

BELL GULLY

Trustees Executors Limited
Maritime Tower
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Attention Mr Yogesh Mody

FROM **Hugh Kettle**
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South Canterbury Finance - request for waivers

We act for South Canterbury Finance Limited (the **Company**) which is party to a debenture trust deed, with Trustees Executors Limited, dated 30 June 1995 (the **Trust Deed**).

Capitalised terms used in this letter have the same meanings given to those terms in the Trust Deed, and references to clauses are to clauses in the Trust Deed.

The Company has asked us to write to you to request a waiver of certain anticipated covenant breaches under the Trust Deed, as set out in more detail below.

Relevant background information

The Company is to announce its preliminary results for the half-year period ended 31 December 2009 on Monday 1 March 2010. The Company is required to provide a covenant compliance certificate to the Trustee on the same date.

The Company has been carefully and thoroughly reviewing its loan portfolio and considering the appropriate level of impairment to apply. Since the last audit, the Company has appointed three new independent directors and has an entirely new senior management team. The Company also has new auditors with Ernst & Young appointed in October 2009.

In the wider economy, further deterioration in the property market throughout 2009 and into this year, combined with asset illiquidity and a constrained financing market generally, have had a further impact on asset values.

While the relevant financial statements are still being finalised, the Company and the board anticipate that the required level of impairment is likely to result in certain of the financial covenants in the Trust Deed not being met as at 1 March. As mentioned in our meeting on 24 February, the increased impairment is largely connected with the Company's property loan portfolio, while its other loan portfolios (business, plant and equipment, consumer and rural) are much less affected.

As at today's date, the level of impairment in the Company's 31 December 2009 financial statements is expected to increase by \$178.5m from the level recorded in its 30 June 2009 financial statements on an unaudited pre-tax basis.

Proposed Recapitalisation

Due to the continued support of Mr Hubbard and his associated companies outside the Charging Group, the Company has arranged two transactions that minimise the impact, in respect of the financial covenants set out in the Trust Deed, of the increased impairment.

The proposed transactions are as follows:

1. The acquisition by the Company of 100% of the ordinary shares in Helicopters (N.Z.) Limited (**HNZ**) from Southbury Corporation Limited. The purchase price for the HNZ shares is \$90,000,000.
2. The acquisition by the Company of 64% of the ordinary shares in Scales Corporation Limited (**Scales**) from Southbury Corporation Limited. The purchase price for the Scales shares is \$72,250,000.

The combined purchase prices represent a total transaction value of \$162,250,000 which is to be met by the Company issuing new ordinary shares, with a value of \$136,650,000, and paying cash of \$25,600,000 to Southbury Corporation Limited.

In each case the transactions are 'related party transactions' for the purposes of the Crown retail deposit guarantee and the Company is required to submit an independent expert opinion to the Crown confirming the fairness of the transaction. They have each been reviewed by approved independent experts – Simmons Corporate Finance and Northington Partners with respect to HNZ and Scales respectively. The opinions confirm that the transactions are in a fair value range and on arms' length terms for the purposes of the retail deposit guarantee.

Scales will not be wholly owned by the Company, and accordingly will not be required to become a Charging Subsidiary. The Company intends to acquire 100% of the shares in HNZ if the Trustee agrees to provide a waiver, under clause 13.3, allowing HNZ to remain a Non-Charging Subsidiary. As required by clause 13.3, 2 directors of the Company will provide a certificate that there are sound commercial reasons why HNZ should not become a Charging Subsidiary. As the trustee is aware, HNZ has a wide range of secured asset finance transactions (on an asset-by-asset basis) and wishes to continue to operate on this basis. Entry into the Charging Group would complicate or prejudice HNZ's ability to continue to fund itself in this way. In addition, it is likely HNZ will be on-sold in the short to medium term and retaining the existing standalone financing structure would maximise HNZ's value.

This waiver would need to remain in place for as long as HNZ continues to be a subsidiary of the Company. If the Trustee is unable to give this waiver, Southbury Corporation will retain a single share in HNZ so it does not become a wholly owned subsidiary of the Company.

Under the structure set out above, the Trust Deed will create a security interest over the shares in, but not the assets of, HNZ and Scales. For the purposes of the Trust Deed, the shares in HNZ and Scales will be treated as equity investments of the Charging Group.

The net impact of these transactions is to increase the Company's equity by \$136,650,000. While this is clearly and materially beneficial for the Company, and offsets the capital erosion to arise from the increased impairments, breaches of the financial covenants are still anticipated as set out below.

Performance against financial covenants and anticipated breaches

The Company is now close to finalising its 31 December 2009 semi-annual results. It is also close to finalising the recapitalisation transactions specified above. As discussed the most relevant financial information is the current financial position of the Company, factoring in the proposed 28 February 2010 transactions.

The compliance certificate to be provided on 1 March 2010 will be based on the estimated 28 February 2010 management accounts, which include the transactions referred to above.

The covenant position as at 28 February 2010 is estimated as follows:

	<u>28-Feb</u>
11.1 Prior Charges/TTA (max 7.5%)	4.4%
16.1(a) Equity securities/total s/h funds (max 100% of s/h funds)	126.1%
16.1(b) Total liabilities/total s/h funds (max 12x)	8.1x
16.1(c) Debt securities & prior charges/weighted assets (maximum 1.0x)	1.008x
16.1(d) Single Group exposure	54.9%
16.1(e) Total contingent liabilities/s/h funds (max 150% of s/h funds)	31.5%

Note that the ratio in clause 16.1(c) corresponds to a margin deficit of \$14.5 million.

Based on the covenant position set out above, the Company seeks the waivers set out below.

Requests for waiver

The Company requests that the Trustee permanently waives, under clause 26.1, the anticipated breaches of clauses 16.1(a) and 16.1(d) as at 1 March 2010.

The Company requests that the Trustee waives, under clause 26.1, the anticipated breach of clause 16.1(c) for the period from 1 March 2010 until 31 March 2010.

For completeness the Company also requests that any breach of the financial covenants set out in clause 16 that subsisted between 31 December 2009 and 1 March 2010 be waived. The Company does not intend to report separately to the Trustee on the 31 December 2009 covenants, unless requested to.

The Company also requests that it be permitted to prepare the compliance certificate provided along with the audited 31 December 2009 financial statements on a like for like basis with the current certificate.

While the waiver of clauses 16.1(a) and 16.1(d) would be permanent, it would not apply to subsequent financial periods (for example, unless a further waiver was granted, the Company would need to comply with the covenants as set out in the Trust Deed when providing the compliance certificate for its 30 June 2010 full year results).

The Company's view is that the acquisitions of shares referred to above comply with clause 17.2(b) (Purchase of Assets) as they are being purchased for not more than a proper value. This is supported by the independent experts' assessments of the transactions. The Company is also of the view that ownership of the HNZ and Scales shares would not breach clause 17.2(c) – the principal business of the Charging Group will continue to be that of a financial intermediary.

In addition, the Company is seeking the Trustee's consent for HNZ to remain outside the Charging Group, as detailed above.

Future intentions

The Company has a number of options available to it to achieve additional recapitalisation. It is in discussions with a number of third parties with a range of investment proposals, although the key trigger to taking the matters described in this letter to the next stage is the completion of the Company's 31 December 2010 audited financial statements.

In the short to medium term, the Company will be seeking to remedy the covenant breaches described in this letter. The disposal of its stake in HNZ would effectively achieve this.

The Company is developing a sustainable business model based around a sound and focussed finance company operation. This will require a focus on the forthcoming NBDT prudential regulation and, in all likelihood, the disposal or separation of assets that do not suit the NBDT regime.

It is equally focussed on liquidity, and (subject to the Trustee's consent) intends to register a memorandum of amendments to its prospectus, on 1 March, which will disclose the relevant matters set out in this letter. Liquidity is currently solid and improving, and has allowed the Company to fully prepay its USPP holders, on a voluntary basis, ahead of schedule. This is an extremely positive development given the background and difficulties of that matter.

The extended Crown retail deposit guarantee remains a vital part of the Company's near-term liquidity strategy and, while the Company has not yet been accepted into the extended guarantee, Treasury has been kept updated as to its position and there has been a number of constructive discussions. Treasury has not raised any 'roadblocks' to the issue of the extended guarantee and

await completion of the matters addressed in this letter in order to process the Company's application.

Timing

Timing is critical given the compliance and reporting obligations that arise on 1 March. It is equally important that a memorandum of amendments to the prospectus is able to be registered that day to ensure the Company can continue to allot debenture stock. The Company will continue to do all that it can to maintain investor confidence and positive sentiment, especially given the negative results that will be reported on 1 March 2010.

On this basis we ask that the requested waivers be granted, and the memorandum of amendments be approved, by no later than 28 February 2010.

Mr Hubbard has asked that we pass on our appreciation to the Trustee for its continued support of the Company and its plans. There have been many significant changes in the Company in recent months, combining the necessary steps to ensure ongoing Trust Deed compliance with the necessary wider reforms and restructuring of the Company to ensure a longer-term restoration of value and reputation strategy can be realised. Mr Hubbard has taken very substantial steps personally to ensure the Company has avoided default and failure and these transactions are a significant feature of this.

We and the Company are available to discuss the matters set out in this letter as required.

Yours faithfully

Bell Gully



Hugh C. Kettle
Partner