BAYWATER FINANCE LIMITED
(IN RECEIVERSHIP)
RECEIVER'S FIRST REPORT
Section 23 of the Receiverships Act 1993

Introduction

On 17 December 2002 Dennis Clifford Parsons, Insolvency Practitioner of Indepth Forensic Limited, Insolvency Practitioners of Hamilton, was appointed Receiver and Manager of all the assets and undertakings of the company Baywater Finance Limited (In Receivership). The appointment was made pursuant to the terms of a Security Trust Deed dated 7 March 2002 between Baywater Finance Limited and Covenant Trustee Company Limited.

Restrictions

This Report has been prepared in accordance with and for the purpose of Section 23 of the Receiverships Act 1993. It is prepared for the sole purpose of reporting on the state of affairs with respect to the property in receivership and the conduct of the receivership. In compiling this report, we have relied on the accuracy of all relevant information provided by the Grantor and the records of the company.

All information contained in this report is for the confidential use of the parties to which it is provided in accordance with Section 26 and 27 of the Receivership Act 1993, and is not to be disseminated or provided to other persons without the express written authority of the Receiver or in accordance with the law.

As Receiver I reserve the right (but am under no obligation) to review this report and if I consider it necessary, to revise the report in light of any information existing at the date of this report which becomes known to us after that date.

Company Statutory Information

Name: Baywater Finance Limited (name changed from Bay Finance Limited on 2 September 2002)
Date of Incorporation: 27 November 2001
Act Registered Under: Companies Act 1993
Former Registered Office: C/- P Young, Chartered Accountant
100 Crosby Road
Chartwell, Hamilton
Type of Business: Finance company
Shareholders: Omega Finance Limited 52,500 shares
Stephen James Skelton 100,000 shares
Scotslord Limited 197,500 shares
Phillip Roger Young )
Vivien Jane Young )
And/or as trustees of )
PR Young Family Trust 350,000 shares
Directors: Phillip Roger Young
Peter Scott Keenan
Charges: Security Trust Deed dated 7 March 2002 between Baywater Finance Limited and Covenant Trustee Company Limited
History of Company Operations

1. The company was incorporated on 27 November 2001 as Bay Finance Limited. On 17 December 2001 the company purchased the principal value of loans held by Omega Finance Limited. The Purchase price was $317,498.62 with adjustments for overdue and prepaid amounts. Omega Finance Limited was a finance company owned and operated by Mr Phillip Young. It had been incorporated earlier in February 2001. Omega Finance Limited had primarily been lending to persons who were purchasing time share holidays at various resorts located at New South Wales / Queensland in Australia.

2. On 7 March 2002 Bay Finance Limited issued a Prospectus (Number One) to the general public for up to $5,000,000 to provide funds for development and expansion of its core lending business. The Prospectus was issued in terms of a Debenture Trust Deed also dated 7 March 2002 between the company and a trustee company, Covenant Trustee Company Limited. The role of the independent trustee was to act on behalf of all holders of debenture stock (commonly referred to as the “stockholders”).

3. The Trust Deed specified that the company had provided to the Trustee (for the benefit of the stockholders) a fixed charge over chattels, insurance policies, uncalled capital and intellectual property plus a floating charge over all of its other assets and undertakings.

4. Bay Finance Limited then proceeded to advertise and invite deposits from the general public. At the date of receivership the Deposit Ledger records a total of 71 different stockholders owed a total in principal of $1,290,466.83 (with interest accrued of $14,909.46). Interest rates offered varied between 9.00% and 11.25% depending on the amount deposited and time period elected.

5. The Prospectus (Number 1) described the company’s activities as “the provision of financial services with particular emphasis on advancing hire purchase loans and loans secured by mortgages to individuals, principally through dealers and retailers.” There appears to be some dispute between the directors over what constituted “adequate” security and the appropriate borrower. Prior to May 2002 the lending was primarily on a “secured” basis. Subsequent to May 2002 the majority of loans were on an “unsecured” basis.

6. On 31 August 2002 the Prospectus Number 1 expired. The Securities Regulations 1983 require that a prospectus include current financial information (including a Statement of Financial Position no older than 9 months). These Regulations were designed to protect the investing public. The company set about preparing a new prospectus however delays occurred in meeting the requirements of the Act. Although a number of draft versions were prepared, no new Prospectus was finalised and registered in terms of the Act.

7. The Trustee advised the Company that all new deposits received from the investing public after 31 August 2002 were “voidable” in terms of the Securities Act, and should be held separately in a Trust Account. The Trustee further advised that these new investors should be advised of the situation with the Prospectus and given the opportunity to withdraw their funds. However the Company continued to take investments and roll over other investments, and did not advise the investors of the “voidable” nature of these investments.
8. During the period 1 September to 17 December 2002 the company continued to make loans to customers. These loans were made from the investor funds noted in Note 7 above.

9. In November 2002 the company was advised by the Trustee that it believed the company was in breach of its obligations under 5.4 (b) of the Trust Deed (failing to operate the business in an efficient, prudent and businesslike manner) and under clause 5.4 (c) of the Trust Deed (failing to comply with the Securities Act).

10. On 14 November 2002 an investigation was undertaken into Baywater Finance Limited in terms of Section 19 of the Corporations (Investigation and Management) Act 1989 by investigating officers of Ministry of Economic Development.

11. On 10 December 2002 the Registrar of Companies issued the company with a Notice pursuant to Section 30 of the Corporations (Investigation and Management) Act 1989. This Notice stated the grounds for its issue as being:

   (a) That the company is, or may be, operating fraudulently or recklessly;

   (b) It is desirable that the Corporations (Investigation and Management) Act 1989 should apply to the company for the purpose of protecting the interests of the corporations’ members of creditors.

This Notice effectively declared the company as being “at risk”.

12. The Financial Accounts of the company reveal in a Statement of Financial Performance (for the period 1 April 2002 to 30 November 2002) a Net Deficit of $107,182. This was after a provision for Bad Debts had been made of $83,714. The Auditors had recommended such a provision.

The Statement of Financial Position at 30 November 2002 indicates the Net Equity of the company was $232,818 (reduced from $350,388 March 2002).

13. The Director Mr Young had initiated negotiations to sell the Loan Portfolio to an independent third party when the Trustee appointed the Receiver on 17 December 2002. At this time the Trustee listed the breaches that had occurred:

   (a) Failure to place depositors funds received after 31 August 2002 and deemed “voidable” in a separate Trust Account to protect these funds;

   (b) Failure to conduct the business in an “efficient, prudent and businesslike manner”;

   (c) During the period 1 April to 30 November 2002 made dividend payments to shareholders in breach of the Trust Deed;

   (d) Failed to make necessary cash injection into the company in respect of the Auditors recommended Provision for Doubtful Debts of $86,979;

   (e) Breach of the Trust Deed caused by the company being declared at risk by the Registrar of Companies.
14. My investigations have revealed:

(a) Prior to May 2002 the company advanced monies to individuals on what can be regarded as a "secured" basis. The majority of these loans were for timeshare resort holiday accommodation with security taken by Baywater Finance Limited by way of an unregistered mortgage supported by a registered caveat over New Zealand real property. The majority of the advances were for amounts of between $10,000 and $20,000 to middle income earners with some accumulated assets.

(b) From May 2002 until mid-November 2002 the company lending policy appears to have materially altered to advance monies of smaller loan value, the majority being loans between $1,000 and $5,000, to lower income earners with few assets. In these cases no security was taken for these advances.

(c) In my opinion this change in lending policy was a material factor in the declining position of the company. Prior to May 2002 no material overdue or defaults in loans appear to have been in evidence. Once the unsecured portfolio was established an increasing number of loans appear to have entered the overdue category. Our analysis indicates that the % of Overdue Accounts to Total Loan Accounts was Nil at the end of June 2002; steadily increased to 10% by the end of October 2002; and exceeding 20% by the end of November 2002.

(d) There appears to have been increasing concern and dispute by and between the directors over the increase in the rate of loan delinquency. By 22 November 2002 a directive was issued by Mr Young to dealers for loans only to be made to applicants with "regular jobs" and to stay away "from beneficiaries and the lower end". In our view the lax lending criteria adopted by the company was quite irregular in the market place. Generally lending on an unsecured basis by competitor companies was usually very limited (in $ amount per loan) and security was required in most instances. To lend to the high-risk sector of the community, to take no security with minimal background credit assessments, and at the level in evidence in Baywater Finance Limited was in my opinion a significant contributing factor to placing the company at "risk".

(e) In terms of security, at the end of May 2002 the total number of loans was 36 which could be regarded as "secured" and performing. By the end of November 2002 the total number of loans had increased to 302, with the categorization having changed to 93.4% (in number) and 77.16% (in total $ value) now being categorized as "unsecured". In my opinion this change was significant.

(f) The Securities Act 1978 created a structure for regulating fund-raising and in particular the offering of debt securities to the general public. This Act specifies the obligations on the fund-raising entity to ensure information (by way of a registered prospectus) is available to investors. I note the comments of various investors who have remarked about the standard of stewardship of Baywater Finance Limited given the fact that the prospectus had expired on 31 August 2002. The company's prospectus expired at that date and in my opinion it was not legally able to accept further deposits or roll over current deposits from the general public.

Despite this apparent legal restraint the company continued to receive deposits (and roll over current deposits). At 5 December 2002 the Auditors calculated:

1. New Deposits (not in a Trust Account) $ 174,000
2. Roll Overs (not in a Trust Account) $ 83,047
3. New Deposits (in a Trust Account) $ 11,000
It is my opinion that when a company offers debt securities to the general public, any investors should have an expectation of complete compliance with relevant legal requirements. Accordingly the circumstances relating to the receipt and roll over of deposits where the prospectus had expired will need to be further investigated.

(g) During the period 1 September to 17 December 2002 the company continued to make loans to customers. A total of 108 loans ($542,396.78) were made. My analysis of these loans is that 6 loans ($189,392.20) were on a secured basis; whilst 102 ($353,004.58) were on an unsecured basis.

(h) The company made distributions to its shareholders on the 20th of the months of April, May, June, July, August, September and October 2002. These are recorded on the Financial Accounts of the company for the period 1 April to 30 November 2002 and total $10,000. However there appears to be a number of journal entries relating to dividend payments, which I am currently investigating.

The distributions made were pursuant to a Solvency Certificate dated 18 July 2002 that purported to apply to each distribution. The company was solvent at the time the distribution was made, however, this practice appears to be in breach of Section 52 of the Companies Act 1993 and was discontinued by the company on legal advice.

(i) The company has issued Capital of 700,000 shares of which only 350,000 shares (with a value of $1.00 per share) have been called up and paid. The remaining shareholding of 350,000 shares appear to be held by the PR Young Family Trust despite being in the name of Mr & Mrs Young personally. These shares were uncalled (and therefore unpaid). The company took legal advice and a Constitution was adopted in late November 2002.

(j) There are a number of other payments that require further investigation.

Assistance provided by the Directors

15 Apart from the provision of the company records on 17 December 2002, Mr P Young has not provided full assistance to the Receiver. On the other hand, Mr Keenan has actively assisted in answering enquires and has promptly provided the information sought.

16 As Receiver I have a statutory obligation in terms of Section 28 of the Receiverships Act 1993 to report any offences that may have been committed by either the company, Baywater Finance Limited, or its directors, that are material to the receivership. I am currently investigating matters relating to the prospectus and the actions of the directors subsequent to the expiry of that prospectus on 31 August 2002.

Financial Position of the Company

17. A statement of the company's financial position at the date of Receivership is attached. I am not in a position to provide a definitive guide as to perceived level of doubtful and bad debts as they relate to the entire Loan portfolio. I am currently assessing each Loan on a month by month basis. Given that there is commercial interest in acquiring some or all of the Loan portfolio, I regard this information as commercially sensitive and accordingly it would be inappropriate that such assessments be released at this point in time. However, I am able to confirm to investors
that I believe that the stockholders are potentially “at risk” for a proportion of their investment principal.

18. As at 17 December 2002 the amount due to stockholders amounted to $1,290,466.83 (principal) with further $14,909.46 (accrued interest), a total of $1,305,376.29.

19. Preferential Creditors:

According to the records of the company, these claims at 17 December 2002 amount to Preferential Employee Entitlements $2,589.48, Inland Revenue Department (for PAYE and RWT) $3,330.98, a total of $5,920.46.

Covenant Trustee Company Limited have filed a Preferential Claim in terms of the Debenture Trust Deed amounting to $25,258.08.

Receivership Time and Costs incurred to 15 January 2003 amount to $13,542.09.

Unsecured Creditors:

The realisation of assets of the company is uncertain. Any assets available to unsecured creditors will depend on the realisation of them. Unsecured Creditors amount to $23,884.52.

PROPOSALS FOR CONDUCTING THE RECEIVERSHIP:

20. The initial problem that I addressed was the rate of loan delinquency facing the company at the date of my appointment. As advised above this level of default had been increasing prior to my appointment. Whilst changes in both lending policy and debt recovery had occurred in November 2002 the effect had not been significant. I am currently addressing these defaults by taking prompt debt management action. These have included:

♦ I have instructed a specialized Debt Management company to contact all overdue accounts and arrange for overdue accounts to be brought back into “current” status. Defaulters are being contacted by mail and by telephone. Reporting is made bi-weekly.

♦ I have maintained the Finpower Computer System operated the company.

♦ I regularly monitor the progress of debt recovery.

♦ All “secured” files have been reviewed. Steps have been taken to correct the security on several loans.

♦ No further loans are being considered.

21. There has been interest expressed by some lending businesses to acquire the Loan Portfolio. I have commenced a due diligence process with one party, which is currently underway. This process is in terms of a strict confidentially agreement to protect both parties. In due course further parties will be invited to enter similar agreements, to ensure the best possible return from any sale is achieved. I stress to all parties that I do not propose to undertake any “fire sale” of company assets in the short term. The objective is to achieve the best available return to stockholders in the foreseeable future. I am in regular contact with the Trustee over the progress in this matter.
22. No property of the company has been disposed of to date.

23. As stated I believe that some risk does exist to the principal amounts due to stockholders. As a preliminary step I have called upon the $350,000 in uncalled capital held by the shareholders to be paid to the company. Counsel for Mr & Mrs Young and the PR Young Family Trust have denied any liability. This recovery action is to continue.

24. Should the Loan Portfolio not be “saleable” in the medium term, I propose to manage the Loan Portfolio down in an ordered manner and to periodically repay stockholders from the realisation of that Loan Portfolio. Payment of stockholders would be in accordance with the provisions of Sections 8.12 and 8.13 of the Debenture Trust Deed. Borrowers would be encouraged to refinance their debt where possible with other lenders. Sound debt management and debt reduction policies would be maintained with the view to achieving the best return to stockholders.

25. I do not anticipate any initial payment to stockholders before 31 March 2003. At this point I believe I will be able to provide a timetable of repayments to stockholders.

DATED at Hamilton this 24th day of January 2003

DC Parsons
Receiver
# BAYWATER FINANCE LIMITED
## (IN RECEIVERSHIP)
### STATEMENT OF FINANCIAL POSITION AS AT 17 DECEMBER 2002

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>$</th>
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<tbody>
<tr>
<td>Cash in Company Bank Accounts</td>
<td>5,807</td>
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<tr>
<td>Cash in Solicitor Trust Account (3 Depositors)</td>
<td>11,000</td>
</tr>
<tr>
<td>Fixed Assets (at Book Value)</td>
<td>13,164</td>
</tr>
<tr>
<td>Loans Due (at Book Value – Net of Unearned Interest)*</td>
<td>1,527,217</td>
</tr>
<tr>
<td>Uncalled Capital (PR Young Family Trust) – disputed</td>
<td>350,000</td>
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<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>$1,907,188</strong></td>
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</table>

<table>
<thead>
<tr>
<th>CREDITORS</th>
<th>$</th>
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</thead>
<tbody>
<tr>
<td>4 Preferential Creditors</td>
<td>5,920</td>
</tr>
<tr>
<td>1 Secured creditor</td>
<td>25,258</td>
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<tr>
<td>3 Depositors (In Trust)</td>
<td>11,000</td>
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<tr>
<td>71 Stockholders (Principal and Interest)</td>
<td>1,305,376</td>
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<tr>
<td>11 Unsecured creditors</td>
<td>23,884</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td><strong>$1,371,438</strong></td>
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<thead>
<tr>
<th>SURPLUS (DEFICIT)</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated surplus, subject to costs of Receivership</td>
<td>Please refer to Report – unable to determine</td>
</tr>
</tbody>
</table>

* Please note the comments contained within the Report. No allowance has been made for Bad or Doubtful Debts in respect of this Loan Portfolio

Disclaimer of Liability

We have compiled the Statement of Affairs as at the date of the Receivership.

A compilation is limited to the collection, classification and summarisation of the books and records of the company together with information supplied by the Directors. A compilation does not involve the verification of that information. I have not carried out an audit or review assignment of the information supplied and therefore I do not accept any responsibility for the accuracy of the information from which the Statement of Affairs has been prepared. Further, the Statement of affairs has been prepared for the purpose of the receivership only, and I do not accept any responsibility on any ground whatsoever, including liability in negligence, to any other person.

DC Parsons
Receiver