

'BB+' Rating On South Canterbury Finance Ltd. Placed On CreditWatch Negative On Concerns That Risks Are Increasing

Counterparty Credit Rating

BB+/Watch Neg/B

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Overview

- Standard & Poor's is concerned that South Canterbury Finance Ltd.'s risk profile has increased since we lowered the ratings on Aug. 13, 2009.
- SCF plans to release its audited financial statements for fiscal year ended June 30, 2009, on or soon after Sept. 30, which it expects will be in line with unaudited market guidance provided on Aug. 28, 2009.
- SCF also plans to register a new debenture prospectus and appoint two or more independent directors, on or soon after Sept. 30, as well as announce a major restructure and recapitalization by the end of the year.
- We have placed our 'BB+' long-term issuer credit rating on CreditWatch with negative implications.

Rating Action

On Sept. 21, 2009, Standard & Poor's Ratings Services placed its 'BB+' long-term rating on New Zealand finance company, South Canterbury Finance Ltd. (SCF) on CreditWatch with negative implications. A CreditWatch Negative listing by Standard & Poor's implies a one-in-two likelihood of a rating downgrade within the next three months.

Rationale

The rating action follows our concern that SCF's risk profile has increased since we lowered our ratings on the company on Aug. 13, 2009. We are concerned about the increasing pressure on liquidity; still-weak asset quality; and governance issues including, but not limited to, related party exposures. Since its ratings downgrade, SCF has ceased allotting

securities under its existing debenture prospectus (unrated by Standard & Poor's), provided market guidance of an increase in its unaudited net after tax loss for fiscal 2009 to NZ\$69 million, and had two of its four directors resign with pending replacements. These negative developments have occurred against a backdrop of a major restructuring and recapitalization initiative that SCF has said it will announce in coming weeks.

Ameliorating our concerns, to an extent, are that SCF's principal shareholder has undertaken to underwrite NZ\$25 million of SCF's problem loans, noting that the underwrite agreement is untested and that SCF plans to register a new prospectus with audited financials for fiscal 2009 on or soon after Sept. 30, 2009. Offsetting the benefit of the shareholder underwrite, however, is that about \$31 million of dividends will be repatriated to the shareholder from fiscal-2009 profit despite the company experiencing an unaudited net after-tax loss of \$69 million.

The CreditWatch action reflects our view that with no debenture prospectus in the public domain, SCF's funding flexibility and liquidity are undermined at the 'BB+' rating at least in the short-term. Technically, SCF does not have access to the new and reinvested debenture funds, which reside in a trust account. This increases pressure on SCF's funding and liquidity. Furthermore, SCF's liquidity levels are modest after the company's decision to shift its holdings of liquid assets from cash to higher-risk and higher-yield investments and in related party entities of uncertain credit standing. Additionally, U.S. private placement (facility is unrated by Standard & Poor's) investors continue to review their funding support for SCF, which, if resulted in a requirement to repay the facility, has the potential to significantly exacerbate liquidity concerns.

Liquidity pressures would moderate if SCF were able to permanently maintain a liquidity level that would support its ability to repay the U.S. private-placement issue while at the same time maintaining sufficient excess cash to support daily operations, which are potentially volatile given the confluence of negative developments impacting SCF. Maintenance of sufficient liquidity also depends on continued debenture investor and banker confidence in the company, noting that the unaudited after-tax loss for fiscal 2009 has caused SCF to be in technical breach of the interest-cover covenant on its unused banking facilities. This creates uncertainty in terms of SCF's ability to access banking facilities at a time when liquidity is paramount.

The ratings may be lowered by one or more notches if SCF's debenture prospectus were to remain out of the market on or soon after Sept. 30, 2009, or if the confluence of actual or potential liquidity concerns caused Standard & Poor's to consider SCF's financial strength no longer congruent with our 'BB' category rating. In particular, and independent of our other liquidity concerns, should rating triggers embedded in the U.S. private-placement facility result in funding providers withdrawing support for SCF, this would likely significantly exacerbate liquidity concerns and could cause a downward revision of our rating on SCF by multiple rating notches—potentially into the 'B' category rating range. Should U.S. private placement investors continue their funding support for SCF, downward rating pressure would likely be less severe.

The ratings equally may be lowered by one or more notches if the company were to announce any new adverse developments that could affect its 2009 financial statements. This is in the context of SCF's most recent market guidance that they have revised losses upwards because of higher provisions—almost two months after its accounting year ended.

The 'BB+' rating reflects our view that SCF's primary shareholder, Mr. Allan Hubbard, will remain committed to providing timely support to SCF if required. If SCF's credit profile deteriorates, evidence of the shareholder's support would be required to keep the rating at 'BB+'. If support is not forthcoming, or is of a type and nature not sufficient to afford debenture- and bondholders' confidence, it is likely the rating will be immediately lowered.

CreditWatch

The ratings could be taken off CreditWatch Negative within a matter of weeks if:

- SCF is able to demonstrate its ability to reaccess the debenture-investor market with no long-term negative effects impacting its debenture profile;
- Its audit and subsequent fiscal-2009 audited financial statements reveal no new material adverse findings concerning its financial strength;
- It is able to source two or more highly qualified independent directors to assist in addressing weaknesses in SCF's financial strength profile and guide the company through a major restructure and recapitalization; and
- More generally, Standard & Poor's gains greater confidence that the support of private placement investors and bankers as well as debenture investors will be retained.

The CreditWatch could be longer-lasting if Standard & Poor's has uncertainties regarding SCF's restructure and recapitalization plans, after they are announced. In our view, any recapitalization plans favoring debt rather than equity, or involving a complex reorganization of business units within the Southbury Group (unrated) that may weaken the interests of SCF debenture or other liability holders is likely to have a negative effect on our rating. Even so, Standard & Poor's expects the CreditWatch will be resolved in no more than 90 days.

Even if SCF is able to satisfactorily address negative rating pressures, at best—after the CreditWatch is resolved—it is likely the rating could be affirmed with a negative outlook reflecting near-term pressures on SCF's financial profile, and medium-term uncertainty concerning restructuring and recapitalization initiatives. Negative rating pressures are not likely to ease until SCF can address liquidity, asset quality, and governance concerns.

Related Research

This article is based in part on the following criteria articles:

Credit Policy Update: Criteria On Use Of CreditWatch And Outlooks Clarified, published on Sept. 30, 2005.

Rating Finance Companies, published on March 18, 2004.

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
South Canterbury Finance Ltd.		
Counterparty Credit Rating		BB+/Watch Neg/B BB+/Negative/B
South Canterbury Finance Ltd.		
Senior Secured (3 issues)		BB+/Watch Neg BB+

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