



Grant Thornton

Second Statutory Managers' Report

Aorangi Securities Limited, Hubbard Management Funds,
Mr AJ and Mrs MJ Hubbard and Associated Trust Entities.

26 August 2010

Introduction

History

On June 20 2010, Richard Grant Simpson and Trevor Francis Thornton were appointed statutory managers of Aorangi Securities Limited ("Aorangi"), a number of charitable trusts and Mr Allan and Mrs Margaret (Jean) Hubbard personally. Since that date the statutory management team has been working through the affairs of the various entities and interests of Mr and Mrs Hubbard in order to establish the current position.

Purpose of this Report

This second report has been prepared by the statutory managers for the purpose of reporting to investors as to the status of investments in Aorangi and Hubbard Management Funds ("HMF").

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

References

In this report, we refer to a number of entities. Aorangi received money from investors and has apparently applied the money to a combination of independent parties and entities associated with Mr and Mrs Hubbard. A charitable trust, Te Tua Charitable Trust ("Te Tua"), which is also in statutory management, has borrowed money from Aorangi and provided interest free loans to a range of business people. A number of other charitable trusts, now under our management, were formed in March 2010 and they purported to have taken ownership of some assets associated with Mr and Mrs Hubbard.

Aorangi Securities Limited

It is now two months since our appointment as statutory managers and this is our second report. While we have made good progress, this is going to be a long process because of the intricate and complex relationship between the affairs of Aorangi, Mr and Mrs Hubbard and the associated charitable trusts and the Hubbards' other business interests. In our opinion, the accounting records and governance relating to the assets the company holds are very poor. Therefore, we do not expect to have completed our tasks by the end of the year.

The problem we have to face as statutory managers of Aorangi is that Mr Hubbard has allowed Aorangi to accept deposits from investors on call and to invest those funds in investments or loans which are nearly all long term in nature. Much of the money that has been invested in Aorangi has been reinvested by Mr Hubbard, into minority share interests and mortgages over shares in approximately 25 dairy farms. With the number of dairy farm sales being at historically low levels there is very little opportunity to free up this capital so that it can be returned to investors. We discuss this more fully later in the report.

We also do not yet know the exact value of Aorangi's investment in the farming industry. We are presently having valuations completed on the farms where Aorangi has an interest so that we can assess the value of Aorangi's interest. These valuations should be finished by the end of September.

For these reasons, it is highly unlikely that we will be in a position to return any significant amounts of capital to investors this side of Christmas.

On a slightly brighter note, it is our priority to try and be in a position to make a small repayment to investors in October. There is an alarming gap between the income that Aorangi is presently receiving from its loans and investments and the amount it needs to pay out to its investors. Any payment at this time will be treated as a repayment of capital and will be dependent on the amount of funds paid to Aorangi by borrowers and from the investments in farms. Interest payments remain suspended.

Aorangi has only a small amount of available cash. This will be used for the possible capital repayment during October.

Actions taken to date

The actions taken to date by the statutory management team have been to:

- Suspend all capital and interest payments in order to treat all investors the same.
- Create files for each of the loans and investments, as the existing documentation was sparse and incomplete.

- Undertake a detailed review of each of the loans and investments, the securities over the assets, whether or not these have been registered, payment histories and identification of potential matters to be addressed.
- Move from information gathering and assessment to management processes designed to maximise value for the investors and the company.
- Ascertain the amount due to investors is approximately \$96 million.
- Work with the farming businesses and deal with the numerous financing and trading issues, some of which had remained unresolved for a considerable period

Aorangi Loans

Aorangi has received \$96 million from individual investors. Mr Hubbard has purported to have \$34 million of equity in the company by way of the assets he has introduced. Since our last report loans of nearly \$1.4 million have been identified as not recoverable. In turn, Aorangi has invested approximately \$130 million in the following:

- \$83 million in farming entities;
- \$24 million in Te Tua Charitable Trust; and
- \$23 million in other commercial entities.

Farming sector

Aorangi has \$83 million invested in the farming sector. This includes:

- \$59 million in farming businesses associated with Mr Hubbard; and
- \$24 million in first and second mortgages over land.

Farming investments and loans

Many of the relevant farming businesses are struggling financially. They have been unable to make payments to Aorangi. During March 2010, Mr Hubbard had to mortgage his own assets and introduce his own cash to enable the March interest payment to be made to Aorangi investors. The income flow to Aorangi from the farming investments will be from profits distributed by these farms. We believe only 17 of the 51 loans and investments will be able to meet their full interest obligations or distribute sufficient profits on 30 September 2010 to fund Aorangi. There are others who will only make partial payments. We anticipate there will be a shortfall of approximately \$1 million on this date, which is 50% of what would have been required to service the interest obligations to the Aorangi investors. We will be contacting all 51 borrowers before 30 September to confirm their ability to pay the amounts required.

Realisation of farming assets

We have commenced discussions with some of the farming business partners to see if they are interested in buying out Aorangi's interests. The success of these negotiations will depend on many factors including the amount of equity that these business partners can invest in the business and the level of support that the banks will give to them.

If it was necessary to sell a number of farming investments at the same time or at the wrong point in the seasonal cycle, in order to meet investor demands, we consider that the proceeds may well be substantially below the assessed market value.

It is important to note that any major sell down will only be as a last resort. Our priority is to retain, where possible, the full value of Aorangi's investment in the farming sector.

We are heartened by a pledge to investors from Mr Hubbard that his investment in Aorangi could be used to help off-set any potential losses. This arrangement is yet to be formalised. Given the current position of Mr Hubbard, we are of the opinion that he will not be able to contribute further funds to support Aorangi as he has in the past.

Dairy farm sales are at historic lows and the amount of cash deposit now required by banks for such purchases has increased markedly in recent times. Therefore, any realisation of farming assets will involve considerable effort and time.

Te Tua Charitable Trust loan

Te Tua is unable to make its interest payments to Aorangi and there appears to be a substantial reduction in the overall value of its investments. Te Tua has been advanced approximately \$24 million by Aorangi with interest being charged to Te Tua at 10% per annum. The majority of the Te Tua loans are interest free.

Many of the loans are made to farmers and share milkers in the early years of their business to give them a "helping hand". The loans are typically repayable in equal instalments of principal over a period of five to seven years, often with an initial repayment holiday.

The assets of Te Tua were subject to a high-level review by Mr Hubbard earlier this year. We have his file note indicating that he considered then there was a loss of approximately \$10 million at that time. A valuation review by a registered valuer engaged prior to our appointment indicates that a further \$5 million loss may be appropriate. This has occurred because Te Tua has taken over loans where entities have encountered financial difficulty. These are unlikely to be recoverable. Our work in this area continues and we are taking steps to manage this portfolio and maximise returns.

Other commercial entities

Of the \$23 million invested in other commercial entities, \$10 million is in Southbury Group Limited, a company that Mr Hubbard is the major shareholder. The remaining \$13 million are mainly in first and second mortgages to a range of businesses. We are presently undertaking valuations of most of these businesses.

We are also negotiating with a small number of businesses to help them repay their loans and refinance at a lower rate via the banks.

Concluding comments on Aorangi

Because of the concentration of investment, the prospects for the investors rely heavily on the future of the dairy industry being profitable. The dairy payout level is very volatile and so is the profitability of the farms. This poses significant risks for the Aorangi investors for both payment of interest and capital.

Also of concern is the way investments have been structured meaning many Aorangi investments rank behind all other creditors of the farming ventures. This is far from ideal.

This will be a long process and while we are making progress we do not expect to have completed our tasks by the end of the year. Final resolution and realisation of the assets may take several years. We will do everything we can to speed up the process and maximise returns to investors.

Aorangi currently has only a small amount of available cash. While it is our priority to try and be in a position to make a small capital payment to investors in October, this will depend on loan and interest payments received. We will update investors on the value of the Aorangi assets and the overall position in our next report.

Hubbard Management Funds (“HMF”)

HMF is an investment management business operated by Mr Hubbard. The statutory managers' work is substantially complete with respect to the verification and reconciliation of HMF assets to what was reported by Mr Hubbard to investors in their 31 March 2010 statements.

We are of the opinion that the total value of HMF as at 31 March 2010 is at least 25% less than reported by Mr Hubbard in the 31 March 2010 statements. We are also of the opinion that the value has deteriorated further since that date because of the high risk nature of the portfolio in what has been a difficult period for share markets.

Our work has identified the following:

- The standard of accounting, systems and processes of HMF fall well short of what would be expected for a fund of this size.
- The statements sent to the investors by Mr Hubbard for the year ended 31 March 2010 show a value for HMF of about \$82 million.
- Shares and other investments in excess of \$13 million which do not exist have been allocated by Mr Hubbard to investors within the HMF portfolio.
- Shares and investments of \$8 million owned by HMF had not been allocated to investors.
- Uninvested funds on hand of \$6m has been reported to investors by Mr Hubbard as at 31 March 2010 however the cash available on that date was less than \$350,000.
- There are investments in venture capital funds and unlisted companies where there is not an active market and therefore the valuation and ability to realise the assets is uncertain.
- There are outstanding contractual obligations to venture capital funds of over \$8 million which will need to be funded. However, HMF is unable to accept further investor deposits at this time. Should HMF not be able to fund these commitments, there may be further losses to investors.
- There is an exposure to Southbury Group Limited of over \$10 million. The assets of Southbury Group appear to be pledged as security to other parties ahead of HMF. As noted earlier, Mr and Mrs Hubbard are the majority shareholders in Southbury Group Limited.

HMF has been described to us by an independent fund manager as having:

- an investment profile that is not consistent with what we understand would be appropriate for a typical investor in HMF;
- a high risk profile;
- a number of small holdings that add no value to HMF;
- investments in private equity funds, second tier companies and “penny dreadfuls”;
- very few blue chip shares; and
- many illiquid investments.

Concluding comments on HMF

It is our opinion that the annual statements prepared by Mr Hubbard and sent to investors have over stated the investor's position by at least 25% in total as at 31 March 2010 and this will have deteriorated further since that date. The accounting records were not fully reconciled before the statements were sent. Investments have been allocated to investors in excess of those actually held by HMF. The investment risk profile of HMF is not consistent with the normal requirements of the typical HMF investor and is relatively high risk.

Other matters

Emergency Fund

We are mindful of the impact the statutory management is having on some distressed investors and have appointed a highly respected retired banker as an independent administrator, to discuss the needs of those unable to cover urgent living expenses. He will assess the needs of the applicants and make recommendations to the statutory managers for payments from an emergency fund established by the statutory managers. If investors live outside South Canterbury, a suitably qualified person in their area will be identified to make the assessment. Should you need assistance to meet urgent living expenses, please contact our Christchurch office on (03) 379 9580.

Next report on Aorangi and HMF

We expect to provide you with a further report at the end of September 2010.

Serious Fraud Office investigation

As you know, the Serious Fraud Office is undertaking an investigation into certain matters associated with Aorangi. The statutory managers are independent of these investigations, although we are complying with their formal statutory requests.

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 date of this report. If we become aware of any additional information not known to us at the date of this report, we reserve the right, but shall not be obliged to, review or update this report.

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