but ranking prior to ordinary and preference share capital (and guaranteed by Southbury Group).
Maturity Date	30 September 2010.
Initial Public Offering (“IPO”) Commitment	Southbury Corporation will undertake an IPO of Shares by 31 March 2010, and failing that an IPO of HNZ will be undertaken.
Exchange Date	The allotment date of the IPO of Southbury Corporation.
Exchange Terms	Each MEB will mandatorily exchange into Shares in the IPO of Southbury Corporation (or HNZ) at the Exchange Price.
Exchange Price	IPO issue price on a dollar for dollar basis.

5. Private Placement – Current Status (cont'd)

- ▶ Forsyth Barr is in discussions with a small number of high net worth and high profile investors in relation to the private placement:
 - the key terms of the Exchangeable Bonds have been agreed with a core investor group;
 - all of the investors are high net worth individuals and none of the investors have a lending relationship with SCF; and
 - Harmos Horton Lusk have been appointed to prepare draft documents.
- ▶ Forsyth Barr is confident that this placement will be agreed and executed by mid-late September 2009 as per the following timetable.

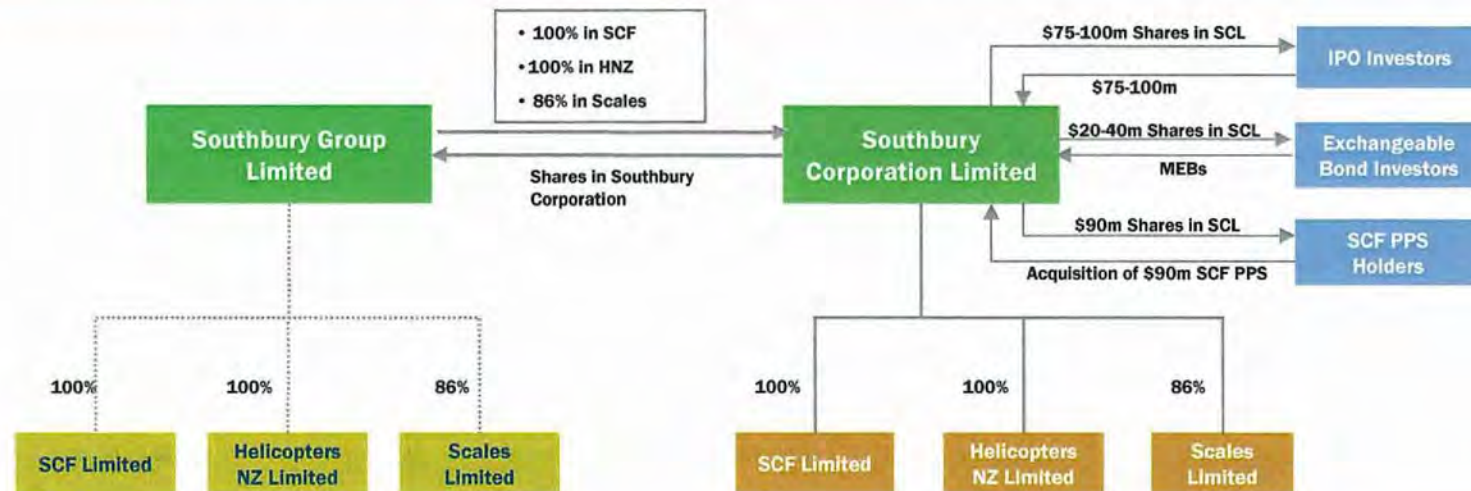
Event	Timing
Legal Review of Terms Sheet / Issue Structure	Fri 28 August – Wed 2 September
Draft Documentation	Mon 31 Aug – Thu September
Southbury / Investors Agree Terms Sheet	Tue 8 September
Subsequent Due Dilligence	Wed 9 – 16 September
Negotiate / Finalise Documents	Wed 9 – 16 September
Documents Executed	Fri 18 September
Settlement	Tue 22 September

6. Proposed Restructuring of Southbury Group

Southbury Group will transfer its interests in SCF (100%), HNZ (100%) and Scales (86%) to a new vehicle – Southbury Corporation – which will list on the NZX and raise new equity capital via an IPO.

Current Southbury Group/SCF ownership structure

Restructure of Southbury Group and IPO of Southbury Corporation



The restructuring will involve the following key steps:

1. Transfer of Southbury's shareholdings in SCF, HNZ Scales to the newly created Southbury Corporation for shares.
2. IPO of \$75-100 million of Shares in Southbury Corporation to new investors and listing on the NZX.
3. Simultaneously with the IPO and listing of Southbury Corporation:
 - ▶ Exchange offer to existing SCF perpetual preference shareholders offering \$0.80 of Shares in Southbury Corporation for each \$1.00 face value.
 - ▶ Exchangeable Bonds issued by HNZ mandatorily exchange into Shares in Southbury Corporation at the IPO price.
4. The proceeds of the IPO are used to recapitalise SCF.

7. Pro-forma Capitalisation of Southbury Corporation

Southbury Corporation will be a substantial NZX listed company with shareholders funds in excess of \$320 million.

- ▶ The table below presents a pro-forma financial profile of Southbury Corporation:
 - the total book value of Southbury Group (assuming no capital is raised) as at 30 June 2009 is estimated to be approximately \$135 million; and
 - pro-forma projected pre-tax earnings for Southbury Corporation for the financial year to 30 June 2010 are estimated to be \$33-37 million.
- ▶ Following the capital raising, Southbury Corporation is expected to have a total indicative valuation of \$277-417 million:
 - total equity raised is \$185-230 million, incorporating \$95-140 million of new cash.

Financial profile of Southbury Group (existing)			
	Book Value (\$m) 30 June 2009	Forecast NPBT (\$m) 30 June 2010	Forecast NPAT (\$m) ⁽¹⁾ 30 June 2010
Existing SCF ordinary equity	92	18-22	13-15
HNZ	80	12	8
Scales	76	12	8
	248	42-46	29-32
Less Debt ⁽²⁾	113	9	6.3
Total	135	33-37	23-26

(1) Assumes full tax

(2) Based on ANZ loan of \$43m and a SCF loan of \$70m at an assumed rate of 8.00%

(3) Based on ANZ loan of \$43m and a SCF loan of \$70m and assuming these loans are transferred from Southbury Group to Southbury Corporation

Financial profile of Southbury Corporation (post capital raising)	
	Indicative valuation (\$m)
Existing SCF ordinary equity	80-100
HNZ	75-100
Scales	<u>50-100</u>
	205-300
Additional new equity from PPS exchange	90
Additional new equity from placement	20-40
Additional new equity from IPO	75-100
	390-530
Less parent company debt ⁽³⁾	113
Total	277-417
Cash raised	95-140
Equity raised	185-230

8. Pro-forma Capitalisation of SCF

Following the IPO of Southbury Corporation, SCF will be a strongly capitalised finance company with total equity of circa \$330 million.

- ▶ The table below presents the pro-forma financial profile of SCF post capital raising, assuming:
 - 75% exchange participation in relation to the PPS;
 - \$118 million equity cash injection provided via the private placement and IPO capital raising ⁽¹⁾.
- ▶ As shown, SCF's total equity increases to circa \$330 million:
 - the quality mix of SCF's equity is also significantly improved, with over 90% of total equity being in the form of ordinary equity/retained earnings:
 - based on SCF's 30 June FY09 financial position, this percentage (pre-capital raising) is only 43% because the preference share capital at this date totalled \$120 million; and
 - this represents a superior outcome relative to the introduction of further tier 1 hybrid equity, and is consistent with global trends in regulatory capital requirement for deposit takers.

Financial profile of SCF (\$m)		Financial profile of SCF (\$m)	
As at 30 June 2009		Post capital raising	
		Ordinary Equity	
Ordinary Equity	92	Opening	92
		Placement	30 ⁽¹⁾
		Plus: Exchange of PPS	90
		Plus: Equity injection	<u>88</u> ⁽¹⁾
			300
		PPS	
PPS	120	Opening	120
		Less: Exchange	<u>(90)</u>
			30
Total Equity	212	Total Equity	330

(1) Mid points of \$20-40m and \$75-100m respectively

9. SCF – Sale of Non-Core Assets

SCF is committed to the ongoing realisation of its non-core assets as it refocuses its lending operations on core assets.

- ▶ SCF has identified up to \$385 million of non-core assets which are capable of being liquidated over the next 12-18 months.
- ▶ SCF's non-core assets include approximately \$120 million of listed shares and bonds:
 - in particular, SCF holds \$20 million of Silver Fern Farm's bonds, \$17 million of Fletcher Building capital notes, \$7 million of TOWER bonds, \$4.5 million of Contact bonds and \$3.75 million of NZ Post subordinated notes;
 - the majority of these assets have been held for liquidity purposes and can be readily realised for cash;
 - we note that the retail debt market is currently in short supply, and as such the liquidation of these holdings in a controlled manner could realise optimal proceeds; and
 - we also note that the Fletcher Building notes, the TOWER bonds, the Contact bonds and the NZ Post subordinated notes are trading at or above par value. The Contact bonds and NZ Post notes are currently trading at significant premiums to face value.
- ▶ A further \$143 million of non-core assets relate to SCF holdings in Dairy Holdings (approximately 33%) (\$75.7 million) and South Island Farms (\$67.2 million):
 - an IPO of a merged Dairy Holdings (total current value \$233 million) and South Island Farms (together in excess of \$300 million) would be a very saleable IPO:
 - provide a unique NZX listed exposure to the New Zealand Dairy Sector; and
 - lever off the expected rebound in milk powder prices and dairy farm values in 2010.
- ▶ SCF also has a prepaid tax asset of \$39.8m which we understand SCF is expecting to realise in December 2009.

10. SCF – Reduction in Related Party Loans

SCF is in the process of reviewing all related party lending and is committed to reducing related party lending over the next 6-9 months.

- ▶ As at 30 June 2009, SCF had total related party lending of approximately \$170m.
- ▶ Since 30 June 2009, SCF has reduced related party lending by in excess of \$40m:
 - SCF's \$30m loan to Kelt Finance is no longer a related party loan with Kelt Finance now forming part of the SCF Charging Group;
 - \$12m loan to South Island Farms has been refinanced.
- ▶ SCF is targeting at least another \$40m reduction in related party lending prior to 30 June 2010:
 - key related party loans identified include SCF's \$22m loan to HNZ, a \$6m loan to Dairy Holdings and a further reduction in lending to SCF's parent, Southbury Group.

11. Indicative IPO Timetable

An IPO of Southbury Corporation can be completed and its shares listed on the NZX prior to 31 December 2009.

Indicative Timetable																		
Week Commencing	24 Aug	31 Aug	7 Sep	14 Sep	21 Sep	28 Sep	5 Oct	12 Oct	19 Oct	26 Oct	2 Nov	9 Nov	16 Nov	23 Nov	30 Nov	7 Dec	14 Dec	
Offer team appointed	■																	
Due diligence		■	■	■	■				■			■					■	
Apply for Takeovers Panel waiver for Scales change in ownership		■																
Agreement for change of ownership to Treasury/RBNZ		■				■												
Discussions with banks/S&P			■			■												
Confirm financial disclosure requirements	■																	
Prepare requisite historical financial information		■	■	■	■													
Prepare pro forma consolidated financial information		■	■	■	■													
Prepare 2010 prospective financial information				■	■	■												
Board review/approval of requisite financial information				■	■	■	■											
Auditor review/approval of requisite financial information							■	■	■									
Offer document drafted		■	■	■	■	■	■	■										
Draft/finalise terms of Exchange Offer		■	■	■	■	■	■	■										
Negotiate/agree underwriting agreement							■	■	■				■					
Board approval of offer document									■									
Auditor approval of offer document									■	■								
Offer document with NZX and Companies Office for approval									■	■	■							
Offer document registered										■	■							
Firm allocation process												■	■					
Broker/Institution roadshow												■	■					
Offer document printed/distributed												■	■					
Preferential pool													■	■	■	■		
Retail offer period													■	■	■	■	■	
Allotment date																	■	

RECAPITALISATION OF SOUTHBURY GROUP LIMITED