

Receivers' first report on the state of affairs of Capital + Merchant Finance
Limited (In Receivership)

Pursuant to Section 23 of the Receiverships Act 1993

Company Number 1180423

Grant Thornton 

31 January 2008

Registrar of Companies
Companies Office
Private Bag 92061
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Auckland

CAPITAL + MERCHANT FINANCE LIMITED (IN RECEIVERSHIP)

Attached is our first report in relation to Capital + Merchant Finance Limited pursuant to Section 23 of the Receiverships Act 1993. A copy of this report has been sent to Fortress Credit Corporation (Australia) II Pty Limited and Perpetual Trust Limited.



R G Simpson
Receiver



I W Downes
Receiver

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Introduction

We, Richard Grant Simpson and Timothy Wilson Downes of Grant Thornton were appointed jointly and severally as receivers and managers of all the assets, property and undertakings of Capital + Merchant Finance Limited ("Capital + Merchant Finance" or "the Company") on 23 November 2007 by Fortress Credit Corporation (Australia) II Pty Limited ("Fortress").

We were appointed under the powers contained within a general security agreement dated 5 October 2006 issued by the Company.

We set out below our first report on the state of the affairs of the Company as required by section 23 of the Receiverships Act 1993.

Grant Graham and Brendan Gibson of Korda Mentha ("the Second Receivers") were appointed receivers on 29 November 2007 by Perpetual Trust Limited ("Perpetual"), under its second ranking security over the Company's assets. Perpetual acts as trustee for some 7,000 debenture holders.

While we have been appointed by the first ranking secured creditor, Fortress, we have been mindful of the need to ensure that all our actions and transactions entered into during our receivership are in the best interests of all of the Company's stakeholders, including the debenture holders.

The property in receivership comprises all of the assets, property and undertakings of the Company, which are now under our control. The assets primarily consist of the following:

- Loans advanced to third parties;
- Advances to related parties;
- Accounts receivable;
- Investment in a subsidiary;
- Prepayments; and
- Recorded taxation assets.

The directors of Capital + Merchant Finance at the date of our appointment were:

Neal Nicholls
Owen Tallentire
Colin Ryan
Robert Sutherland

Wayne Douglas resigned as a Director on 15 February 2007.

Events Leading Up To Our Appointment

In October 2006 Capital + Merchant Finance entered into a term loan facility agreement with Fortress entitling Capital + Merchant Finance to borrow up to 10% of its Total Tangible Assets or \$18 million whichever was the lesser. This facility was renewed and increased to \$22 million on 31 August 2007.

Due to the well publicised failure of a number of finance companies in the New Zealand market in recent times, the new investments and debenture reinvestment rates with Capital + Merchant Finance were adversely impacted. For example, we understand reinvestment rates by its investors fell to 10% – 20% from around 50% a year ago.

A number of the properties for which Capital + Merchant Finance held securities were subject to unsuccessful attempts at sale and had diminishing prospects of realisation at the required values on the open market. As a consequence, as a number of the larger loans expired, Capital + Merchant Finance either rolled over or extended already existing facilities as opposed to the option of taking action to enforce security rights.

As a result of the above factors, the Company faced a short to medium term cash problem.

Capital + Merchant Finance put in place alternative funding facilities to diversify away from being solely reliant on debenture stock funding from the public. This included entering into a

securitisation program with the Diversified Mortgage Trust No 1 Limited ("DMT"), by selling certain loans, obtaining the secured loan facility with Fortress and selling certain loans to a related party, Capital + Merchant Investments Limited ("CMI").

For some months, Capital + Merchant Finance was not making any new advances. In addition, interest due on existing loans was capitalised.

Due, we understand, to concerns regarding the Company and finance industry as a whole, some weeks prior to our appointment Perpetual appointed Korda Mentha (previously Ferrier Hodgson) to undertake a review of the position of Capital + Merchant Finance including a review of the expected weekly cashflow and key loans that were forecast for repayment. A further report on related party loans was undertaken by Korda Mentha in November 2007.

The reports indicated a poor prognosis for cashflows and a concern about the ability of large borrowers to repay.

Prior to our appointment Fortress and Capital + Merchant Finance were in frequent contact regarding Capital + Merchant Finance's compliance with the facility agreement with Fortress.

On 22 November 2007 Fortress issued a notice of demand to Capital + Merchant Finance and on 23 November 2007 Fortress appointed us as receivers.

Events Following Our Appointment

Upon appointment we attended the Company's premises to secure the assets and records. We were refused entry to the premises. An injunction was sought by the directors of the Company to restrain us from taking any further steps until an order of the court was obtained.

A hearing was held on 28 November 2007. Justice Harrison ruled on 29 November 2007 that our receivership could proceed. Perpetual then appointed the Second Receivers.

In his judgement, the Judge commented that on a realistic assessment of its financial position, Capital + Merchant Finance should not have been receiving any public money in recent months.

After the judgement was received, we again attended the Company's premises to secure the assets and records, prior to investigating the most appropriate method of asset realisation. Our actions in this regard have included:

- Securing the key assets, including downloading and securing all back up computer software.
- Confirmation of the security in place in respect of the individual loan assets.
- Undertaking an initial investigation into the affairs of the Company.
- Review of the mortgage indemnity insurance policy held by the Company.

Immediately following our appointment we restructured the management of the Company. We terminated the \$250,000 per month management agreement with Capital + Merchant Group Limited and retained the services of the Chief Financial Officer and one of the Loan Managers. All other accounting functions have been carried out by ourselves since our appointment.

Particulars Of Assets And Liabilities

The table below summarises the reported financial position of Capital + Merchant Finance as at 23 November 2007, based on un-audited management information. The position, set out in the table below, shows positive net assets of approximately \$10 million.

Having reviewed the position, it is our view that the net asset figure should be negative.

Capital + Merchant Finance Limited Draft Management Accounts Unaudited	As at 23 November 2007 \$000's
Cash at Bank	337
GST Refund	173
Accounts Receivable	1,997
Loans and Advances	182,597
Accrued Interest	1,364
Other Investments	4,996
Subsidiaries	8,290
Total Assets	199,754
Accounts Payable	1,610
Fortress	20,550
Secured Debentures	167,052
Taxation	196
Total Liabilities	189,408
Net Assets	10,346

The key elements of the assets and liabilities are discussed below.

Loans and Advances (\$182.597m)

The Company's major asset is the loans and advances, which consists of 55 loans with a total book value of \$182.597 million.

The majority of the loans are for property development projects in various stages of completion. Interest is accruing and is capitalising on most of the loan balances.

The table below summarises the priority position of the loans, including the number with first, second or third ranking mortgages, or other securities.

Loan Book	Number of Loans	\$000's
1st Mortgage	1	1,487
2nd/3rd Mortgage	8	48,260
Business Loans	7	13,079
Related Party Loans	6	37,631
Due from Subsidiary	1	3,949
DMT	15	12,482
CMI	17	65,708
Total	55	182,597

An initial review of the loans and advances shows that under - recovery provisions appear to be understated in the Company's financial records.

Business Loans (\$13.079m)

Of the seven business loans totalling \$13.079 million, one borrower is in receivership and another is in liquidation. The amounts due by these borrowers is \$3.375 million.

Related Party Loans (\$37.631m)

There were six related party loans totalling \$37.631 million. The borrowing companies are apparently controlled by either Messrs Tallentire, or Douglas, or Nicholls.

Due from Subsidiary (\$3.949m)

Capital + Merchant Finance is owed \$3.949 million by Numeria Leasing Limited, a subsidiary of the Company.

DMT (\$12.482m)

DMT loans of \$12.482 million relate to Capital + Merchant Finance's participatory interests in loans sold to DMT from May 2006.

Perpetual holds mortgages over security in trust for DMT and Capital + Merchant Finance. Capital + Merchant Finance holds a security position secondary to DMT.

As Capital + Merchant Finance holds a secondary security position to DMT, realisation of the loans will be dependant on the respective realisations by DMT.

We are in discussions with, and are involved in the loan realisation process where applicable with DMT on all the loans, and the respective realisations that may be achieved.

CMI (\$65.708m)

We were also appointed receivers of CMI by Fortress on 23 November 2007.

CMI loans of \$65.708 million relate to Capital + Merchant Finance's participatory interests in 17 loans with a total value of \$114.380 million sold to CMI.

CMI holds mortgages over the properties involved and Capital + Merchant Finance also is secured.

Although Capital + Merchant Finance stands on its own, its financial position is dependant on the total realisation received by CMI.

Capital + Merchant Finance holds security secondary to CMI's security. This means that Capital + Merchant Finance will only receive money from CMI when CMI has repaid its separate debt of some \$50 million owing to Fortress.

Loan Concentration

The combined Capital + Merchant Finance and CMI loan portfolios have a total concentration of 35% (\$90 million) relating to interests of two borrowers being 19% (\$48.4 million) for one borrower and 16% (\$41.2 million) for the other borrower.

Recovery Strategy

Each loan is being individually analysed by us to determine the appropriate strategy for maximising realisations. Due to commercial and confidentiality reasons we are unable to provide specific details in respect of individual loans.

The options being considered for each loan include, but are not limited to:

- Refinancing by the borrower;
- Consideration of purchase and/or settlement proposals received;
- Partial/full completion of developments with the assistance of the borrower and other financiers.
- Formal recovery action through the rights attached to securities held;
- An orderly sell down by the borrower; and
- Any other options that may improve the realisable value of securities held.

We have engaged a range of consultants, legal advisers and valuers to assist in the assessment of respective realisation options.

Insurance Policies Held

Capital + Merchant Finance holds an insurance policy in respect of certain loans, covering amounts of unrecovered principle. The policy was in respect of 42 of the loans as at the date of receivership.

Due to the substantial affect on the likely recovery, particularly to debenture holders, we have investigated the insurance position. We have not yet confirmed whether or not there is effective cover in place.

We are taking legal and specialist insurance advice on this matter.

In the meantime we have continued to pay the insurance premiums and to comply with the reporting requirements of the insurance policy.

Cash at Bank (\$337k)

The cash at bank held by the Company's banker has been collected.

GST Refund (\$173k)

We are in the process of confirming the details of the GST refund owing. We will submit a claim, if appropriate, to the Inland Revenue Department.

Accounts Receivable (\$1.997m)

Accounts receivable is represented by trade receivables (\$257k) and prepayments and accruals (\$1.740m). We are investigating the recoverability of these.

Accrued Interest (\$1.364m)

This is interest accrued on loans and advances as at the date of the receivership.

Other Investments (\$4.996m)

Other investments include \$4.706 million invested in DMT A, B and C capital notes totalling \$3.206 million and a \$1.5 million security deposit.

The notes and the security deposit are repayable on 31 December 2008.

Investment in Subsidiary (\$8.290m)

This investment is 100 percent of the shares in Numeria Leasing Limited, which were purchased from Numeria Finance Limited in March 2007.

We have removed the Directors of Numeria Leasing Limited and have appointed ourselves as Directors.

We have offered the business and/or shares for sale and we are currently working with a number of potential purchasers.

In the meantime, we are working closely with the management of Numeria Leasing Limited to ensure its efficient operation.

Fortress (\$20.550m)

Fortress is secured by a General Security Agreement dated 5 October 2006 and a Deed of Priority between Capital + Merchant Finance, Perpetual Trust Limited and Fortress dated 5 October 2006.

Based upon the information available, we expect Fortress will be repaid in full.

Secured Debentures (\$167.052m)

Secured debentures comprise:

- Capital Secured Debentures \$90.732 million
- Investment Debentures \$76.320 million

The Capital Secured Debentures are subject to the insurance arrangements referred to earlier in this report.

In addition debenture holders are secured by a Debenture Trust Deed in favour of Perpetual dated 5 April 2002 and amended by a Deed of Modification dated 25 November 2002 and a Deed of Variation dated 19 May 2006. The Trust Deed provides a first ranking security (subject to a Deed of Priority to Fortress) to Perpetual as trustee representing the interests of all the secured debenture investors.

There are approximately 7,000 individual investors.

Estimated Return to Secured Debenture Holders

Realisations from the assets depend on certain events occurring. The outcomes from various events could materially affect the amount Capital + Merchant Finance receives.

It is clear from our work, however, that there will not be a full recovery to secured debenture holders.

Our initial estimate is that secured debenture holders may recover up to 59% of their investment over time.

We detail our estimate below:

Capital + Merchant Finance Estimated Realisation	As at 23 Nov 2007 \$000's	Realisation Low High \$000's \$000's	
Cash at Bank	337	337	337
GST Refund	173	-	173
Accounts Receivable	1,997	-	1,000
Loans and Advances	182,597	43,662	113,017
Accrued Interest	1,364	-	-
Other Investments	4,996	-	4,706
Subsidiary	8,290	see note 1 below	
Total Assets	199,754	43,999	119,233
Less Fortress	20,550	20,550	20,550
Available for Secured debenture holders	179,204	23,449	98,683
Secured Debentures	167,052	167,052	167,052
Surplus/(Shortfall) to Secured Debenture Holders	12,152	(143,603)	(68,369)
Estimated Percentage Return to Secured Debenture Holders		14%	59%

Note 1

Our estimated realisation does not include an estimate for the sale of the subsidiary as an estimate by us at this stage may influence the value of any offers.

Effect of Insurance Policy

We have not provided for any recovery from the insurance policy in the above estimate.

Future Costs and Revenues

Interest will continue to accrue on both loans and advances and amounts due to secured creditors. In addition the estimated realisation figures are subject to costs.

Preferential Creditors

We are liaising with the Inland Revenue Department to establish the extent of any preferential claims. The information we have to date indicates that no amounts are owing for GST or PAYE.

No amounts were owing to employees at the date of our appointment as the Company did not employ staff.

Unsecured Creditors

Based on the information we have, it appears that no funds will be available to meet the claims of unsecured creditors.

Other Information

All records of the Company held at its premises were secured by us and a full back up of computer records was obtained immediately following our appointment.

We are aware of concerns raised by investors and other parties in respect of certain activities of the Company and certain parties, prior to the receivership. As a result we are investigating the circumstances in respect of the following:

- Specific transactions entered into by the Company prior to our appointment;
- The activities and conduct of the Company, the officers of the Company and third parties leading up to the appointment of Receivers;
- Any other matters that come to our attention.

Due to the potential legal consequences and the nature of these investigations, we are unable to provide details regarding these issues or our findings to date.

Any investigations by us in relation to these issues will be carried out with due regard to an assessment by our legal advisors regarding the circumstances and the potential remedies available.

Appendix 1

Restrictions

All information contained in this report is provided in accordance with Section 23 of the Receiverships Act 1993.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon by us is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

We have not independently verified the accuracy of the information provided to us, and have not conducted any form of audit in respect of the company. We express no opinion on the reliability, accuracy or completeness of the information provided to us and upon which we have relied. Whilst all care and attention has been taken in compiling this report, we do not accept any liability whatsoever arising from this report.

The statements and opinions expressed in this report are based on information available and assumptions made as at the date of this report. It is possible that actual outcomes may be significantly different from those disclosed in this report.

We reserve the right, but will be under no obligation, to review or amend our report, as additional information becomes available.

In addition the following should be noted:

- Certain values included in tables in this report have been rounded and therefore may not add exactly.
- All amounts are stated in New Zealand dollars.

Appendix 2

Directory

CMI:	Capital + Merchant Investments Limited (In Receivership)
DMT:	Diversified Mortgage Trust No 1 Limited
Fortress:	Fortress Credit Corporation (Australia) II Pty Limited Level 43, 50 Bridge Street, Sydney, NSW 2000, Australia
Perpetual:	Perpetual Trust Limited Level 1 Pyne Gould Corporation Building, 233 Cambridge Terrace, Christchurch
Receivers:	Richard Simpson and Timothy Downes of Grant Thornton
Second Receivers:	Grant Graham and Brendan Gibson of Korda Mentha