



Grant Thornton

Ninth Statutory Managers' Report

Hubbard Management Funds

30 November 2011

Introduction

As you know, Graeme McGlenn, Richard Simpson and Trevor Thornton were appointed statutory managers of Hubbard Churcher Trust Management Limited and Forrester Nominee Company Limited, which hold the majority of assets in Hubbard Management Funds (HMF), in mid 2010.

This report has been prepared to provide an update to investors on the status of their investments in HMF. Copies of our previous reports are available on our website www.grantthornton.co.nz along with answers to frequently asked questions.

As this is an update report, readers may need to review previous reports to gain contextual information.

We have undertaken a significant amount of work to understand the nature of HMF in order to determine the equitable method of distributing HMF's investments to its investors. We have now filed papers in the Court for determination.

We have confirmed that it is necessary to ask the Court to direct us on how each investor's share of HMF should be calculated.

In this report we summarise the work we have undertaken to get to this point and we provide our assessment of your share of HMF.

Key findings

We have undertaken an exhaustive review of HMF in order to obtain an understanding of HMF.

In summary, the key findings of our reconciliation and our other work to date are:

- The total value of the investments as reported on investor statements prepared by Mr Hubbard as at 31 March 2010 is significantly greater than the value of the underlying assets of HMF at that time.
- The portfolio said to be held by an investor at a given time may not have been in fact what was held by HMF on their behalf.
- Transactions reported as having occurred in the periods referred to in investor statements may not have occurred then, or at all.
- The system operated by Mr Hubbard resulted in valuation errors in the investor statements.
- The accounting system and the record-keeping for HMF were such that there was no easy way to align what was owned by HMF with what was allocated to investors.

Issues identified

As a result of the discrepancies revealed in our reconciliation of the fund as at 31 March 2010, we realised that there were considerable problems within HMF and also considerable uncertainty as to the most appropriate way of dealing with the issues that we had discovered. We commenced further work and enquiries in an attempt to resolve these issues, which can be summarised as follows:

- 1 What is the nature of HMF and how was it constituted?
- 2 How, why and when did the apparent shortfall arise?
- 3 What is the most appropriate and equitable method of distribution to each investor?
- 4 When can distribution occur?

Further actions by Statutory Managers

In order to attempt to resolve the above issues we undertook further actions and investigations as follows:

Reconciliations – 2007, 2008, 2009

We carefully reviewed HMF's position to try to find a point in time where investors' holdings as shown on their annual investment statements matched the investments. We found that at 31 March in each of 2007, 2008 and 2009 there were significant variances.

Enquiries of Hubbard Churcher Partners ("HCP")

We made enquiries with various HCP staff who had some involvement with HMF at various times, and also with Mr Hubbard, to gain an understanding of how transactions for HMF were accounted for.

Enquiries made of third parties

We approached sharebrokers and Share Registry companies to confirm HMF's investment holdings.

Engagement of investment advisors

We engaged Hamilton Hindin Greene ("HHG"), a reputable independent firm of investment advisers and sharebrokers, to provide investment advice and assistance in managing the HMF Investment Portfolio.

HHG prepared an analysis of the HMF Investment Portfolio and advised that:

- The portfolio had been constructed on a high risk/high return philosophy and that until we are able to sell certain assets, there is a risk of loss, particularly as the inflow of investor funds had ceased and there were forward commitments in respect of private equity and venture capital funds made by Mr Hubbard.
- Of significant concern is the fact that as at 31 March 2010, almost a quarter of the HMF Investment Portfolio was invested in unlisted entities. We are advised that some of these investments have little or no current realisable value, while others appear to be reasonable investments but are not publicly traded and so are not easily sold.
- Australian-listed investments outside of the ASX200 represent almost a quarter of the portfolio, with one investment in the resources sector accounting for most of this amount.
- A large percentage of the listed portfolio is made up of smaller listed company investments, which may also be difficult to sell, as demand and market liquidity for such shares is limited.

- There are related-party investments in Aorangi Securities Limited, South Canterbury Finance Limited and Southbury Group Limited totalling \$19,575,100. When potential losses are discounted, the estimated cash realisations of these assets amount to approximately \$1,075,100 reflecting a significant shortfall for HMF investors.
- In summary, at the date of our appointment, the portfolio appears to have a focus towards smaller listed companies in the resource sector, and generally it is a higher risk portfolio. It appears to have been assembled on an ad hoc basis and does not appear to have a predetermined guidance structure or asset allocation methodology.

Interim management of portfolio

In consultation with HHG, we developed a strategy for the interim management of HMF pending resolution of the many issues identified. In December 2010, we obtained an Order from the High Court in relation to the interim management of HMF.

Engagement of expert actuaries

After much research into case law on the subject of distribution, we concluded that the state of the records of HMF precluded many of the methods of distribution that have been approved by the Courts in other cases.

Therefore, in July 2011, we engaged Eriksens, Actuaries and Professional Investment Advisors, to assist us with the analysis of HMF and the issues we had identified. They worked in consultation with us to review relevant HMF records and to undertake sampling work with a view to forming a professional view as to the nature of HMF and the appropriate way of resolving the issues.

We worked together with Eriksens to develop our recommendation for HMF and we comment on this subsequently in this report.

Statutory Managers' recommendation to the Court

As previously reported, it was not clear whether HMF is a personalised investment fund or a pooled investment fund. The answer to this has a significant impact on the allocation of the funds to each investor in HMF. To provide everyone with certainty, we consider there is a need for the Court to review the evidence for each of the possible distribution methods and to conclude which distribution method is going to provide the most equitable and fair allocation of funds and investments to each investor.

As noted earlier in this report, we identified a number of issues that needed to be resolved. We now set out our conclusions which form the basis of our recommendation to the Court.

What is the nature of HMF and when was it constituted?

Our conclusion, based on the work we have done and the investigation work carried out by Eriksens, is that HMF is a collection of individual investment portfolios, managed by Mr Hubbard on a fully discretionary basis.

Investors can be said to own the investments which appear in their statements, however, due to the way HMF was operated, the statements often reflected the intended position rather than the actual position, as at 31 March in at least the last 4 years to 31 March 2010. This makes it impossible to provide investors with the assets on the statements and requires an equitable way of allocating the shortfalls.

How, why and when did the shortfall arise?

In our opinion, the shortfall arose, in part, because of the unusual system of management and accounting adopted by Mr Hubbard. There were no effective and regular reconciliations performed to ensure that the statements provided to investors actually matched the investments and cash held as at each balance date.

What is the most appropriate and equitable method of distribution to each investor?

We have proposed the following procedure to the Court:

The 31 March 2010 statements will be adjusted for transactions for the period from 1 April 2010 to 20 June 2010 when statutory management occurred. Mr Hubbard had not indicated how these transactions were to be handled in the records and therefore we have processed these in a manner that would appear to be consistent with the prior transactions.

Adjustments will then be made to each investors statement as at 21 June 2010 (being the first day of the statutory management) to reflect the adjustments needed, on an investment by investment basis, to align the combined statements of the investors to the assets actually held by the Fund. This process will impact each investor differently but reflects the view that HMF was a fully discretionary personal investment fund where Mr Hubbard made all decisions on allocations, purchases and sales.

We are proposing to the Court that from 21 June 2010 that HMF's investments be pooled and profits and losses be shared proportionately. The reason for this is we have had no alternative to managing HMF as a pool since our appointment because:

- There are no written individual investment plans for investors.
- There are virtually no written investment instructions from investors to HMF.
- There are no foundation documents or recorded strategy showing how HMF is to operate.
- The investments held by HMF did not agree with the aggregate investments recorded on clients' statements.

The revised statements and the shares and investments shown on these statements have been pooled with all investors getting the same returns on the adjusted portfolio from that point on.

When are payments likely to be made to investors?

We propose to make proportional payments to HMF investors as we realise the assets following the directions of the Court. Some of the assets are either not easily saleable or they will need to run to maturity, so the payments will be progressive over an extended period. We would hope that 25% may be able to be realised reasonably quickly and paid to investors once we have the ruling from the Court and there is no appeal to the Court's decision. Another 25% is likely to be able to be realised within 12 months of then with the remainder having a 1-3 year timeframe.

Our estimate of the value of your investment in HMF

In order to provide you with an indication of your share of HMF based on our recommendation to the Court, we enclose the following provisional documents:

- A statement as at 31 March 2010 which Mr Hubbard produced;
- A listing of the transactions for the period 1 April 2010 to 20 June 2010 so you may compare this to any records you hold to ensure accuracy along with a statement as at 20 June 2010 to reflect securities held before any adjustments are made to align the statements with the securities actually held;
- A list of the adjustments to your portfolio, including any overdrawn cash account adjustments, because of shortages in investments and cash held by HMF and a statement of the portfolio value following all the adjustments. The value on the statement as at 21 June 2010 is our assessment of your share of HMF's assets as at that date.
- A portfolio valuation of your account at 31 October 2011 using the process we are recommending to the Court.

It is almost certain that amendments will be required to these provisional statements and transactions and our intention is to provide a final spreadsheet of the proposed distribution summary to the Court prior to the hearing of this matter.

Additionally, any assets that can be proved to be owned individually will be transferred to the investor, together with associated income. The effective date of these transfers will be 21 June 2010 for the purposes of the calculations.

The accounting records for HMF are incomplete and they are difficult to follow. Please review the statements as at 31 March 2010 and 20 June 2010 and advise us if the payments made by HMF to you, and by you to HMF, are not correct. If you think you can prove that money you paid to HMF was immediately used to buy investments that you nominated at the time you made the payment, please advise us.

The value noted on the provisional portfolio valuation as at 21 June 2010 is our estimate of the value of your investment as at that date. This is just an estimate and will change as new evidence comes to light. It will also change with market value changes and the costs of the Statutory Management.

We must emphasise that these estimates are based on the recommendations that we have placed before the Court. There is no guarantee that the Court will adopt these. As noted, the statements are provisional and subject to change and should only be regarded as indicative.

Timing of Court application – representation for investors

We have recently filed the necessary documents for the case to commence with the Court. We will provide investors with access to the documents we have filed as soon as possible.

There is considerable pressure within the court system and our legal advisers estimate that it is unlikely the HMF case will be heard before the middle of 2012. We will be working with the Court to speed this process if possible because we know investors need access to their money.

It is likely that the notice of proceedings will need to be made available to each investor to provide them with the opportunity to consider whether they wish to be represented. Given the very large volume of papers filed (over 2,000 pages), we are asking the Court for guidance on how we make the documents available. It is likely that a copy of these papers will be placed on our website to be available to investors. In these papers, all references to individual investors have been removed and replaced with an investor number. We have advised all investors of their own investor number in separate correspondence.

This is a complicated matter needing careful consideration by each investor. Clearly, if all investors wish to be represented, the process will be extended significantly and therefore we are asking the Court to appoint a lawyer on behalf of the investors to reduce the time needed in Court. Should the Court make this appointment, we will advise all investors of the lawyer's name and contact details. This lawyer would be funded as a cost of HMF rather than of individual investors.

Timing of payments to investors

As soon as we have a decision from the Court, we propose to make proportional payments to HMF investors as we realise the assets.

The liquid portion of the portfolio, approximately 25% of HMF, could be realised quickly and it would be our intention to distribute funds as soon as possible to investors, subject to ongoing commitments to private equity funds and the costs of administration of HMF.

The remainder of the fund would be realised as soon as practical without having a “fire sale”. With regard to some of the investments where there is a limited market, again about 25% of HMF, we estimate this could take up to a year. The private equity funds would need to run their course which could be several years. We would investigate sale of these interests, however, most are at an early stage and buyers are seeking a discount, whereas the fund managers are suggesting the funds will realise about 20% per annum compounding, as a target return. Our investment advisers have suggested that based on the investments held, this return is realistic.

We will ask investors whether or not they would prefer, where possible, for investments held in their portfolio to be transferred to them rather than sold.

As soon as we have a hearing date from the Court, we will report to investors setting out a possible timetable for payments to be made from HMF. However, any timetable will depend on the case proceeding smoothly in the Court, a judgement being received promptly and that no investor appeals the decision.

Administration costs

Costs to date

The total costs incurred in the statutory management from June 2010 to October 2011 are as follows:

	Total since appointment \$
Grant Thornton fees and disbursements	1,293,479
Legal costs	755,694
Other third party disbursements	137,327
GST	314,565
Total	2,501,065

Administration fee

As noted in previous reports, Mr Hubbard previously charged investors a management fee of between 1% and 1.5% of the funds recorded on statements as at 31 March in each year. From June 2010 to October 2011 this would have amounted to between \$912,000 and \$1.369 million.

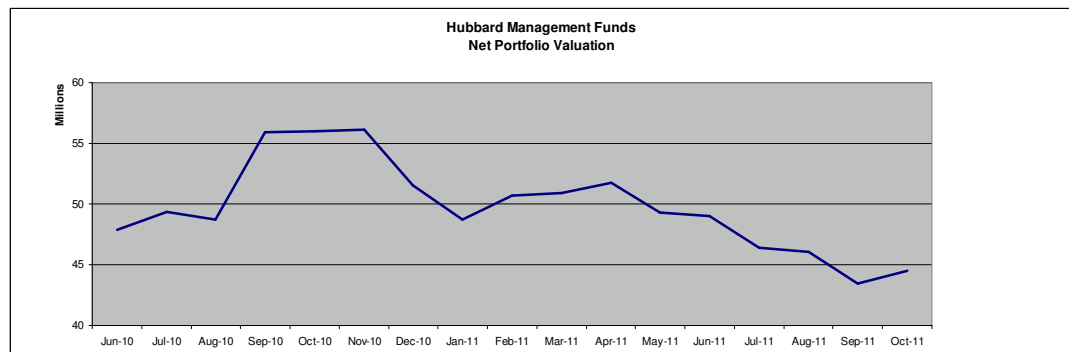
Besides the ongoing management of the HMF, much of our work has been to reconstruct and analyse records and general investigation and correction of past accounts and reconciliations. Additionally we have needed to prepare materials for the filing with the Court to get directions on how to equitably resolve the difficulties of HMF.

Oversight

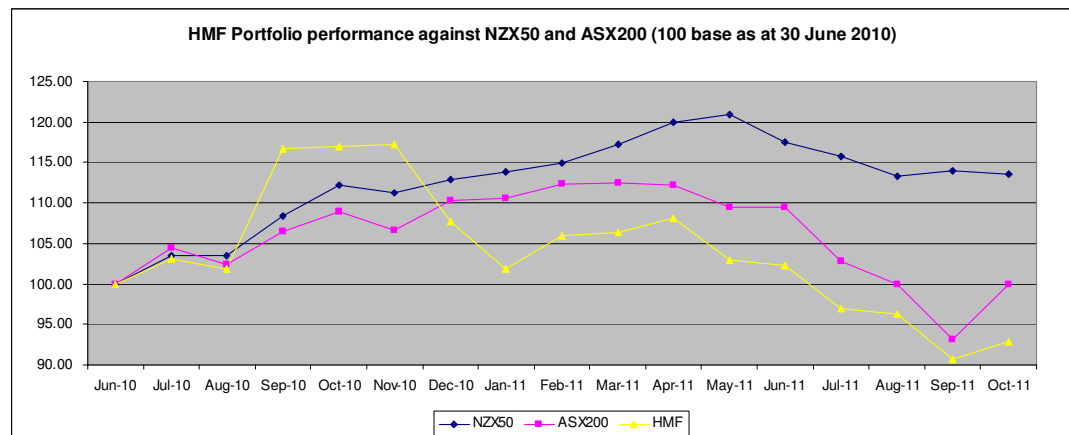
We requested the costs of our administration to be independently reviewed to provide assurance that they were in order and the Ministry of Economic Development appointed a reviewer for that purpose.

HMF valuation

The valuation of the HMF assets (after adjustments for charged assets) as at 31 October 2011 was \$44.478m. The graph below shows the movement in the net asset valuation since our appointment.



The trend since April 2011 has been negative reflecting the overall sentiment globally. This can be seen in the trends in key indices in the New Zealand and Australian markets, the NZX50 and the ASX200.



As commented previously, the HMF portfolio has a bias toward lower capitalisation stocks, and to the resources sector. This has increased the volatility of the results over the period. The NZX50 has few stocks in the resources sector compared with the ASX200 and this contributes to the NZX50 out performing the ASX200 over the period. The resources bias in the ASX200 shows a reasonable correlation with the performance of the HMF fund.

Other matters

Investor liaison

The Grant Thornton website at www.grantthornton.co.nz provides answers to frequently asked questions. This web page also provides links to our past reports.

Next report on Hubbard Management Funds

We expect to provide you with a further report at the end of March 2012. We will also report to you again once we have a timetable for the Court hearing.

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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