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Research Update:

South Canterbury Finance Ltd. 'BB+' Rating Removed From CreditWatch Negative And Affirmed; Outlook Negative

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Research Update:

South Canterbury Finance Ltd. 'BB+' Rating Removed From CreditWatch Negative And Affirmed; Outlook Negative

Overview

- We have affirmed the 'BB+' rating on South Canterbury Finance Ltd. (SCF), and removed it from CreditWatch Negative, where it was initially placed on Sept. 20, 2009.
- In our view, the negative pressures that we indicated in our previous CreditWatch Negative rating action have partially ameliorated.
- The outlook is negative reflecting near-term pressures on SCF's financial profile, principally liquidity, asset quality, and governance issues, and medium-term uncertainty concerning restructuring and recapitalization initiatives.

Rating Action

On Dec. 24, 2009, Standard & Poor's Ratings Services affirmed its 'BB+' long-term rating on New Zealand finance company, South Canterbury Finance Ltd. (SCF). At the same time, the rating was removed from CreditWatch Negative, where it was initially placed on Sept. 20, 2009. The outlook is negative.

Rationale

The rating affirmation reflects SCF's success in ameliorating specific concerns raised when we placed the rating on CreditWatch negative. Specifically:

- SCF has been able to again access the debenture-investor market with an average retention rate of about 50%, and new debenture inflows of about NZ$8 million per week;
- Its audited financial statements for fiscal 2009 have revealed nothing of concern;
- It has sourced three new independent directors to assist in the management of the company; and
- It has been able to retain the confidence of its new private placement investors as well as its debenture investors.

That said, SCF's financial profile--particularly liquidity and asset quality--is weak at the current rating level. Because SCF had no debenture prospectus in the public domain for longer than six weeks, its liquidity position has weakened. Also, SCF no longer has access to its banking facility, which also undermines its liquidity position. Our rating also factors in the ongoing pressure of negative asset quality trends, which on further deterioration could increase lending losses. Additionally, SCF is in the early stages of formally addressing matters concerning related party investments. These pressures--against a backdrop of a nascent restructuring and recapitalization initiative--cause us uncertainty in the near and medium term. To contend with negative pressures on its financial strength, SCF is taking remedial steps, which, if successful, will probably ameliorate our concerns. SCF is looking to steadily rebuild its internal cash position. Further, it is looking to source an alternative liquidity provider, which will materially lessen uncertainty associated with cash flow planning prior to its recapitalization, which is planned for April 2010.

SCF is also evaluating strategic options, including a more urgent and assertive approach to reducing nonperforming assets, related-party investments, and noncore assets.

Outlook

The negative outlook reflects immediate pressures on SCF's financial profile and medium-term uncertainty concerning restructuring and recapitalization initiatives. Negative rating pressures are not likely to ease until SCF can address liquidity, asset quality, and governance concerns, including related-party investments.

In our view, any recapitalization plans favoring debt rather than equity, or involving a complex reorganization of business units within the Southbury Group (unrated), that may weaken the interests of SCF debenture or other liability holders will likely trouble the rating.

Standard & Poor's immediate concern is that SCF maintain higher liquidity leading up to its recapitalization plans, planned for April 2010. Failure to do so is likely to lead to the company being downgraded.

An equally important but slightly less urgent concern is that SCF's restructuring and recapitalization initiatives restore financial strength to a level that we believe is consistent and sustainable at the current rating level. Failure to do so is likely to lead the finance company being downgraded.

Standard & Poor's expects the negative outlook to be resolved if:

- Liquidity pressures moderate such that SCF is able to permanently maintain a liquidity level that would support its daily operations, while leaving sufficient excess cash to manage potential volatility given the confluence of negative developments affecting SCF; and, more generally, the continuing difficult market for New Zealand nonbank deposit takers.
- SCF is able to manage its credit loss experience within our expectations of the 'BB' rating category.
- SCF is able to eliminate related party investments.
- It is able to successfully restructure its business such that it does not weaken the interests of its debenture or other liability holders; and
- It is able to recapitalize to a level that we believe is consistent with the 'BB+' rating level.

Related Research

This article is based in part on the following criteria articles:
Rating Finance Companies, published on March 18, 2004.
Credit Policy Update: Criteria On Use Of CreditWatch And Outlooks Clarified, published on Sept. 30, 2005.

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
South Canterbury Finance Ltd.		
Counterparty Credit Rating	BB+/Negative/B	BB+/Watch Neg/B
South Canterbury Finance Ltd.		
Senior Secured (3 issues)	BB+	BB+/Watch Neg

Complete ratings information is available to RatingsDirect on the Global Credit Portal subscribers at www.globalcreditportal.com and RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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Press Release

'BB+' Rating On South Canterbury Finance Removed From CreditWatch Negative And Affirmed; Outlook Negative

Melbourne (Standard & Poor's) Dec. 24, 2009—Standard & Poor's Ratings Services said today that it had affirmed its 'BB+' long-term and 'B' short-term counterparty credit ratings on South Canterbury Finance Ltd. (SCF). At the same time, the 'BB+' rating was removed from CreditWatch Negative, where it was initially placed on Sept. 20, 2009. The outlook is negative.

"The rating affirmation reflects SCF's success in ameliorating specific concerns raised when we placed the rating on CreditWatch Negative," Standard & Poor's credit analyst Derryl D'silva said. Specifically, SCF has been able to again access the debenture-investor market; it has sourced three new independent directors to assist in the management of the company; it has been able to retain the confidence of its new private placement investors as well as its debenture investors; and its audited financial statements for fiscal 2009 have revealed nothing of concern.

That said, SCF's financial profile—particularly liquidity and asset quality—is weak at the current rating level. With no debenture prospectus in the public domain for longer than six weeks, and no access to a banking facility, SCF's liquidity position has weakened. Our rating also factors in the ongoing pressure of negative asset quality trends, which, on further deterioration, could increase lending losses. Additionally, SCF is in the early stages of formally addressing matters concerning related-party investments. These pressures, against a backdrop of a nascent restructuring and recapitalization initiative, give us cause for uncertainty in the near and medium term.

To contend with these negative pressures, SCF is taking remedial steps, which, if successful, will probably ameliorate our concerns. SCF is looking to steadily rebuild its internal cash position. Further, it is looking to source an alternative liquidity provider, and is also evaluating strategic options, including a more urgent and assertive approach in reducing nonperforming assets, and related party investments, and noncore assets.

"The negative outlook reflects immediate pressures on SCF's financial profile, principally liquidity, asset quality, and governance issues, and medium-term uncertainty concerning restructuring and recapitalization initiatives," said Mr. D'silva.

Our immediate concern is that SCF maintain higher liquidity, leading up to its recapitalization plans; its failure to do so would likely to lead to the company being downgraded. An equally important but slightly less urgent concern is that SCF's restructuring and recapitalization initiatives restore financial strength to a level that we believe is consistent and sustainable at the current rating level. Failure to do this would likely to lead the finance company being downgraded.

Conversely, negative pressure will abate if SCF is able to moderate liquidity pressures, manage its credit loss experience, eliminate related party investments, and successfully restructure and recapitalize the business to a level that is consistent with the 'BB+' rating level.

About Standard & Poor's

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