

# Sixth Statutory Managers' Report

Aorangi Securities Limited

4 March 2011

# Introduction

## History

On 20 June 2010, Richard Grant Simpson and Trevor Francis Thornton were appointed statutory managers of Aorangi Securities Limited (“Aorangi”). Graeme Carson McGlenn was appointed as an additional statutory manager on 13 September 2010.

## Purpose of this report

This sixth report has been prepared to provide an update for investors on the status of their investments in Aorangi. Copies of our previous reports are available on our website [www.granthornton.co.nz](http://www.granthornton.co.nz) along with some answers to frequently asked questions. As this is an update report readers may need to review previous reports to gain contextual information.

This report is specifically addressed to Aorangi investors. Previously our reports have been combined with a report to investors in the Hubbard Management Funds. A separate report has been provided to those investors. This separate method of reporting is in order to better respond to feedback and requests we have received.

In exercising our role as statutory managers, we recognise the need to protect the interests of the shareholders, creditors and beneficiaries of Aorangi, resolve the difficulties that have been encountered and preserve, as far as possible, the business interests and investments of Aorangi, HMF and Mr and Mrs Hubbard.

## References

In this report, we refer to a number of entities. Aorangi received money from investors and has applied the money to a combination of independent parties and entities associated with Mr and Mrs Hubbard. One charitable trust, Te Tua Charitable Trust (“Te Tua”) has provided interest free loans to a range of business people. Mr Hubbard has pledged approximately \$24 million of Te Tua assets to Aorangi.

# Aorangi loans and investments

## Introduction

The orderly process of realising the loans and investments continues. We have discussed the realisation process with Mr Hubbard who has indicated that the assets could be realised over a 3-4 year period. In many instances the loans and investments are non-performing and require intensive management to be in a position to realise. We have commented on some of those situations in previous reports and provide more detail on specific situations later in this report.

## Aorangi loans

The loan book comprises a wide variety of assets including farms, commercial property, forestry, infrastructure, personal and business loans. As noted above most of the loans are non-performing and in many cases interest has never been paid.

We continue to collate information on the loans. This information was incomplete at the time of our appointment. This includes acquiring and reviewing copies of loan and mortgage documentation, financial records, business plans, certificates of title etc. In each case we have undertaken an assessment of the potential collectability of the loan.

Proactive steps continue to collect the loans. Because of the long-standing support given to many borrowers over the years by Mr Hubbard (and indirectly the Aorangi investors), we have been asking borrowers for early repayment of their loans. We consider some borrowers are able to repay their loans earlier than required and it would be of great benefit to the investors in Aorangi if they did. We regret to report that such requests have to date been unsuccessful.

In certain circumstances we have issued formal demand for repayment, issued Property Law Act notices or have entered into repayment arrangements with borrowers for collection over a period of time.

In some instances agents have been appointed to oversee the sale of underlying security held. This sale process has been completed and sale and purchase documentation agreed and executed for certain assets.

## Interest receivable from Aorangi loans

Of the \$1.272 million in interest due in the December quarter, only one third (\$456,420) had been received by mid February 2011. Almost half of that interest due was from borrowers related to Mr Hubbard, and of the half related to Mr Hubbard, only a third has been paid. These borrowers are for the most part struggling financially and are unable to meet their interest commitments. The total interest arrears are now \$3,900,787. It is of particular concern that only one third of the borrowers associated with Mr Hubbard are meeting their full commitment to Aorangi.

A number of non-Hubbard related borrowers have also not met their interest obligations. It is our view that they have been placed in this situation by borrowing more from Aorangi than they are able to service. Whilst this is unfortunate, the borrower's obligations need to be met to enable investors to receive their entitlement. With the support of Mr Hubbard, legal action has been taken against a number of borrowers to address the non-payment issues.

#### Examples of specific loan issues

We have taken steps to negotiate a potential partial loan repayment with a farming company that owes Aorangi a significant amount of money (42% by value of the Aorangi loans to parties unrelated to Mr Hubbard). In this particular case, Aorangi initially held a first mortgage security which was sufficient to cover the amount outstanding under the loan. Before our appointment, Mr Hubbard agreed that Aorangi would move to the position of second mortgagee to raise cash for Aorangi. This decision has left Aorangi exposed to a potential shortfall in the event of a sale of the property based on current valuations. In settlement of the balance of the loan, it is proposed that Aorangi take a half share in the farm itself. Unfortunately negotiations on this significant loan repayment and investment restructure are being delayed and potentially undermined by a family dispute.

Our focus on targeting loans with interest arrears has been successful. We have one loan where a full repayment of loan and interest arrears amounting to \$1.37 million has been agreed. An agreement for sale and purchase of the property has been entered into for a sale price equivalent to the independent valuation. This further demonstrates that we are continuing to meet the market and that assets are not being sold for fire sale prices. This sale is expected to settle and the proceeds paid to Aorangi shortly.

Three small loans have been repaid with two refinancing at lower interest rates and one is to be repaid in full shortly. These repayments totalled \$132,000. It has been necessary in two cases to remove mortgages held over these properties by South Canterbury Finance Limited ("SCF"). It is understood Mr Hubbard had the intention of selling these mortgages to SCF to raise cash for Aorangi.

A complex recovery and litigation process has commenced on an Aorangi loan that is in excess of one third of the commercial portfolio. This process involves 22 parties being given notice of loan default and the recovery action process. Accompanying this has been the assessment of future land tenure issues, carbon credits and reforestation. The borrower has made numerous commitments to refinance but continues to fail to make the required interest payment of close to \$250,000 each quarter.

Two stalled North Island property development projects owe Aorangi and Mr Hubbard close to \$10 million in total. Overseas funding is being pursued by the borrowers and the result of this world wide search is expected soon. No property sales have been made from these developments for at least 18 months meaning no payments have been made to Aorangi. Interest is accruing but the state of the local property market is such that the full loan value is unlikely to be received. We have assessed the current value of the land less holding and further development costs in our assessment of the Aorangi loan book value.

## Borrowers Payments to date

<b>Loans/Investments</b>	<b>Payments Dec 2010 – mid Feb 2011 \$</b>	<b>Total payments received since 20 June 2010 \$</b>
Mortgages	456,420	1,275,694
Investments	-	25,000
Te Tua Charitable Trust	-	600,000
	<b>456,420</b>	<b>1,900,694</b>

Total interest arrears are now approximately at \$3.9 million. Of these arrears, \$1.785 million is owed by parties related to Mr Hubbard.

## Investments

The investments are predominately stakes in farming equity partnerships (mainly in the dairy sector) and some commercial property investments.

In most cases the relevant companies' constitutions contain a provision for shareholders to have first option to buy shares from each other and a process if they fail to agree on a price for these. In many instances the partners are interested in acquiring Aorangi's/Hubbard's share of the partnership. Where this interest has been expressed, we have reviewed valuations of assets, analysed and reviewed financial information and budgets and forecasts and discussed the business with independent farm advisers. We have then facilitated the exchange of information including valuations of the properties in question to promote the determination of a fair value for the sale of the Aorangi/Hubbard stake. We have held discussions with various partners, received initial proposals and in some instances have prepared and negotiated transaction documentation.

Where appropriate, we have also introduced potential investors to the existing partners to assist in an acquisition of the stake, and have facilitated discussions with bankers and other funders that may assist this process.

In some instances the existing partners do not wish to, or are unable to acquire the Aorangi/Hubbard stake and we have already begun a process for identifying third parties that may wish to acquire the Aorangi/Hubbard interests. This process has included farm visits, receipt of initial proposals and ongoing discussions about price and structure. While Mr Hubbard has stated publicly that these investments are not for sale, for funds to be available to repay investors we believe it is necessary that we progress these discussions and undertake realisations where appropriate.

Some of the farm investments have required an intensive period of restructuring and steps have been taken to establish appropriate governance structures, set up advisory panels, restructure banking arrangements, establish financial reporting regimes and appoint farm advisers.

For the commercial property investments, we have held discussions with the partners in the investments and in one instance tabled a proposal to the partners for discussion. This proposal for the partners to acquire the Aorangi investment has been rejected by the other partners and it is now likely that the relevant property will be marketed for sale.

Aorangi has a substantial equity investment of \$10 million in Southbury Group Limited. The receivers of Southbury Group Limited have indicated that there is unlikely to be any return to Aorangi on that investment.

#### Examples of specific investment issues

Negotiations are continuing in relation to the sale of one of the Aorangi's investments which, if successful, has the potential to realise investors in excess of \$10 million. The other stakeholders in that partnership have conducted a commercial negotiation with us that will realise a return to investors of at least the independently assessed valuation. This valuation is supported by recent farm sales. The sale of this interest will be subject to some form of resolution of a claim from a close associate of Mr Hubbard amounting to approximately \$5 million. This claim is being vigorously disputed by the statutory managers because if it were successful, this person would get a preference over other Aorangi and Hubbard Management Funds investors.

After prolonged negotiations we have achieved a four year arrangement with the other shareholders in another farming company. Agreement has been reached on matters including milking proceeds and future governance of the business. Certainty has been achieved in the banking arrangements, providing a sound business platform to operate from in the future. No financial returns will be available to Aorangi investors in the short term as all profits will be used to reduce the company's debt to the bank. The farm's financial position should however be enhanced through this arrangement, ultimately improving the return to Aorangi investors. We have reserved our right to sell Aorangi's interest in the farm in the event that a sale is considered beneficial to investors.

#### Possible restructure of Aorangi

We are considering the establishment of a farming investment entity that would own some of Aorangi's interests in the various dairy farms. Investors may be able to elect to transfer their investment from Aorangi to this new venture.

There is still more work to be done before we are in a position to seek the views of the investors on any restructuring proposal. We will report further on this aspect in our next report.

#### Costs

In our fourth report to Aorangi investors, we disclosed the costs incurred by the statutory managers, our legal expenses and the costs of external advisers to date. Further costs of \$882,543 GST inclusive to the end of January 2011 have been incurred.

#### Mr Hubbard's promise to make good Aorangi investor losses

The formalisation of this process is in progress. This is being conducted in three parts:

- 1 A global "pledge" by Mr and Mrs Hubbard is to be sent to their solicitors to confirm acceptance and to formalise the promises Mr Hubbard has made.
- 2 The annulment of transfers of shares to Charitable Trusts in conjunction with the other farming shareholders.
- 3 Mr and Mrs Hubbard's interests in various assets are to be transferred to Aorangi for the benefit of investors. These assets have a recorded value in the region of \$50-60 million, and are already included in the Aorangi portfolio.

### Estimated return to investors

We are constantly reviewing the potential realisation of the Aorangi portfolio of investments. Many of the properties have been valued by independent valuers and we are assessing the financial position of the borrowers by examining their latest financial statements.

The amount due to investors is \$96m. The preliminary estimate of the realisable value of the portfolio is in the range of approximately \$87 million to \$97 million. This recovery will be subject to costs relating to the management and realisation of the portfolio. Based on these estimates, investors could suffer a loss and Mr Hubbard would receive no money from Aorangi. No interest would be paid with realisations at this level.

Aorangi Securities Limited – preliminary estimated realisable value as at  
31 January 2011

Loans/Investments as at January 2011	Book value \$	Provision \$	Preliminary Estimated Reliable Value \$ (Note 1)
Third Party	26,024,696	(4,024,696)	22,000,000
Related Party	86,641,126	(29,641,126)	57,000,000
Te Tua Charitable Trust	27,835,773	(16,985,547)	10,850,226
Cash on Hand	2,106,074	-	2,106,074
<b>Total</b>	<b>142,607,669</b>	<b>(50,651,369)</b>	<b>91,956,300</b>

Note 1: This is a mid point of a range of a preliminary estimate of realisable values. Preliminary estimated realisable values are based on information currently available, and are subject to market conditions at the time of sale. Estimates may be affected by more up to date information including asset valuations, additional financial information and security documents

The values in the table above are subject to statutory management and realisation costs and they assume the investments currently recorded in the Mr and Mrs Hubbard's name are effectively transferred to Aorangi. The realisation process could take a number of years.

### Interest rate on deposits

We have previously advised that we will review the interest rate that will be payable should sufficient funds be available to meet the investors' advances. As noted, we believe it will be difficult to recover all the investors' investments, making an interest payment unlikely. Systems have been established to calculate interest if sufficient funds are recovered.

We have determined that a reasonable rate for a call account during the year to 31 March 2011 would be 3%. This is significantly lower than the rate paid to 31 March 2010 but it is a realistic return for funds that were on call. We will review the rate for future periods against market information at the time. A limited number of investors have investment authorities and those that do have acknowledged the interest rate may vary.

### Further payment to Aorangi investors

We are still expecting to be able to make a further distribution of 10 cents per dollar invested by the end of June 2011. This is of course dependent on expected settlements taking place when scheduled.

## Te Tua Charitable Trust

### General Overview

Since our last report, we have continued to make progress in locating and negotiating with borrowers of Te Tua. Mr Hubbard has provided us with assistance where the terms of the loans have not been recorded and the borrower has disputed the position. Any repayment to Aorangi is dependent on the successful recovery of the Te Tua loans.

Our current estimate of the expected recoveries from the loan book of \$8.741 million is an increase from our previous estimate of \$5.884 million contained in our fourth report. The increase reflects the number of borrowers making regular repayments as a result of our efforts and our increased knowledge and understanding of the loan terms.

In consultation with our legal advisers, we are taking action to recover loans where borrowers are overseas and/or where borrowers have not responded to our communications.

The other investments comprise debentures in finance companies that are either in receivership or liquidation. There may be very limited returns on these investments over time, but we have fully provided for their impairment.

Te Tua's assets are described in the table below.

### Assets as at 31 January 2011

<b>Assets</b>	<b>Book Value \$</b>	<b>Provision \$</b>	<b>Net Value \$</b>
Loans	23,473,470	(14,731,590)	8,741,880
Properties	483,806	491,194	975,000
Other investments	2,745,151	(2,745,151)	-
Cash on hand	1,133,346	-	1,133,346
<b>Total</b>	<b>27,835,773</b>	<b>(16,965,547)</b>	<b>10,850,226</b>

Te Tua's loans have been categorised as shown by the following table as at 31 January 2011

## Te Tua loans

## Loan Provisioning as at 31 January 2011

Category of Loans	Loan \$	Provision \$	Net Loan \$
Current and paying	6,764,223	(1,352,845)	5,411,378
Current and paying, but a low repayment	5,889,632	(3,944,816)	1,944,816
Death of a spouse	101,912	-	101,912
Not due for repayment yet	2,646,667	(1,323,334)	1,323,334
Subject to recovery action	280,000	(224,000)	56,000
Non-performing loans under investigation	5,619,060	(5,619,060)	-
Likely to write off	2,264,660	(2,264,660)	-
Minor	2,876	(2,876)	-
Less credits	(95,560)	-	(95,560)
<b>Total</b>	<b>23,473,470</b>	<b>(14,731,590)</b>	<b>8,741,880</b>

## Te Tua loans current and paying

Currently, 36 loans are up to date and the borrowers are making regular repayments.

## Te Tua loans current and paying, but a low repayment

There are five loans in this category, where repayments are being made. However, the repayments are at a low level which will require the loan to be repaid over an extended number of years. We are negotiating increased payments where possible.

## Death of a spouse

One loan is not repayable until the death of the spouse of the borrower. The Trust has full mortgage security but there is obviously no certainty as to when repayment will be received.

## Not due for repayment yet

Two loans have annual repayments that are due to be made later this year. We located another borrower who was able to provide us with copies of the loan documentation, which records loan repayments commencing in April 2011. The Trust has a general security agreement over the company and a registered mortgage over the property.

## Non-performing loans under investigation

There are 26 loans in this category.

We have referred many of these loans to Mr. Hubbard as the terms of the loans advised by the borrower have not been documented by Te Tua. This lack of documentation has meant that this process takes longer to resolve than would otherwise be the case.

Some borrowers have advised us that they are looking at selling property to meet their obligations to Te Tua. However, as Te Tua is generally an unsecured lender, the range of recovery options available to us is limited. We continue to communicate with these borrowers and have placed caveats over property where possible.

Other borrowers have been located overseas and through our legal advisers we have been communicating with these borrowers.

#### Te Tua loans likely to be written off

Two loans relate to a company that has ceased trading and a secured creditor has commenced recovery action against the borrower. Te Tua is, in each case, an unsecured creditor and we understand that even the secured creditor is likely to incur a shortfall.

Similarly, three personal borrowers are unable to meet their obligations to either a secured creditor and/or Inland Revenue. Te Tua is an unsecured creditor in each case.

Mr Hubbard has advised that one loan was settled prior to our appointment and nothing further is payable and the amount of \$605,962 will be written off. .

#### Properties

We are at an advanced stage of negotiating a lease for a property for which rent had not been paid in the 12 years prior to our appointment. We have been receiving a monthly rental payment since our appointment and have nearly reached agreement regarding the unpaid arrears. We are however restricted by the Limitation Act 2010 in only being able to claim for six years of the unpaid rental. The property's roof, however, is no longer safe and we are arranging for it to be replaced.

Te Tua has an interest in other properties and we are looking to sell these.

#### Other investments

The other investments are composed of debentures in finance companies that are either in receivership or liquidation. There may be no or very limited returns on these investments over time and we have fully provided for the estimated losses.

#### Cash on hand

Te Tua's bank account at 31 January 2011 was \$1,133,346.

## Other matters

### Investor liaison

A web page on the Grant Thornton website [www.grantthornton.co.nz](http://www.grantthornton.co.nz) to answer frequently asked questions has been established. This web page also has copies of our past reports.

### Next report on Aorangi

We expect to provide you with a further report by the end of June 2011.

### Disclaimer

The statements and opinions expressed in this report have been made in good faith, and on the basis that all information that we have relied upon is true and accurate in all material respects. In preparing this report we have relied upon, and have not necessarily independently verified, the information and explanations provided to us and we express no opinion as to the accuracy or completeness of that information, other than to note that our investigations are ongoing.

The contents of this report are based on the information available to us at the time we compiled the report. If we become aware of any additional information not known to us at the time we compiled this report, we reserve the right, but shall not be obliged, to review or update this report.



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