

## **Nathans Finance NZ Limited (In Receivership)**

### **Receivers' Seventh Report on the State of Affairs of Nathans Finance NZ Limited (In Receivership)**

Pursuant to Section 24 of the Receiverships Act 1993

October 2010

#### **IMPORTANT NOTE**

- This report has been prepared in accordance with and for the purpose of Section 24 of the Receiverships Act 1993, for the sole purpose of reporting on the state of affairs with respect to the property in receivership and the conduct of the receivership for the six month period 20 February 2010 to 19 August 2010.
- All information contained in this report is provided in accordance with Sections 26 and 27 of the Receiverships Act 1993.
- This report is subject to the restrictions set out at Appendix I. In particular, in preparing this report we have relied upon and not independently verified or audited information or explanations provided to us.

## **Nathans Finance NZ Limited (In Receivership)**

### **Receivers' Seventh Report on the State of Affairs Pursuant to Section 24 of the Receiverships Act 1993**

October 2010

#### **1. Introduction**

Colin McCloy and John Waller were appointed receivers of Nathans Finance NZ Limited ("Nathans") by Perpetual Trust Limited on 20 August 2007.

This report has been prepared in accordance with and for the purpose of Section 24 of the Receiverships Act 1993, reporting on the state of affairs with respect to the property in receivership and the conduct of the receivership. It provides a formal update on progress with the receivership. This report is subject to the restrictions at Appendix I.

Nathans is a subsidiary of VTL Group Limited (In Receivership) ("VTL"), which is an NZX listed company.

At the date of Nathans' receivership VTL owned a number of vending machine franchise businesses which operated in New Zealand and Australia ("24seven Australasia"), North America ("24seven US"), and Shop 24 Europe and US ("Shop24"). At the date of receivership Nathans had advanced \$171m of debt to VTL, 24seven Australasia, 24seven US, Shop 24, their franchisors and franchisees. In addition Nathans owned \$10m of fixed assets, mainly vending machines. Accordingly, Nathans' vending-related assets at receivership totalled \$181m, or 93% of its total assets, which were recorded at a book value of \$194m. Recoveries from Nathans' vending assets will therefore have the single largest impact on the ultimate returns for Nathans investors.

This report provides an update, the potential returns for Nathans investors and the receivers' investigations into the financial affairs of Nathans in the period prior to receivership.

## **2. Events following our appointment**

Following our appointment as receivers we:

- Secured key assets;
- Secured documents and obtaining an electronic back-up of computer records;
- Communicated with investors and Perpetual Trust Limited;
- Undertook investigations into the financial standing of Nathans;
- Developed asset realisation strategies.

As mentioned in our previous reports, Nathans' receivers continued to provide funding to VTL to enable it to trade pending the sale of its 24seven and Shop24 business by way of a managed process. At the same time we have sought to recover the loans to VTL and related parties.

However, recovery of amounts owed by VTL and related parties has been increasingly difficult given deteriorating global economic conditions. As a result, the directors of VTL requested that receivers be appointed to manage the affairs of VTL. We continue to manage the receiverships of Nathans and VTL in conjunction with each other to enable both receiverships to be managed as effectively and cost efficiently as possible.

At the commencement of the receivership of Nathans Colin McCloy and John Waller were appointed as joint and several receivers. However, Mr Waller has subsequently retired from his position at PricewaterhouseCoopers and has accordingly resigned as receiver of Nathans. Maurice Noone of PricewaterhouseCoopers was appointed receiver of Nathans on 22 December 2008.

### 3. Particulars of assets and proposals for disposal of receivership property

Presented in the table adjacent is a summary of the Nathans unaudited balance sheet as at 20 August 2007, being the date of receivership. The balance sheet was prepared from Nathans' records and information supplied to us by both Nathans and its directors. We have not audited the balance sheet, and it is subject to the restrictions set out at Appendix I.

At the date of receivership, Nathans records indicated it had total assets at book value of \$194m, including:

- Cash of \$7.5m which has been recovered by the receivers;
- \$54m loans to VTL which are unlikely to be recovered;
- \$57.8m loans to VTL subsidiaries, a large portion of which is unlikely to be recovered;
- \$38.9m loans to VTL's master franchisees, which are unlikely to be recovered;
- \$11.3m of franchisee loans which the receivers are actively pursuing;
- \$3.7m of loans to parties associated with current or former directors of VTL. The receivers are actively pursuing these loans with judgment having been obtained against several parties which the receivers are looking to enforce;
- \$5.3m of commercial loans, the recovery of which has been finalised; and

- Fixed assets at book value of \$10m, most of which are vending machines related to VTL's business.

<b>Nathans Finance NZ Limited (In Receivership)</b>	<b>Book value</b>
<b>Management Unaudited Balance Sheet</b>	<b>NZ\$'000</b>
<b>At 20 August 2007</b>	
Cash	7,589
VTL Group Limited – loan	54,081
Other VTL Group company loans	57,854
Master franchisee loans	38,893
Franchisee loans	11,364
Lease machine loans	3,000
Machine finance leases	540
Related party loans	3,732
Assigned loan receivable	1,349
Commercial loans	5,298
Fixed Assets (net of depreciation)	10,830
<b>Total Assets at Book Value</b>	<b>194,534</b>
Secured Debenture Holders	174,462
Preferential Creditors	902
Unsecured Creditors	132
<b>Total Creditors</b>	<b>175,496</b>
<b>Net Shareholders Funds at Book Value</b>	<b>19,038</b>

*Source: Nathans Finance financial records and management information*

In our view the recoverable value of the assets was materially overstated at 20 August 2007. In this regard we note that shortly after the receivership of Nathans, the directors of VTL reported a loss of \$133m for the 14 month period ended 31 August 2007. The loss will have a direct impact on the potential recoveries for the Nathans receivers and ultimately Nathans investors.

The magnitude of the loss is a serious concern and has been the subject of investigation by the receivers of Nathans.

A number of matters of concern have since been reported to certain Government Authorities (discussed below).

Ultimately the recoveries for Nathans investors will be determined by recoveries from VTL's 24seven Australasia, 24seven US and Shop24 business units; and recovery of other assets. We comment on each below:

***24seven Australasia (Australia and New Zealand)***

24seven Australasia was offered for sale by way of a formal competitive tender process, managed by PwC Auckland. A number of bids were received and a sale as a going concern was concluded at the end of May 2008.

***24seven US (California and Texas)***

The 24seven US business comprises operations in California and Texas. 24seven California was sold as a going concern with the proceeds of sale received in late April 2008. The receivers were not able to conclude a sale of the Texas business as the business operations had deteriorated to a point where no sale was possible. The proceeds received from the sale of the California business were insignificant when compared to the funds deployed by VTL to engage in that business.

***Shop24 (Europe and United States)***

As previously advised, a detailed fund raising information memorandum was prepared and issued to interested parties earlier in the receivership. A number of parties expressed interest and evaluated the opportunity. The receivers have completed a sale of the business. The sale proceeds are insignificant when compared to the funds deployed by VTL to engage in the business.

***Recovery of Other Assets***

The receivership of Banks Transport (2006) Limited, which Nathans was a secured creditor of, was completed in November 2009. A distribution of \$137k was made to Nathans, representing partial repayment of the outstanding balance.

Legal proceedings in respect of the loans to related parties of Nathans and VTL continue to progress.

We continue to assess the best strategy to realise loans to VTL franchisees on a case by case basis, and note that some of Nathans' franchisee loans were realised in conjunction with the sale of the 24seven Australasia and 24seven US California businesses.

Please note that we have omitted certain details concerning our proposal for the disposal of receivership property as we believe that their inclusion would materially prejudice the exercise of our functions and in particular our duty to obtain the best price reasonably obtainable for the sale of receivership property.

#### **4. Particulars of debts and liabilities outstanding and requiring to be satisfied from the property in receivership**

##### **Nathans Secured Debenture Investors**

Nathans has 7,082 secured debenture investors, with investments totalling \$174m.

We wrote to investors on 24 August 2007 advising of our appointment as receivers and requesting their confirmation of the amounts recorded as outstanding in respect of their investments.

We continue to update investors on a regular basis.

##### ***Amount and Timing of Returns to Secured Debenture Investors***

It is clear that, in light of the pre-receivership losses reported by the directors of VTL and recoveries to date, investors are likely to face a significant loss.

We made payment of 2.2% of the principal investment to secured debenture investors of Nathans in December 2008. A further payment of 1.5% of the principal investment was made to secured debenture investors of Nathans in December 2009.

Further distributions to secured debenture investors will be dependent on the outcome of a number of actions currently in progress, including legal claims against various parties, particularly the legal action against the directors and auditors of Nathans (discussed below). A number of these actions may result in the realisation of substantial funds which will have a material impact on further recoveries for secured debenture investors.

The receivers currently have cash on hand of approximately \$1.7 million. This represents funds retained to cover the Inland Revenue Department's preferential claim, litigation costs and contingent costs.

### **Preferential creditors**

#### ***Employee entitlements***

Nathans had four employees at the date of receivership. Based on the information available from Nathans records, employee preferential entitlements relating to salaries, wages, and holiday entitlements accrued as at the date of receivership were approximately \$15k. These entitlements have been distributed to the respective employees over the course of the receivership.

#### ***Inland Revenue Department ("IRD")***

The IRD has a preferential claim primarily in respect of Resident and Non-Resident Withholding Tax unpaid at the date of receivership. The total preferential amount owed to the IRD is \$886,073.

#### ***Unsecured creditors***

There are unlikely to be any amounts available for payment to unsecured creditors.

## 5. Other matters

### Investigation into the affairs of Nathans and VTL

As mentioned previously, in light of the significant trading losses incurred by VTL in the period prior to receivership, the receivers initiated an investigation into the affairs of both Nathans and VTL. As a result of these investigations (which are ongoing), a number of serious matters came to our attention and were referred to a number of Government agencies, including the New Zealand Securities Commission (“Securities Commission”).

On 23 December 2008 the Securities Commission announced that it had laid criminal charges and issued civil proceedings against Nathans directors John Hotchin, Donald Young, Kenneth Moses and Mervyn Doolan. The Securities Commission alleges (amongst other things) that the directors made untrue statements in the registered prospectus and investment statement. The charges relate to statements concerning:

- Lending to related parties;
- Nathans’ bad debts disclosure;
- Nathans’ liquidity;
- The diversification of Nathans’ lending;
- Management of the loans in accordance with robust policies and processes; and
- Nathans’ disclosure of all material matters.

The Securities Commission also alleges that letters sent to members of the public advertising Nathans Finance debenture stock contained untrue statements about some of the matters referred to above. These claims do not apply to Mr Hotchin who had resigned his directorship by the time the letters were sent out.

Three of Nathans’ directors (Hotchin, Young and Moses) appeared in the Auckland District Court on 23 January 2009 in respect of the above charges. They entered no plea and were granted bail.

In February 2010 there was a depositions hearing in which it was determined that there was a case to be answered by the Nathans directors in respect of their actions. The trial is due to start on 14 March 2011.

#### *Legal action against Nathans’ directors and auditors*

We have commenced legal action against the directors, a former director, and the auditors of Nathans for breaches of the Companies Act 1993 and their common law obligations (in relation to the directors) and for breach of contract and negligence (in relation to the auditors). The claim is for damages of \$74.6m (or a maximum of \$73.2m against the auditors).

For legal reasons we are unable to disclose further details of the case, as we are in the early stages of the claim. No hearing date has been set. The claims involve complex legal issues and we are unable to accurately predict a timeframe for their resolution. It is clear however that the outcome of the legal action will have a





material impact on the amount and timing of any proceeds ultimately available for Nathans investors.

We continue to investigate the affairs of both Nathans and VTL and assist various Government agencies with their investigations.

Should stakeholders have any queries arising from this report, please contact Colin McCloy or Maurice Noone in writing via our website, facsimile, or private bag address, as follows:

Nathans Finance NZ Limited (In Receivership)  
PricewaterhouseCoopers  
Private Bag 92-162  
AUCKLAND  
Facsimile: +64 9 355 8013  
Website: [www.pwc.com/nz/nathansfinance](http://www.pwc.com/nz/nathansfinance)

Yours faithfully  
Nathans Finance NZ Limited (In Receivership)

A handwritten signature in grey ink, appearing to read 'Colin McCloy'.

Colin McCloy  
Receiver

## Appendix I

### Restrictions

This report has been prepared in accordance with and for the purpose of Section 24 of the Receiverships Act 1993, reporting on the state of affairs with respect to the property in receivership and the conduct of the receivership. All information contained in this report is provided in accordance with Sections 26 and 27 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 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 information provided to us, and have not conducted any form of audit in respect of Nathans. Accordingly, 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 as at the date of the report.

We reserve the right, but will be under no obligation, to review or amend our report, if any additional information, which was in existence on the date of this report was not brought to our attention, or subsequently comes to light.

We have relied on forecasts and assumptions prepared by Nathans about future events which, by their nature, are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

In addition the following should be noted:

- Unless otherwise stated all amounts are stated in New Zealand Dollars.

## Appendix II

### Receipts and payments

The table below sets out the receipts and payments for Nathans from 20 August 2007 to 19 August 2010.

<b>Nathans Finance NZ Limited (In Receivership)</b>	
<b>Receipts and Payments Summary</b>	
<b>For the Period 20 August 2007 to 19 August 2010</b>	<b>NZ\$'000</b>
<b>Receipts</b>	
Balance brought forward	18,306
GST Refunds	33
Net Interest Received	19
	<b>18,358</b>
<b>Expenses</b>	
Balance brought forward	16,226
Advances to VTL	28
Consulting Fees	69
Computer Expenses	9
GST on Payments	36
Investor register maintenance and distribution costs	11
Legal Costs	141
Other Expenses	0.2
Receivers Disbursements	5
Receivers Fees	91
	<b>16,616</b>
<b>Balance at bank as at 19 August 2010</b>	<b>1,742</b>

\* Nathans holds funds in various currencies. Accordingly this Balance Brought Forward amount has been adjusted to reflect the movement in the relevant exchange rates since the last reporting period.