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

[2] 9(2)(b)(i) - to protect trade secrets

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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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Preliminary Overview of Findings

Commercial in Confidence

Draft Findings Subject to Change

18 August 2009

Contents

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Preliminary comments on:

- Group structure.
- Governance.
- Financial position – unaudited 30 June 2009.
- Loan management systems and processes.
- Impairment considerations.
- Financial position and covenant compliance.
- Liquidity.
- Company's restructuring plan:
  - Equity.
  - Assets.
- Forecast liquidity.
- Potential for a call under the Crown Guarantee.

Restrictions

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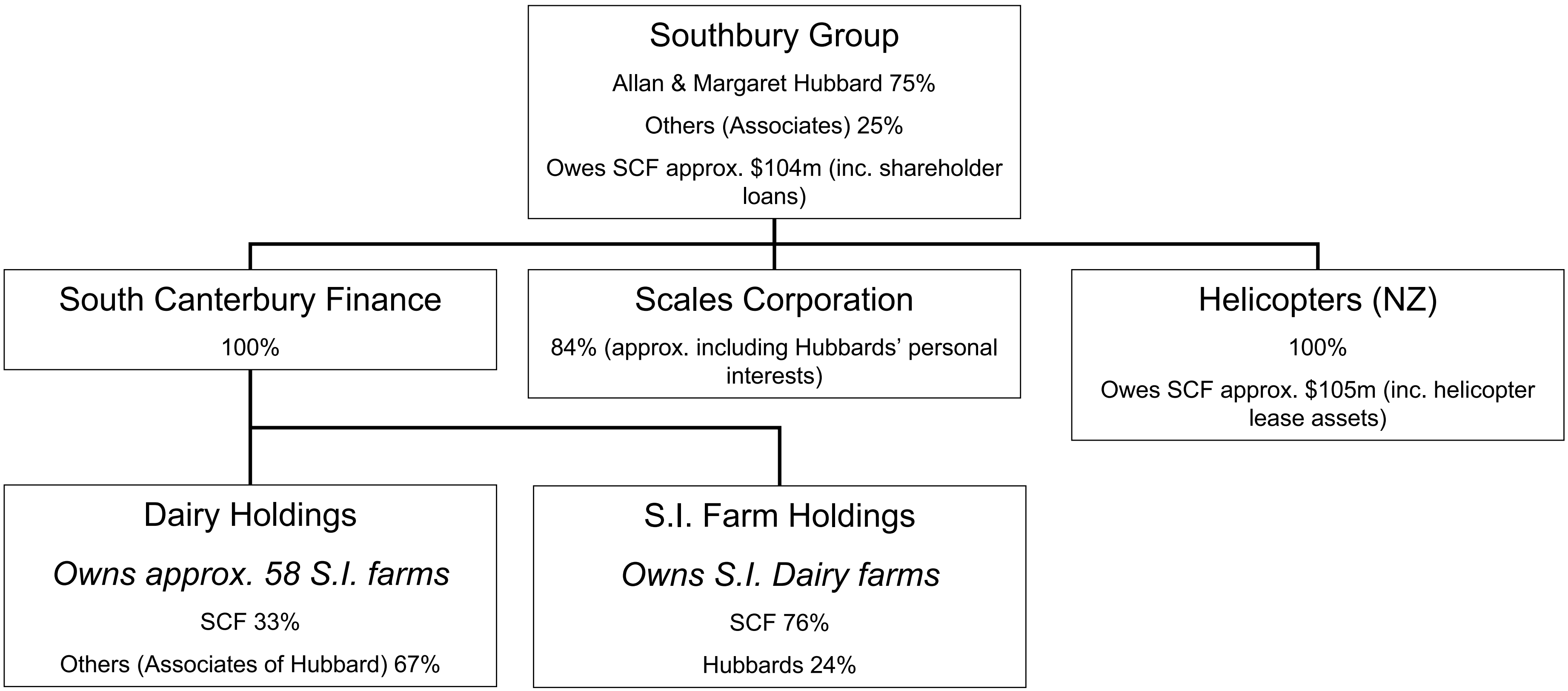
- Presentation discusses draft findings on work completed to date.
- Further information will be obtained from the companies that may require changes to the views expressed herein.
- Information in this presentation should not be relied on as KordaMentha's final view.
- Information is subject to change and changes will occur before our final reports are issued.
- All information is strictly confidential and should not be disclosed without our express permission in each and every instance.
- All findings are subject to the restrictions that will be contained in our final report.

Group Structure

- Allan Hubbard is a shareholder or director of some 500 entities.
- We are advised that the most substantial assets now sit either in SCF or Southbury but we do not have visibility into Mr Hubbard's personal assets.



Governance

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South Canterbury Finance Board

- Allan Hubbard (as the shareholder) has appointed the directors of SCF:
  - Allan Hubbard (since 1961).
  - Edward Sullivan (1990): partner in Timaru law firm.
  - Bob White (1990): accountant based in Timaru.
  - Stuart Nattrass (2002): also a director of Pike River Coal and Fonterra.
- Directors also own shares in Southbury Group, funded by SCF.
- SCF advises that it intends appointing two truly independent directors, although it seems unlikely that will occur in the near-term outside of an equity raising process.

Advisory Board

- Established to execute recapitalisation / restructuring.

[1]

- Leading negotiations with key stakeholders:
  - Equity investor;
  - Treasury / Government;
  - US Private Placement noteholders;
  - BNZ.

Management

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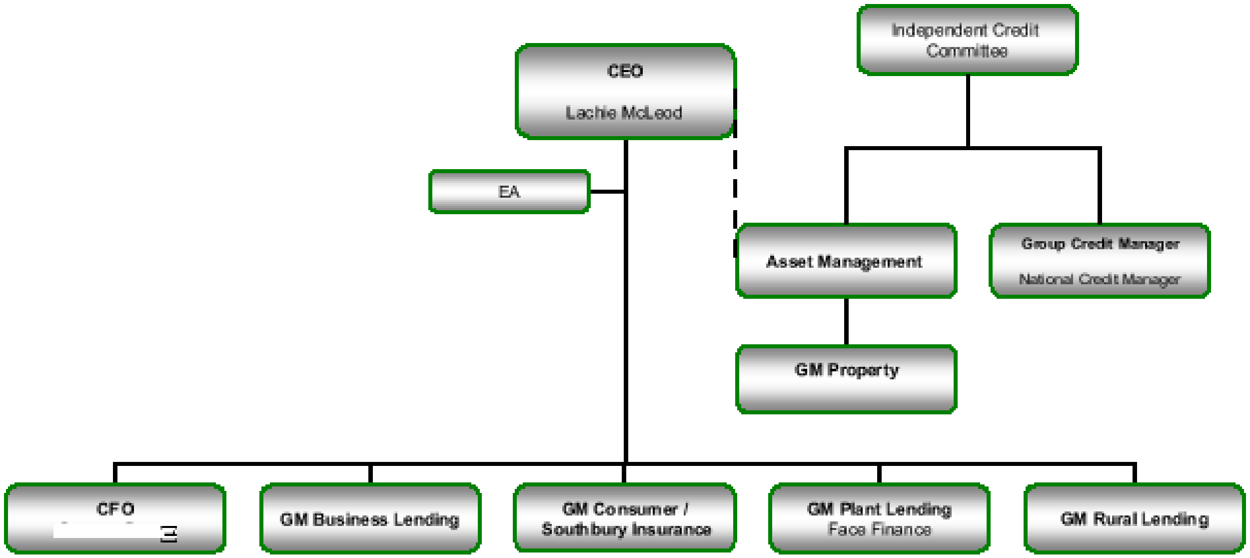
- Previous structure was totally inappropriate for a business of this size:
  - Origination and credit not appropriately structured.
- Organisation recently restructured to reduce cost, establish industry specialisation, and separate loan management and credit processes.



Financial Position – unaudited 30 June 2009

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$ million	
Cash & Equivalents	148
Tax	48
Other CA	29
Net Loans	1,651
PP&E	107
Shares & Investments	328
Other	1
Deposits	(1,576)
Bonds	(350)
USPP (net)	(125)
Other	(27)
Net Assets / Equity	**234**

Approx. $80 million at 13 Aug 09

$ million	
Subs & Assocs	
South Island Farms (69%)	
Dairy Holdings (33%)	
Listed Bonds & Shares	
Unlisted Shares	
Total (subject to rounding)	

Coy selling to support liquidity (circa. $25 million sold since 30 June)

Financial Position – unaudited 30 June 2009

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Subsidiaries & Associates –

- We have not finalised our review of the carrying value of these assets.

	$ million
Property	
Equity in Flexi-Lease (lease receivables)	
Equity in Subs not Wholly Owned	
Equity in Hornchurch (Investments)	
Miscellaneous	
Total (subject to rounding)	

Tax – $48 million

- $9 million deferred tax asset (accounting treatment only).
  - Ability to carry at 30 June being tested.
- $39 million prepayment into Imputation Credit Account:
  - Company would like to recover but recoverability and timing currently uncertain.

Loan Review Process

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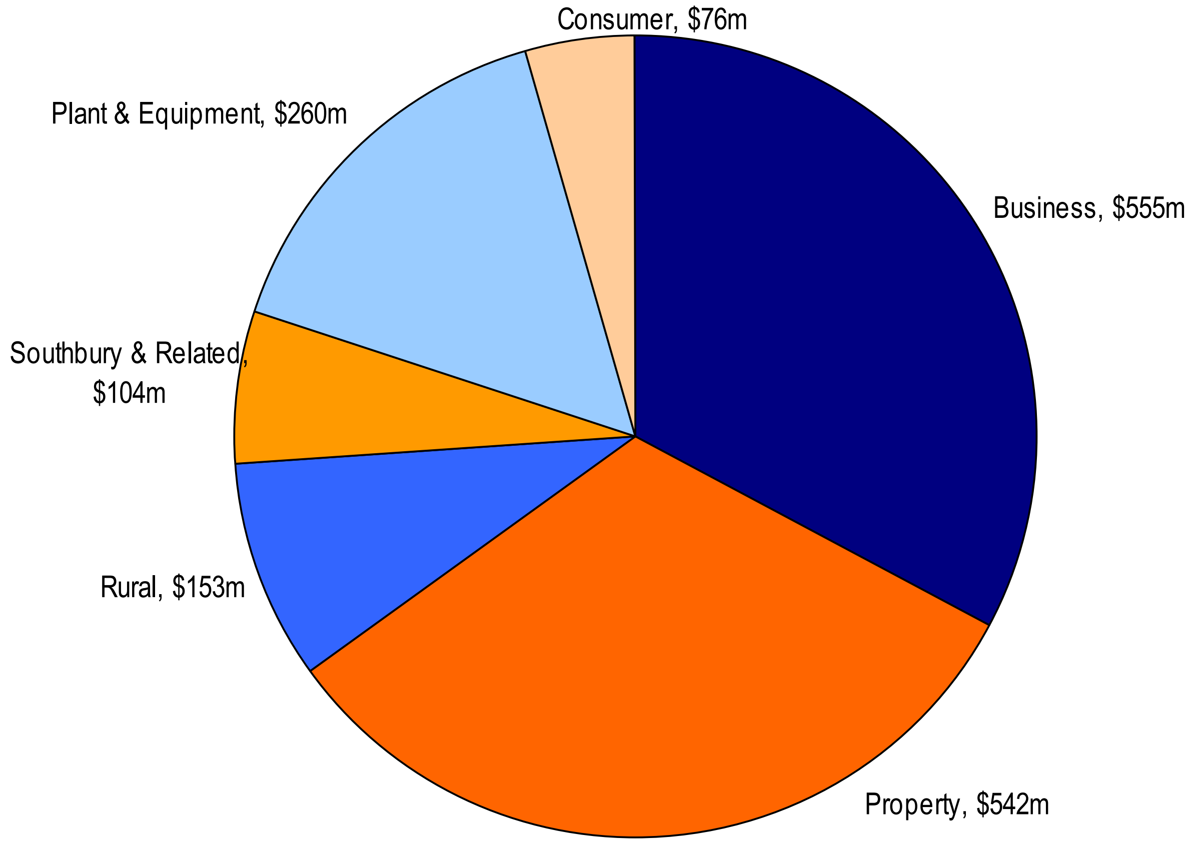
- Consumer loan book reviewed on a portfolio basis.
- [redacted] specific loans reviewed for other categories, representing:
  - [redacted] by value of the total loan portfolio; and
  - [redacted] by number. This metric is distorted by the large number of loan balances below $500k.
- The review was weighted based on:
  - The risk inherent in a portfolio (e.g. property, rural);
  - The relativity of a specific loan category to the total loan book.
- Our review aimed to understand:
  - General compliance with credit policy;
  - Credit approval processes;
  - Loan management systems and processes;
  - Liquidity of the loan book; and
  - Potential impairment.

Loan Portfolio

Loan Portfolio - $1,689 million (before provisions)



Loan Portfolio

- Consumer finance book (predominantly personal loans) is comprised of approximately 9,000 borrowers and is generally well managed.
- Plant & Equipment (Face Finance) portfolio is generally originated within credit policy and subsequently well managed.
- Property and Business portfolios are largely illiquid.
- The Property portfolio is significantly impaired.
- Rural portfolio comprises approximately 200 loans, 80% of which are less than $1 million.

Loan Management Systems & Processes

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Loan Origination and Management

- Credit policy is not always complied with, to varying degrees.
- Inappropriate level of analysis of borrowers at origination.
- Lack of covenants and regular monitoring will prevent company from identifying at risk files and taking action to mitigate its position.
- Lack of independent valuation evidence, either at origination or subsequently, is inappropriate.
- No existing risk grading framework, which makes analysis of the loan book (especially for provisioning) extremely difficult.
  - The Company advises that it is in the process of implementing a risk grading framework.

Loan Management Systems & Processes

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Loan Origination and Management (cont.)

- Lack of exit strategies when writing loans compromises liquidity. In many cases there are no realistic exit strategies, particularly for business loans.
- Directors and other related parties appear to have been involved in loan management and lending decisions outside the credit chain although we understand this is being addressed.
  - Loans have been managed directly by Allan Hubbard, including the Southbury loan.
  - The Company advises that this process is progressively ceasing.
- It is important to recognise there are some very good loan managers and the portfolio needs to be reallocated accordingly – this process is underway.

Impairment Considerations

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Current Status

- We have considered management's comments on our specific impairment range.
- We have not yet received the Company's collective provisioning assessment.
- **This overview is preliminary and subject to change.**
  - Collective provisioning remains outstanding.
  - Southbury loan impairment remains outstanding.
  - Auditors' view not yet received.
- Company's additional $58 million provision announced for 30 June 2009 is comprised of:
  - $35 million write-off of Waterfront Fund investment.
  - $23 million additional specific provisions.
- Company's specific loan impairment provisions now total **$44.5 million.**
- We have also identified at-risk loans, being those which do not currently require a provision but which exhibit characteristics that suggest there may be a risk of future loss.

Southbury & Directly Related Loans

- We are awaiting updated financial information for Southbury.
- Southbury directly owes SCF $81 million.
- Further $22 million owing to SCF by shareholders of Southbury, secured over their Southbury shares (Andy Borland, Lachie McLeod, Stuart Nattrass, Ed Sullivan).
- Southbury now essentially has three assets:
  - Helicopters NZ, which is for sale.
  - Scales Corporation (majority shareholder).
  - SCF, to which we ascribe no value for current purposes.
- We believe Southbury's direct loan ($81 million) does not need to be impaired but the loans to shareholders may (on the assumption they do not have assets to make-good any loss – we have no information in this regard).
- The Company has advised that it is analysing recoverability / potential impairment of the Southbury shareholder loans.

Impairment Considerations

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Specific Impairment – Preliminary Review

$ millions	Total Book	Specific Impairment Coy	[3]
Business	$555m	$5m	
Property	$542m	$30m	
Rural	$153m	$3m	
Southbury	$104m	TBC	
Plant & Equip	$260m	$5m	
Consumer	$76m	$1m	
	$1689m	**$44m**	

– *This impairment is not an IFRS-compliant provision.*

- Company reviewing Southbury potential impairment.
- [3] million is our specific impairment recommendation but SCF disagrees.
- SCF advises its auditors are arriving at a provision above $44 million.
- Expect SCF will adopt a provision above $44 million but below our analysis.
- Impairment is different to liquidity, which is very poor within the Property and Business books.

Impairment Considerations

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At-Risk Loans

- Loans that exhibit characteristics that indicate potential for future default:
  - Second mortgage assets – high risk of significant loss if first mortgagees take action.
  - Repayment dependent on factors outside the company's control.
  - Indication of declining performance.
  - Concerns about value of security but no objective evidence against which to measure impairment.

[3]

Impairment Considerations

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Collective Provisioning

- Not yet discussed with the Company.
- Needs to take account of:
  - Lack of independent valuation evidence and covenants.
  - At risk files identified through file review.
- Absence of risk grading system makes analysis extremely difficult.
- 3% collective provision on unimpaired / not “at-risk” book equals $30 million.
- Key variable is the collective provisioning on the “at-risk” portion of the book, as 3% is likely to be too low (but [3] is likely to be far too high).

[3]

Impairment Considerations

Total Potential Provision

- Extremely sensitive to collective provisioning.
- Ranges cannot be finalised until collective provision assessment is complete.
- Under different scenarios could reach
- On our assumptions, the increase above 30 June 2009 provisioning already announced could range between

- Company is likely to adopt a much lower provision but auditor's position not yet known.

Financial Position – Potential

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- Net Assets / Equity will be significantly reduced.

[3]

- [3] million in net assets is supported by the following for which our review is not yet complete:
  - $9 million deferred tax asset that will have to be removed from the balance sheet if SCF is not profitable.
  - $39 million prepayment into the ICA that we assume is collectible.
  - [3] million as equity in entities owning farming assets [3] [3]
  - [3] million in other assets, primarily distressed properties.

Covenant Compliance

BNZ / CBA Facility

- Default (interest cover) at 30 June 2009.
- Banks extended reporting date to 31 August 2009 to avoid earlier market disclosure.

US Private Placement

- May have been in breach at 31 Dec 2008 but covenants not being reported.
- Breach of financial covenants at 30 June 2009 to be declared 30 August 2009 gives lenders a right of acceleration (majority vote required).
- S&P downgrade only a breach after 90-days.

Trust Deed

- Potential for defaults to arise:
  - Liabilities exceed 12x Shareholders Funds if equity falls below $170 million.
  - USPP is called and not paid within 14 days.
- Company advises Southbury loan was greater than 35% of equity when trust deed signed so it does not have to comply with that Trust Deed covenant.

Company's Plan

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- Advisory board appreciates the seriousness of the Company's position.
  - The business has $1 billion of assets that are non-core / illiquid.
  - The level of provisioning may cause issues with BNZ/CBA, the US Private Placement Noteholders and Standard & Poors.
    - Whether issues arise with the Trustee will depend on the level adopted for the audited accounts.
  - The existing shareholders do not have the capacity to rectify the Company's capital problems.
  - Management and Governance has to be further restructured.
  - There are a range of parties who could cause the business to fail in the very short-term.
- Advisory board is finalising a restructuring strategy using:
  - Cameron & Partners for advice and to negotiate with Government.
  - Deloitte for modelling.
- We have yet to sight anything in writing.

Company's Plan

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Immediate Steps

- $150 million Equity Raising:
  - Company advises negotiating with an Australian fund it cannot yet name.
  - Terms Sheet being negotiated – SCF aiming to finalise this week.
  - Injection to be in three $50 million tranches over 2009 and 2010.
  - Investor to be granted a capital note with a coupon – Tier 1 capital sitting above preference shareholders.
  - Company agrees is inherently conditional on future liquidity issues being addressed (e.g. extension of Government retail deposit guarantee).
  - Conditional on "high-level due diligence", including receipt of our report.

Company's Plan

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- US Private Placement renegotiated to avoid repayment:
  - Company seeking government guarantee through wholesale funding guarantee scheme; or
  - New terms to be negotiated, on a more aggressive amortisation schedule and with an immediate partial principal repayment.
- Trust Deed breaches to be remedied through the Equity raising:
  - Trust Deed permits inclusion in Shareholders Funds calculation of "Underwritten" equity if it is unconditionally payable within three months.
  - Adequacy of the amount and the timing of the injection depends on the level of provisioning.
- Governance to be restructured.
  - Investor to appoint directors and have a say in management structures / personnel decisions.
- Standby bank facilities to be necessarily secured.

Company's Plan

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Longer-Term Steps

- Systems and processes to be restructured:
  - Company acknowledges inadequacies that have led to illiquid or poorly performing assets.
- Management to be restructured.
- Balance sheet to be restructured:
  - Other Assets to be sold down.
  - Related party loans to be repaid over extended period.
  - Illiquid loans to be sold / assigned.
- Further capital ultimately raised to stabilise Company's balance sheet.
- Key issue will be whether immediate steps are sufficient to provide space for the Company to achieve its plan.

Liquidity

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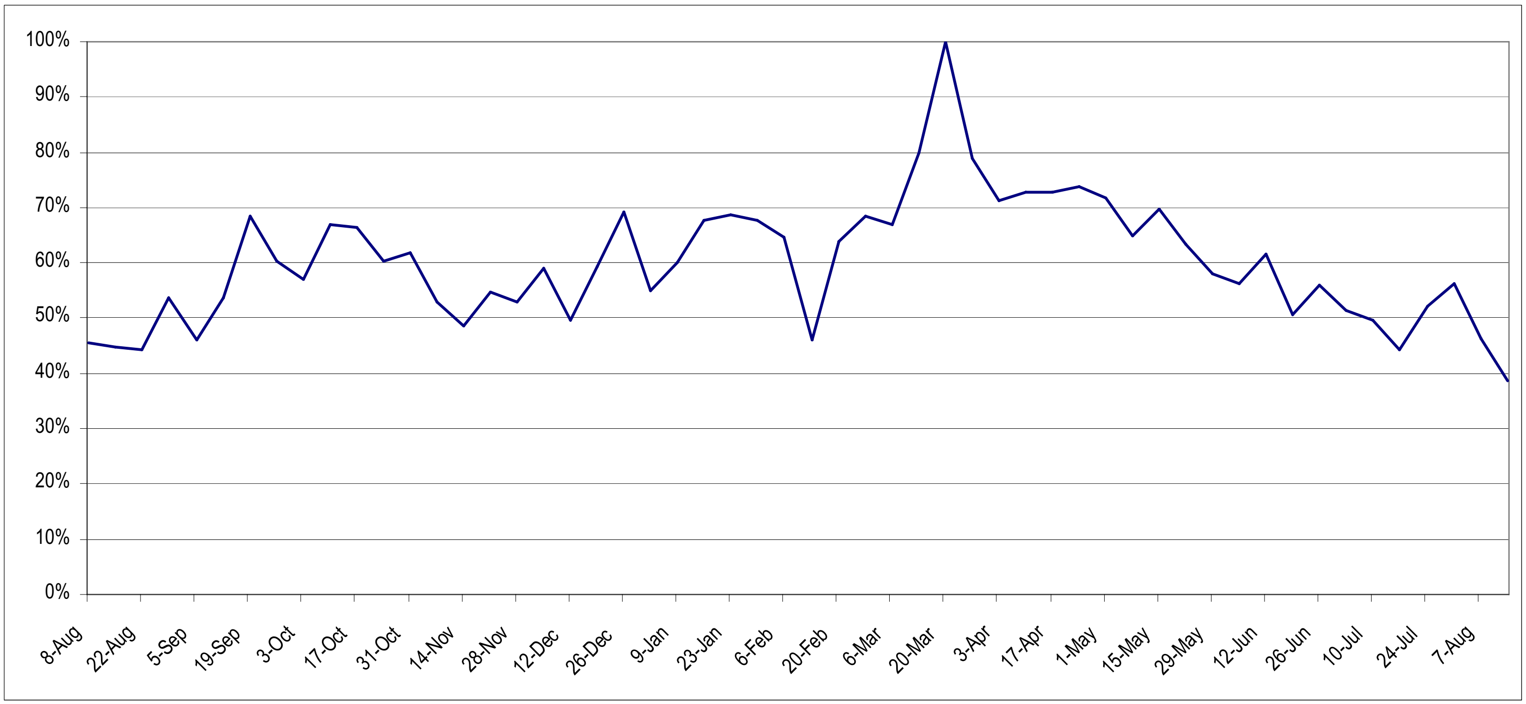
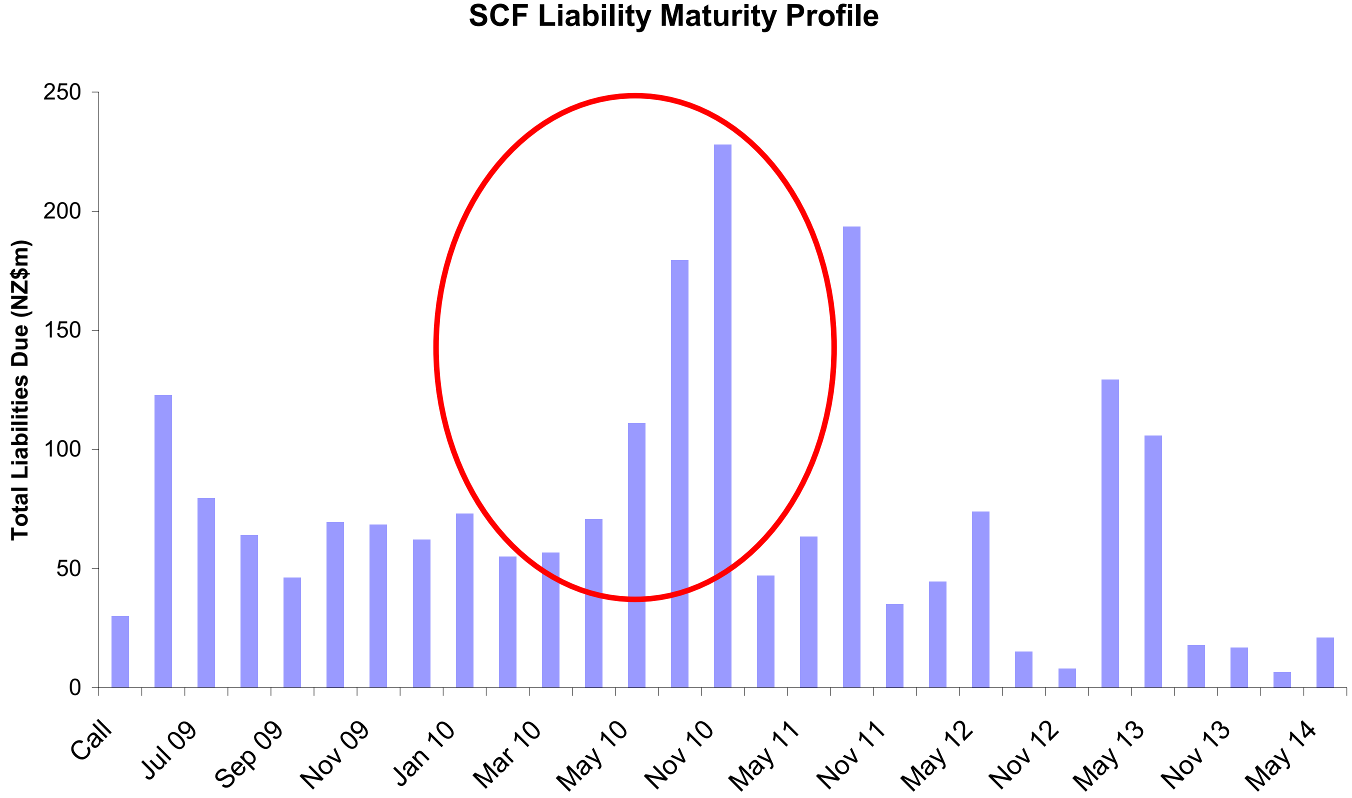
- Company's cash on hand remains around $80 million.
- Reinvestment rate has been around 40% to 50% since June but has been steadily reducing over recent weeks:



Liquidity

- There is a large increase in maturities leading into the expiry of the Crown Guarantee on 12 October 2010:



NB: graph plots quarterly repayments so guarantee expiry plotted in Nov-10 quarter

Liquidity Issues

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- Company is working on a financial model to test liquidity and profitability under various scenarios, including the proposed capital restructuring.
- We have reviewed drafts that indicate:
  - Status-quo is not sustainable past early 2010.
  - Sale of “other assets” alone will not support liquidity through 2010.
    - Asset sale strategy will necessarily run into the medium-term.
  - Equity injection will need to be greater than $150 million to create long-term stability.
- An immediate liquidity crisis will arise is the US PP noteholders call for repayment (NZ$125 million).
- SCF has placed $10 million on trust for depositors who have invested since last Monday (10 August 2009). SCF will potentially have to continue placing funds on trust until the Companies Office approves a new prospectus.

Crown Guarantee

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- The Company estimates that $1,841 million owing to 38,096 investors is covered by the guarantee, if it were to default within the guarantee period:

Product ($ million at 8 July 2009)	No of Investments	No of Individual Investors	Gross Investment
Secured Debenture Stock	45,838	30,908	1,549
Unsecured Deposits	1,178	1,017	30
2010 Bonds		`	100
2011 Bonds		3,031	125
2012 Bonds		3,140	125
less Investments >$1m			(52)
less Non-Resident Deposits			(33)
less Related Party Deposits			(3)
Total Potential Crown Gtee Exposure		**38,096**	**1,841**

Timing Considerations

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Our Next Steps to Complete Report – 14 days

- Review liquidity projections and monitor liquidity daily.
- **Week ending 28 August 2009** understand the audited position on:
  - Specific provisioning;
  - Collective provisioning; and
  - Carrying value of Other Assets and Southbury-related loans.
- Receive indicative terms sheet for equity placement.
- Receive report prepared by Cameron & Partners and Advisory Board summarising restructuring proposal, including short-term and long-term objectives.
- Review final financial projections: liquidity; profitability; and, capital structure.
- Final report **28 August 2009.**

Timing Considerations

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- Timing is now critical.
- **28 August 2009** SCF must advise the market of its 30 June 2009 result, which will reveal:
  - Significant loss. Loss will be higher than preliminary announcement.
  - Breach of banking covenants.
  - Breach of US Private Placement covenants.
- SCF believes it will comply with its Trust Deed – we need to understand how.
- Company will also announce it is negotiating with:
  - Investor as part of a fresh capital raising;
  - BNZ in relation to the breaches of its Standby lines; and
  - US PP to secure a waiver / fresh terms.
- **Mid-September 2009** SCF is aiming to have secured fresh capital.

Key Stakeholders

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- A number of parties need to be managed through this process:
  - Regulatory Authorities:
    - MED / Companies Office.
    - Securities Commission.
    - NZX.
  - Treasury.
  - Reserve Bank.
  - Trustee.
  - US Private Placement Noteholders.
- Standard & Poors are less relevant to the outcome, other than potential for negative press around further downgrades.

The Critical Issue

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- SCF accepts that a significant equity injection (proposed $150 million) and governance and management restructuring are the only solution to any go forward.
- We have yet to see anything in writing or be advised as to identity of the prospective investor.
- Our comments/concerns are:
  - The need for cash injection is immediate and hence it is disappointing this process has been started very late.
  - We have real concerns that $150 million may not be enough.
  - The loan book has a liquidity lockup and the business lacks projected 2010 profitability. Our report will raise issues rather than being an endorsement for the investment.
- The next predetermined waypoint will be 28 August 2009 when the 30 June 2009 results are released. This will elevate publicity already heightened by the S&P downgrade, and potential for US PP reaction.
- Breaches of the Trust Deed and US PP arrangements may now be unavoidable.
- We understand that the Company's current strategy will be to advise at the time of releasing its accounts that its recapitalisation plan will be advised early/mid September.