Simmons Corporate Finance

Mercer Group Limited

Independent Adviser's Report and Appraisal Report

In Respect of the Allotment of Shares Under the Underwriting Arrangements with Interests Associated with Humphry Rolleston

November 2010

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Section **Page**

1. Introduction

1.1 Background

Mercer Group Limited (**Mercer Group** or the **Company**) is listed on the main equities security market (**NZSX**) operated by NZX Limited (**NZX**) with a market capitalisation of $5 million as at 26 November 2010 and audited equity of $17 million as at 30 June 2010.

Mercer Group is an industrial investment company with a number of wholly owned subsidiaries. The Group's principal activities are:

- the manufacture and supply of kitchen, bathroom and laundry products in New Zealand and Australia by Mercer Products
- stainless steel fabrication and equipment manufacture and supply by Mercer Stainless workshops in Christchurch, New Plymouth and Brisbane
- the supply of equipment and related products and services for sterilisation, washing and disinfection by Mercer Medical.

A profile of the Company is set out in section 4.

1.2 Rights Issue

Mercer Group intends to raise approximately $9.0 million by undertaking a pro rata renounceable offer of up to 180,008,410 new ordinary shares at a price of $0.05 per new ordinary share (the **Rights Issue**).

The Rights Issue will be fully underwritten jointly by Murray Capital Rakaia Fund Limited Partnership (the **Rakaia Fund**) and Asset Management Limited (**Asset Management**) (the **Underwriting Arrangements**).

The Rakaia Fund and Asset Management are associated with Humphry Rolleston. Mr Rolleston is a director of Mercer Group and a substantial security holder in the Company.

Remuneration for the Underwriting Arrangements will consist of:

- the payment to the Rakaia Fund of a fee of $135,006 (the **Arrangement Fee**)
- the issue of warrants to the Rakaia Fund to subscribe for new ordinary shares at an exercise price of $0.05 per new ordinary share (the **Rakaia Warrants**).

The maximum number of ordinary shares held by the Rakaia Fund pursuant to the Underwriting Arrangements and the exercise of all of the Rakaia Warrants will equal 100,000,000 shares.

Proceeds from the Rights Issue will be applied towards:

- reducing the Company's loans from Westpac New Zealand Limited (**Westpac**), Gresham Finance Limited (**Gresham**) and Paul Hewitson (one of the Company's directors)
- paying the costs associated with the Rights Issue, including the Arrangement Fee
- funding the Company's working capital requirements.

1.3 Rolleston Associates

We refer to the Rakaia Fund, Asset Management, Gresham and Mr Rolleston and his associates collectively as the **Rolleston Associates**.

The Rolleston Associates hold 18.62% of the Company's ordinary shares at present.

Rolleston Associates' Current Shareholding Levels		
	No of Shares	**%**
Mr Rolleston & Graham Riley as trustees of the Rolleston Investment Trust	6,372,855	16.29%
Mr Rolleston	4,729	0.01%
Asset Management [1]	795,687	2.03%
Asset Trading Limited (**Asset Trading**) [1]	109,387	0.28%
Victoria Mansions Limited (**Victoria Mansions**) [2]	3,857	0.01%
Gresham [2]	-	-
Rakaia Fund	-	-
	7,286,515	18.62%

1 Wholly owned by Mr Rolleston and Mr Riley as trustees of the Rolleston Investment Trust
2 Wholly owned by Asset Management

Rakaia Fund

The Rakaia Fund is a private equity fund structured as a limited partnership. It invests in and lends to medium-sized New Zealand companies, focussing on companies that are capital constrained, have strong growth prospects, require restructuring and / or could act as a vehicle for industry consolidation.

Murray Capital General Partner Limited (**MCGPL**) is the general partner of the Rakaia Fund. MCGPL is wholly owned by Murray Capital Limited (**Murray Capital**).

Murray Capital manages the Rakaia Fund. It is a Christchurch based principal investment firm and is part of Murray & Company Limited (**Murray & Co**).

The Rakaia Fund is associated with Mr Rolleston as Mr Rolleston is a director of MCGPL, Murray Capital and Murray & Co.

The Rakaia Fund does not hold any shares in the Company at present.

Asset Management

Asset Management is an equity investment company based in Christchurch. It owns a number of private businesses operating in New Zealand, Fiji and the United Kingdom and manages a substantial portfolio of investments.

Asset Management is wholly owned by Mr Rolleston and Mr Riley as trustees of the Rolleston Investment Trust. Mr Rolleston is the sole director of Asset Management.

Asset Management is a limited partner in the Rakaia Fund.

Asset Management currently holds 795,687 shares in the Company (2.03%).

Gresham

Gresham is wholly owned by Asset Management. Mr Rolleston is the sole director of Gresham. Its business is the provision of finance.

Gresham has provided approximately $4.4 million of loans to Mercer Group since August 2009.

Gresham Loans to Mercer Group		
Date	**Use of Funds**	**$000**
6 Aug 09	Working capital	1,150
11 May 10	Reduction of Westpac facilities	1,500
30 Jun 10	Assignment of South Canterbury Finance loan	1,040
29 Sep 10	Working capital	700
		4,390

The interest rate on the loans is 12% per annum. Mercer Group has granted Gresham a second ranking security interest over all of its assets and undertakings.

Gresham does not hold any shares in the Company at present.

1.4 Impact of the Underwriting Arrangements on Shareholding Levels

The Underwriting Arrangements will result in the Rolleston Associates collectively holding between 44.12% and 85.97% of the shares in Mercer Group, depending on the level of entitlements taken up by the Non-associated Shareholders under the Rights Issue and the number of Rakaia Warrants exercised.

Rolleston Associates' Potential Shareholding Levels		
	Low	**High**
Current	18.62%	18.62%
Post the Rights Issue	18.62% [1]	85.47% [2]
Post the exercise of the Rakaia Warrants	44.12% [3]	85.97% [4]

1 Assumes the Non-associated Shareholders take up all of their entitlements under the Rights Issue
2 Assumes the Non-associated Shareholders take up none of their entitlements under the Rights Issue
3 Assumes the Non-associated Shareholders take up all of their entitlements and 100,000,000 Rakaia Warrants are exercised
4 Assumes the Non-associated Shareholders take up none of their entitlements and 7,791,590 Rakaia Warrants are exercised

1.5 Annual Meeting

The Company's shareholders other than the Rolleston Associates (the **Non-associated Shareholders**) will vote on 4 ordinary resolutions in respect of matters associated with the Rights Issue (the **Rights Issue Resolutions**) at the Company's annual meeting on 17 December 2010:

- the Rights Issue (resolution 3(d))
- the Underwriting Arrangements (resolution 3(e))
- the Rakaia Warrants (resolution 3(f))
- the Arrangement Fee (resolution 3(g)).

The Rights Issue is conditional on all 4 Rights Issue Resolutions being approved. Accordingly, each resolution is conditional on all of the other resolutions being approved. If any resolution is not approved, then no resolutions will be approved and therefore the Rights Issue cannot proceed.

The Rolleston Associates are not permitted to vote on the Rights Issue Resolutions.

Shareholders will also vote on ordinary resolutions in respect of:

- the re-election of Stuart Heal as a director of the Company (resolution 3(a))
- the re-election of Humphry Rolleston as a director of the Company (resolution 3(b))
- that the directors reappoint the Company's auditors and be authorised to fix the auditors' fees for the coming year (resolution 3(c)).

1.6 Regulatory Requirements

Takeovers Code

Rule 6 of the Code prohibits:

- a person who holds or controls less than 20% of the voting rights in a code company from increasing its holding or control of voting rights beyond 20%
- a person holding or controlling 20% or more of the voting rights in a code company from increasing its control of voting rights

unless the person and that person's associates comply with exceptions to this fundamental rule.

One of the exceptions, set out in Rule 7(d) of the Code, enables a person and its associates to increase their holding or control of voting rights by an allotment of shares if the allotment is approved by an ordinary resolution of the code company.

The Rights Issue, the Underwriting Arrangements and the exercise of the Rakaia Warrants will result in the Rolleston Associates increasing their control of the voting rights in Mercer Group from 18.62% to between 44.12% and 85.97%.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on ordinary resolutions in respect of the Rights Issue, Underwriting Arrangements and the exercise of the Rakaia Warrants in accordance with the Code.

Rule 18 of the Code requires the directors of a code company to obtain an Independent Adviser's Report on the merits of an allotment under Rule 7(d).

This Independent Adviser's Report is to be included in the notice of meeting pursuant to Rule 16(h).

NZSX Listing Rules

Listing Rule 7.3.1 of the NZSX Listing Rules (the **Listing Rules**) states that no Issuer shall issue any Equity Securities unless the precise terms and conditions of the specific proposal to issue those Equity Securities have been approved by separate resolutions (passed by a simple majority of votes) of holders of each Class of Quoted Equity Securities of the Issuer whose rights or entitlements could be affected by that issue.

Listing Rule 7.5 states that no issue of Securities shall be made by an Issuer if there is a significant likelihood that the issue will result in any person or group of Associated Persons materially increasing their ability to exercise, or direct the exercise of effective control of that Issuer unless the precise terms and conditions of the issue have been approved by an ordinary resolution of the Issuer.

The Underwriting Arrangements and the Rakaia Warrants involve the issue of equity securities and such issue will materially increase the Rolleston Associates' ability to exercise, or direct the exercise of effective control of the Company.

Listing Rule 9.2.1 stipulates that an Issuer shall not enter into a Material Transaction if a Related Party is a party to the Material Transaction or to one of a related series of transactions of which the Material Transaction forms part without first obtaining approval of the transaction by way of an ordinary resolution from shareholders not associated with the Related Party.

The Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee are Material Transactions and the Rolleston Associates are Related Parties of the Company.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on ordinary resolutions in respect of the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee in accordance with the Listing Rules.

Listing Rule 6.2.2 (a) requires an Appraisal Report to be prepared where a meeting will consider a resolution required by Listing Rule 7.5. Furthermore, Listing Rule 6.2.2 (b) requires an Appraisal Report to be prepared where more than 50% of the Securities to be issued are acquired by Directors or Associated Persons of Directors of the Issuer.

Listing Rule 9.2.5 (b) requires an Appraisal Report to be prepared where a meeting will consider a resolution required by Listing Rule 9.2.1.

1.7 Purpose of the Report

The directors of Mercer Group other than Mr Rolleston (the **Independent Directors**) have engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the allotment of shares under the Rights Issue, the Underwriting Arrangements and the Rakaia Warrants in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 7 September 2010 to prepare the Independent Adviser's Report.

The Independent Directors have engaged Simmons Corporate Finance to prepare an Appraisal Report on the fairness of the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee in accordance with Listing Rules 6.2.2 (a), 6.2.2 (b) and 9.2.5.

Simmons Corporate Finance was approved by NZX on 8 September 2010 to prepare the Appraisal Report.

Simmons Corporate Finance issues this Independent Adviser's Report and Appraisal Report to the Independent Directors of Mercer Group for the benefit of the Non-associated Shareholders to assist them in forming their own opinion on whether to vote for or against the Rights Issue Resolutions.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits and fairness of the allotment of shares under the Rights Issue, the Underwriting Arrangements and the Rakaia Warrants and the fairness of the Arrangement Fee in relation to each shareholder. This report on the merits and fairness of the allotment of shares under the Rights Issue, the Underwriting Arrangements and the Rakaia Warrants and the fairness of the Arrangement Fee is therefore necessarily general in nature.

This Independent Adviser's Report and Appraisal Report is not to be used for any other purpose without our prior written consent.

2. Evaluation of the Merits of the Allotment of Shares to the Rolleston Associates Under the Underwriting Arrangements

2.1 Basis of Evaluation

The Rights Issue is conditional on all 4 Rights Issue Resolutions being approved. Accordingly, each resolution is conditional on all of the other resolutions being approved. If any resolution is not approved, then no resolutions will be approved and therefore the Rights Issue cannot proceed.

Rule 18 of the Code requires an evaluation of the merits of the allotment of shares to the Rolleston Associates under the Underwriting Arrangements.

There is no legal definition of the term *merits* in New Zealand in either the Code or in any statute dealing with securities or commercial law.

In the absence of an explicit definition of *merits*, guidance can be taken from:

- the Takeovers Panel guidance note on the role of independent advisers dated August 2007
- definitions designed to address similar issues within New Zealand regulations which are relevant to the proposed transaction
- overseas precedents
- the ordinary meaning of the term *merits*.

We are of the view that an assessment of the merits of the allotment of shares to the Rolleston Associates under the Underwriting Arrangements should focus on:

- the requirement for the Rights Issue
- the prospects for Mercer Group without the Rights Issue
- the alternatives to the Rights Issue
- the terms and conditions of the Rights Issue
- the terms and conditions of the Underwriting Arrangements
- the impact of the Rights Issue on Mercer Group's financial position
- the impact of the Underwriting Arrangements on the control of the Company
- the impact of the Rights Issue and the Underwriting Arrangements on Mercer Group's share price
- other benefits and disadvantages to the Rolleston Associates of the Underwriting Arrangements
- the benefits and disadvantages for the Non-associated Shareholders of the Underwriting Arrangements
- the implications if the Rights Issue Resolutions are not approved.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

2.2 Impact of the Underwriting Arrangements on Shareholding Levels

The Underwriting Arrangements will result in the Rolleston Associates collectively holding between 44.12% and 85.97% of the shares in Mercer Group, depending on the level of entitlements taken up by the shareholders under the Rights Issue and the number of Rakaia Warrants exercised.

Rolleston Associates' Future Shareholding Levels

	Current	Post Rights Issue	Post Exercise of Rakaia Warrants
Shareholders Take up 100% of Their Entitlements			
Rolleston Investment Trust	6,372,855	35,687,988 [1]	35,687,988
Mr Rolleston	4,729	26,483 [1]	26,483
Asset Management	795,687	4,455,847 [1]	4,455,847
Asset Trading	109,387	612,567 [1]	612,567
Victoria Mansions	3,857	21,599 [1]	21,599
Rakaia Fund	-	-	100,000,000 [3]
Rolleston Associates	7,286,515	40,804,484	140,804,484
	18.62%	*18.62%*	*44.12%*
Non-associated Shareholders	31,845,748	178,336,189 [1]	178,336,189
	81.38%	*81.38%*	*55.88%*
Total	39,132,263	219,140,673	319,140,673
Shareholders Take up 0% of Their Entitlements			
Rolleston Investment Trust	6,372,855	6,372,855 [2]	6,372,855
Mr Rolleston	4,729	4,729 [2]	4,729
Asset Management	795,687	88,595,687	88,595,687
Asset Trading	109,387	109,387 [2]	109,387
Victoria Mansions	3,857	3,857 [2]	3,857
Rakaia Fund	-	92,208,410	100,000,000 [4]
Rolleston Associates	7,286,515	187,294,925	195,086,515
	18.62%	*85.47%*	*85.97%*
Non-associated Shareholders	31,845,748	31,845,748 [2]	31,845,748
	81.38%	*14.53%*	*14.03%*
Total	39,132,263	219,140,673	226,932,263

1 Assumes the shareholders take up 100% of their entitlements under the Rights Issue
2 Assumes the shareholders take up 0% of their entitlements under the Rights Issue
3 Assumes 100,000,000 Rakaia Warrants are exercised
4 Assumes 7,791,590 Rakaia Warrants are exercised

A feature of the structure of the Underwriting Arrangements and the Rakaia Warrants is that irrespective of the level of entitlements taken up by shareholders under the Rights Issue, the Rakaia Fund will hold 100,000,000 ordinary shares if it exercises all of the Rakaia Warrants.

2.3 Summary of the Evaluation of the Merits of the Allotment of Shares to the Rolleston Associates Under the Underwriting Arrangements

In our opinion, after having regard to all relevant factors, the positive aspects of the allotment of shares under the Underwriting Arrangements outweigh the negative aspects from the perspective of the Non-associated Shareholders.

Our evaluation of the merits of the allotment of shares to the Rolleston Associates under the Underwriting Arrangements is set out in detail in sections 2.4 to 2.18. In summary, the key factors leading to our opinion are:

- the rationale for the Rights Issue is sound. The Company requires an immediate injection of capital to reduce its borrowings and to fund its working capital requirements
- alternative capital raising options to the Rights Issue are limited and are unlikely to provide the same level of capital within a similar timeframe
- the structure of the Rights Issue is reasonable:
  - Non-associated Shareholders are able to fully participate in the capital raising as the Rights Issue is a pro rata offer to all shareholders
  - the rights are renounceable, meaning that shareholders may sell or transfer their rights
  - the subscription price of $0.05 per new ordinary share is within our assessed valuation range for the Company's shares of $0.04 to $0.06 per share
- the terms and conditions of the Underwriting Arrangements are reasonable. The remuneration paid to the Rakaia Fund under the Underwriting Arrangements (in the form of the Arrangement Fee and the Rakaia Warrants) is within a commercial fee range
- the structure of the Rakaia Warrants means that irrespective of the level of entitlements taken up by shareholders under the Rights Issue, the Rakaia Fund will hold 100,000,000 ordinary shares in the Company if it exercises all of the Rakaia Warrants
- the Rights Issue will have a positive impact on the Company's financial position, increasing equity by approximately $8.6 million (52%) and significantly reducing the Company's level of financial leverage
- the full exercise of the Rakaia Warrants will further increase the Company's equity by between approximately $0.4 million and $5.0 million, depending on the number of Rakaia Warrants granted
- the Underwriting Arrangements will significantly increase the Rolleston Associates' ability to influence the outcome of shareholding voting:
  - with a minimum 44.12% collective shareholding, the Rolleston Associates will be able to collectively block special resolutions and most likely pass or block ordinary resolutions
  - with a maximum 85.97% collective shareholding, the Rolleston Associates will be able to collectively pass or block ordinary resolutions and special resolutions

- the Underwriting Arrangements will possibly increase the Rolleston Associates' influence over the Company's board of directors (the **Board**) and operations as we would expect the Rolleston Associates to seek further Board representation
- Non-associated Shareholders not taking up their entitlements under the Rights Issue will see their shareholding interests diluted by 82%
- the exercise of all of the Rakaia Warrants will result in the Non-associated Shareholders' proportionate interests in the Company reducing by between 4% (if they take up their entitlements and depending on the levels taken up by other Non-associated Shareholders) and 83% (if they do not take up their entitlements)
- the Rights Issue will likely have a material negative impact on the Company's share price. The shares last traded on 30 June 2010 at $0.25 and on 26 November 2010 at $0.12. The Rights Issue subscription price is $0.05 per share
- the Underwriting Arrangements are unlikely to have any material impact on the liquidity of Mercer Group's shares
- the Underwriting Arrangements will likely reduce the attraction of Mercer Group as a takeover target to the Rolleston Associates but not necessarily to other bidders
- the implications of the Rights Issue not being approved by the Non-associated Shareholders are significant. Alternative capital raising initiatives will need to be undertaken but there is no guarantee that such initiatives will deliver the level of capital sought or provide capital within the desired timeframes.

There are a number of positive and negative features associated with the allotment of shares to the Rolleston Associates under the Underwriting Arrangements. In our view, when Non-associated Shareholders are evaluating the merits of the transactions, they need to carefully consider:

- firstly, the imperative for the Company to undertake the Rights Issue
- secondly, the need for the Rights Issue to be fully underwritten
- thirdly, the degree to which they will participate in the Rights Issue.

If most or all of the Non-associated Shareholders are of the mind to take up their entitlements under the Rights Issue, then the level of dilution associated with the Underwriting Arrangements significantly diminishes – potentially to the extent that it is not a negative aspect to any great degree (although the exercise of the Rakaia Warrants means that the Non-associated Shareholders will face some level of dilution). In such circumstances, the benefits of the Underwriting Arrangements significantly outweigh the negative aspects.

Conversely, if a number of Non-associated Shareholders are unlikely to take up their entitlements under the Rights Issue, they need to consider whether they will be able to sell their rights or whether the negative aspects of the Underwriting Arrangements, including the potential dilution, justify voting against the Rights Issue Resolutions with the possible outcome that the Company will be undercapitalised and therefore may not be able to maintain its banking facility with Westpac. This in turn may lead to the requirement for large scale asset / business sales or, in the extreme case, the Company being placed into receivership or voluntary administration.

2.4 The Requirement for the Rights Issue

The Rights Issue will raise approximately $9.0 million of equity for Mercer Group to be applied to the repayment of debt, the payment of the costs associated with the Rights Issue and to fund the Company's working capital requirements.

Mercer Group had loans of approximately $13.1 million as at 30 September 2010, including $8.0 million owing to Westpac under a multi option credit facility. The Company has been in breach of its banking covenants in recent times. The Westpac facility expired on 30 September 2010 and has been extended to 31 December 2010. Mercer Group is currently in negotiations with Westpac to further extend the facility. However, the Independent Directors expect that if Westpac were to extend the facility, it would insist on a substantial reduction in the level of the facility. Accordingly, a portion of the proceeds from the Rights Issue will be used to reduce the amount owing to Westpac as well as to repay the loans from Gresham and Mr Hewitson (effectively by way of debt to equity conversion via the Rights Issue).

In addition to reducing debt levels, the Company requires additional capital to fund its working capital requirements. Having fully drawn down the Westpac facility, the Company has needed to borrow additional funds from Gresham and Mr Hewitson in 2009 and 2010. The most recent such loan was for $0.7 million from Gresham in September 2010 which was used to pay overdue creditors. The Rights Issue will provide Mercer Group with sufficient funds for its working capital requirements in the near term.

In the event that all of the Rakaia Warrants are exercised, this will provide the Company with additional equity capital of between approximately $0.4 million (from the issue of 7,791,590 new ordinary shares) and $5.0 million (from the issue of 100,000,000 new ordinary shares) in the next 3 years to fund its operations.

2.5 Alternatives to the Rights Issue

Mercer Group could potentially pursue alternative forms of raising capital including:

- seeking alternate debt funding
- seeking another strategic investor
- making a series of share placements
- asset sales.

Given the Company's current levels of earnings, the fact that it has been in breach of its banking covenants and the conditions currently prevailing in the market for debt funding, we consider it unlikely that Mercer Group could access alternate debt funding on commercially viable terms to fully replace the Westpac facility at this point in time.

The Company may be able to secure additional subordinated debt (akin to the loans from Gresham) which could be used to retire a portion of the Westpac facility. However, this would place Mercer Group in a worse financial position than it currently is in as its level of financial leverage would not change (as it would be substituting senior debt with subordinated debt) but its profitability would reduce as the interest rate on the new subordinated debt would most likely be higher than the interest rate on the senior debt being repaid.

We are advised by the Independent Directors that they had engaged in discussions with a party who was keen on taking a substantial shareholding in the Company through a share placement. However, the share placement did not proceed as the party's bank declined to support its investment in the Company. While we do not discount the possibility of Mercer Group raising capital through placements to 1 or more new shareholders, we believe this would be difficult to achieve in a timely manner in the current environment given the Company's levels of earnings and debt.

Any proceeds from asset / business sales would most likely be applied to reducing the Company's senior debt. Therefore it would only achieve part of the objective of the Rights Issue – but it would not raise capital to fund the Company's future working capital requirements. Furthermore, it is unlikely that the Company would be able to raise sufficient funds within a reasonably short time frame from asset sales.

In summary, we are of the view that other potential funding sources are not realistic alternatives at this point in time:

- the current economic environment is challenging for capital raising
- replacement debt funding at current levels is unlikely to be accessible on commercially viable terms
- the likelihood of Mercer Group securing a substantial investment from an institutional investor or a strategic investor in the near term appears limited
- assets sales are unlikely to generate the level of funds required within the required timeframes.

2.6 The Prospects for Mercer Group Without the Rights Issue

The most pressing issue facing Mercer Group is that its banking facility with Westpac has recently been extended to 31 December 2010 and needs to be either renewed or refinanced in the very near future. The Independent Directors expect that if Westpac were to extend the facility, it would insist on a substantial reduction in the level of the facility. Furthermore, the Company's current level of interest bearing debt (**IBD**) and mix between senior debt and subordinated debt is placing a very high interest burden on the business. Mercer Group needs to urgently reduce its IBD levels. Therefore additional equity capital is required as a matter of priority.

In the event that the Rights Issue does not proceed, Mercer Group may not be able to maintain its banking facility with Westpac. The Company would need to refinance its debts. However, we consider that this would be difficult to achieve in the current environment as alternate sources of funding are unlikely to be available to the Company in the near future. If an alternative funder were to be found, they would most likely only be prepared to refinance an amount less than the current Westpac facility. The failure of Mercer Group to meet its obligations to Westpac could lead to the requirements for large scale asset / business sales or, in the extreme case, the Company being placed into receivership or voluntary administration.

2.7 Structure of the Rights Issue

The key terms of the Rights Issue are:

- the Company's shareholders will be offered up to 180,008,410 new ordinary shares on the basis of 4.6 new ordinary shares for every 1 ordinary share
- an issue price of $0.05 per new ordinary share
- the Rights Issue is renounceable
- new ordinary shares will rank equally in all respects with the existing ordinary shares.

Size of the Rights Issue

The Rights Issue is of a significant size. It will represent a 460% increase in the number of shares on issue for Mercer Group.

We are advised by the Independent Directors that the $9.0 million of equity to be raised under the Rights Issue (before costs) was based on their estimates of the amount of capital required to reduce the Westpac debt, repay the loans owing to Gresham and Mr Hewitson and restore the Company's working capital position to an appropriate level.

Pricing

In theory, the pricing of a renounceable rights issue should have no value transfer implications as all shareholders participate in the rights issue on identical terms and those shareholders not wishing to take up their entitlements may sell their rights and thereby maintain the value of their overall investment in the company.

The Rights Issue is at a significant discount to the Company's share price. The subscription price of $0.05 per share is at a 79% discount to the Company's 1 year volume weighted average share price (**VWAP**) of $0.24. This level of discount is significantly higher than the average discounts observed for rights issues in New Zealand.

However, the analysis of Mercer Group's share price history in section 4.10 shows that trading in the Company's shares is extremely thin. The shares have only traded on 2 days in the past year. Accordingly, we do not consider the observed shares prices necessarily represent a strong indication of the market value of the Company's shares.

We have undertaken an assessment of the value of Mercer Group's shares in section 5. We assess the value of the Company's shares to be in the range of $0.04 to $0.06 per share as at the present date.

We are of the view that the subscription price of $0.05 per share is reasonable as the Rights Issue is a pro rata renounceable offer and the subscription price falls within our assessed valuation range.

Renounceable

The rights are renounceable, meaning that shareholders may sell or transfer their rights. We understand that the Company intends to seek to have the rights quoted on the NZSX. Accordingly, if the Non-associated Shareholders do not wish to take up their entitlement, they may be able to realise some value for the rights by selling them on the NZSX. However, the price, if any, at which the rights will trade on the NZSX is difficult to predict. The actual price that they can achieve for the rights will be dependent on the number of rights offered for sale, the level of demand to purchase the rights and the prevailing share price at the trading dates.

Overseas Shareholders

The prospectus in respect of the Rights Issue (the **Prospectus**) is not to be sent or given to any person outside New Zealand or Australia in circumstances in which the offer or distribution or use of the Prospectus would be unlawful.

2.8 Underwriting Options

On the basis that a Rights Issue is the most appropriate method at the present time for Mercer Group to raise additional capital, Mercer Group does have the following options regarding the underwriting of the Rights Issue:

- the Underwriting Arrangements as proposed or
- it could seek an alternative underwriter or
- it could undertake a non-underwritten issue.

Likely Take-up of Entitlements

The Rights Issue is on a 4.6 for 1 basis. It will result in a 460% increase in the number of shares on issue from the current level of 39,132,263 shares to 219,140,673 shares.

The Company's largest shareholder at present is Allan Hubbard and Jean Hubbard and their associated interests (the **Hubbard Associates**) who collectively hold 45.13% of the Company's shares. Mr and Mrs Hubbard and certain entities associated with them were put into statutory management in June 2010. Accordingly, it is uncertain as to whether the Hubbard Associates will support any rights issue at this point in time.

Given the significant size of the Rights Issue and the position of the Company's largest shareholder, we are of the view that it is probable that the Rights Issue will not be fully subscribed and it is possible that the shortfall in subscriptions will be significant.

Underwriting Arrangements

The principal terms of the Underwriting Arrangements, as documented in the Underwriting Agreement between Mercer Group, the Rakaia Fund and Asset Management dated 16 November 2010 (the **Underwriting Agreement**) are:

- the Rakaia Fund and Asset Management will collectively fully underwrite the Rights Issue. They will subscribe for any of the 180,008,410 new ordinary shares not subscribed for by the Company's shareholders under the Rights Issue (the **Shortfall Shares**) as follows:
  - the Rakaia Fund – up to a maximum of 92,208,410 Shortfall Shares (representing an underwriting exposure of approximately $4.6 million)
  - Asset Management – up to a maximum of 87,800,000 Shortfall Shares (representing an underwriting exposure of approximately $4.4 million)
- the Rakaia Fund and Asset Management will subscribe for the Shortfall Shares in the following order:
  - Asset Management will subscribe for the first 73,800,000 Shortfall Shares, less the number of new ordinary shares subscribed for by the Rolleston Associates
  - the Rakaia Fund will subscribe for the next 92,208,410 Shortfall Shares
  - Asset Management will subscribe for the last 14,000,000 Shortfall Shares
- the Rakaia Fund and Asset Management will not be paid an underwriting fee. Instead, the Rakaia Fund will be paid the Arrangement Fee and granted the Rakaia Warrants. Mercer Group will reimburse the Rakaia Fund's and Asset Management's advisers' fees up to a maximum of $100,000 (excluding GST)
- the Rakaia Fund and Asset Management may, in consultation with Mercer Group, appoint sub-underwriters
- the Underwriting Arrangements are conditional on, amongst other things:
  - shareholder approval of the Rights Issue Resolutions
  - Westpac restructuring its existing facilities with Mercer Group or entering into new loan facilities with Mercer Group
  - no material adverse effect events or circumstances
- to the extent that Mercer Group pursues any other transaction or series of transactions that would be similar in structure and / or commercial effect to the Rights Issue and the Underwriting Arrangements, then Mercer Group will be required to pay a break fee of $75,000 (excluding GST) to the Rakaia Fund.

Underwriting Fees

The payment of underwriting fees to an underwriter is a normal part of a rights issue. The actual fee percentage varies and generally is a function of the discount of the rights price, the size of the issue and the assessment of the risk that the underwriter is assuming (ie the probability that the underwriter will be called upon to purchase any shortfall in subscriptions). Underwriting fees in New Zealand tend to be in the range of 1.5% to 6.0%.

The Rakaia Fund's remuneration under the Underwriting Arrangements will comprise the Arrangement Fee and the Rakaia Warrants. Asset Management will not receive any additional remuneration under the Underwriting Arrangements.

The Arrangement Fee of $135,006 is based on 1.5% of the $9.0 million of capital that is to be raised under the Rights Issue. On its own, the Arrangement Fee is at the bottom end of market levels of underwriting fees.

The terms of the Rakaia Warrants are evaluated in section 2.9. We assess the value of the Rakaia Warrants in section 6 to be in the range of $78,000 to $400,000, depending on the number of Rakaia Warrants that will be granted to the Rakaia Fund.

We assess the value of the total remuneration to be received by the Rakaia Fund under the Underwriting Arrangements to be in the range of $213,006 to $535,006. This equates to 2.4% to 5.9% of the $9.0 million of capital to be underwritten. Given the significant size of the Rights Issue and the uncertainty surrounding whether the Hubbard Associates will take up their entitlements, we consider this level of remuneration to be reasonable.

Under the terms of the Underwriting Arrangements, Mercer Group will also reimburse all of the Rakaia Fund's and Asset Management's advisers' fees and disbursements in respect of the Underwriting Arrangements up to a maximum amount of $100,000 (excluding GST).

Alternative Underwriter

Given the relatively small size of Mercer Group, the significant size of the Rights Issue, the uncertainty surrounding whether the Hubbard Associates will take up their entitlements, the absence of institutional investors on the Company's shareholder register and the limited liquidity of the Company's shares, we consider it unlikely that the underwriting opportunity would hold appeal to potential underwriters other than a party who was prepared to hold a significant shareholding in Mercer Group.

We are advised by the Independent Directors that they sought to agree the Underwriting Arrangements with the Rolleston Associates rather than seeking alternative underwriters on this basis.

No Underwriter

An alternative option to seeking a different underwriter would be for Mercer Group to undertake the Rights Issue without it being underwritten. In general terms, the greater the discount of the subscription price for the new shares under a rights issue to the current share price, the lower the risk of the rights issue being under subscribed.

However, a discounted subscription price does not necessarily guarantee the full take-up of a rights issue. Other factors that impact on the likely level of subscription under a rights issue include the demand for the shares (i.e. liquidity and spread of shareholders), the quantum of the required investment (in this case the average required investment is approximately $4,000 per Non-associated Shareholder (excluding the Hubbard Associates and the 10 largest shareholders)) and the general state of the equity markets.

Given the uncertainty surrounding whether the Hubbard Associates will take up their entitlements, that the average level of investment for the other Non-associated Shareholders is relatively high and the demand for Mercer Group shares is very low (based on volumes traded), we are of the view that Mercer Group would bear considerable risk of not raising the $9.0 million of equity (before costs) if it did not arrange for the Rights Issue to be underwritten.

2.9 Terms of the Rakaia Warrants

The terms of the Rakaia Warrants are set out in the Warrant Subscription Agreement between Mercer Group and the Rakaia Fund dated 16 November 2010 (the **Warrant Subscription Agreement**). The key terms of the Rakaia Warrants are:

- a grant date of 17 December 2010
- each Rakaia Warrant gives the Rakaia Fund the right, but not the obligation, to subscribe for 1 new ordinary share
- the number of Rakaia Warrants to be granted is calculated as:

$$\frac{\$5{,}000{,}000 - \textit{Underwrite } \$}{\$0.05}$$

  where *Underwrite $* represents the dollar amount that the Rakaia Fund is required to subscribe for Shortfall Shares under the Underwriting Arrangements
- an exercise price of $0.05 per new ordinary share
- an exercise period of 3 years commencing on 17 December 2010
- the Rakaia Warrants can be exercised on the last business day of any month during the 3 year exercise period (subject, however, to the ability of the Rakaia Fund to exercise the Rakaia Warrants immediately should the Company be subject to a takeover offer or a change in effective control). At least 5,000,000 Rakaia Warrants must be exercised at any one time (or such lesser number as are not yet exercised)
- the grant of the Rakaia Warrants is conditional on shareholder approval of the Rights Issue Resolutions.

Number of Rakaia Warrants to be Granted

The number of Rakaia Warrants to be granted will range between:

- a minimum of 7,791,590 Rakaia Warrants – if the Rakaia Fund is required to subscribe for the maximum 92,208,410 Shortfall Shares under the Underwriting Arrangements
- a maximum of 100,000,000 Rakaia Warrants – if the Rakaia Fund is not required to subscribe for any Shortfall Shares.

The effect of the Rakaia Warrants is that it will enable the Rakaia Fund to subscribe for 100,000,000 new ordinary shares in the Company through either:

- the Underwriting Arrangements (to a maximum of 92,208,410 Shortfall Shares) plus the Rakaia Warrants (for a minimum of 7,791,590 shares), or
- if the Rakaia Fund is not required to subscribe for any Shortfall Shares under the Underwriting Arrangements, through the Rakaia Warrants.

Irrespective of the level of subscriptions by the Non-associated Shareholders for their entitlements under the Rights Issue, the Rakaia Warrants provide the Rakaia Fund with the ability, but not the obligation, to increase its total shareholding in the Company (including the new ordinary shares taken up under the Underwriting Arrangements) to up to 100,000,000 new ordinary shares at $0.05 per new ordinary share.

Value of the Rakaia Warrants

We assess the value of the Rakaia Warrants in section 6 to be in the range of $78,000 to $400,000 (depending on the number of warrants to be granted).

2.10 Impact on Financial Position

Mercer Group's unaudited equity as at 30 September 2010 was $16.5 million. Its net tangible assets (**NTA**) at that date was $8.8 million (including $3.4 million of deferred tax assets). NTA per share equated to $0.23 per share.

The Rights Issue will raise approximately $9.0 million (less costs of approximately $0.4 million). For illustrative purposes, if the net proceeds were to have been received on 30 September 2010, Mercer Group's equity would increase by 52% to $25.1 million.

NTA per share would decrease by 65% to $0.08, due to the subscription price of $0.05 per share under the Rights Issue being significantly lower than NTA per share as at 30 September 2010.

Illustrative Effect of the Rights Issue

	Equity ($000)	No. of Shares (000)	Equity $ / Share	NTA $ / Share
30 September 2010	16,454	39,132.3	$0.42	$0.23
Rights Issue proceeds	9,000	180,008.4	$0.05	$0.05
Rights Issue costs	(400)	-	($0.00)	($0.00)
Post the Rights Issue	25,054	219,140.7	$0.11	$0.08

The exercise of all of the Rakaia Warrants will raise a further $0.4 million to $5.0 million of equity over the next 3 years, depending on how many Rakaia Warrants are granted (which is a function of the level to which the Non-associated Shareholders take up their entitlements under the Rights Issue) and the timing of the exercise of the warrants.

2.11 Impact on Control

Share Capital and Shareholders

Mercer Group currently has 39,132,263 ordinary fully paid shares on issue. The names, number of shares and percentage holding of the Company's 10 largest shareholders as at 26 November 2010 are set out in section 4.5.

Mercer Group currently has 4 substantial security holders:

- the Hubbard Associates – holding 45.13% of the Company's shares
- the Rolleston Associates – 18.62%
- Russell Field and Anthony Palmer – 7.93%. Mr Field and Mr Palmer are trustees of the J I Urquhart Family Trust. The shares were previously held by Ian Urquhart. Mr Urquhart passed away in September 2010
- interests associated with Ian Farrant, the Company's chairman – 8.74%.

The 4 shareholder groups collectively control 80.42% of the voting rights in the Company at present.

The Rolleston Associates' Potential Shareholding Levels

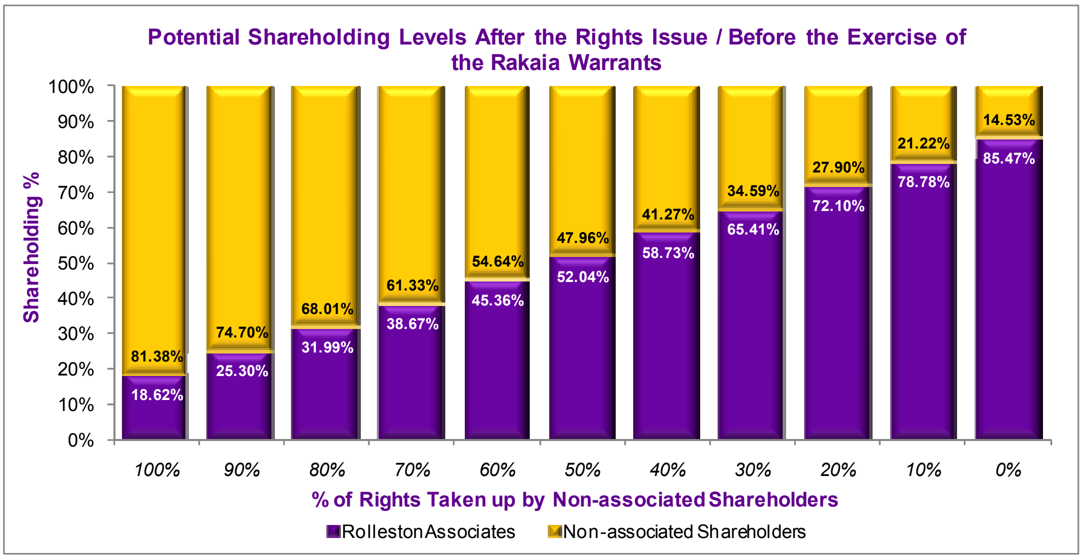
The allotment of shares under the Underwriting Arrangements will enable the Rolleston Associates to increase their shareholdings in Mercer Group without having to make a formal offer to all shareholders in accordance with Rules 7(a) or 7(b) of the Code. This is the principal reason why the Non-associated Shareholders have the opportunity to vote for or against the Rights Issue Resolutions.

After the Rights Issue and Before the Exercise of the Rakaia Warrants

The number of new ordinary shares that the Rolleston Associates will subscribe for through the Rights Issue will vary according to the level of shortfall in acceptances by the Non-associated Shareholders to their entitlements. If the Non-associated Shareholders take up all of their rights, then the Rolleston Associates will retain their existing shareholding level of 18.62% immediately after the Rights Issue.

If the Non-associated Shareholders approve the Underwriting Arrangements but do not take up any of their rights, and the Rolleston Associates do not enter into any sub-underwrite arrangements, then the Rolleston Associates will subscribe for all 180,008,410 new ordinary shares issued under the Rights Issue and will increase their shareholding level to 85.47%.

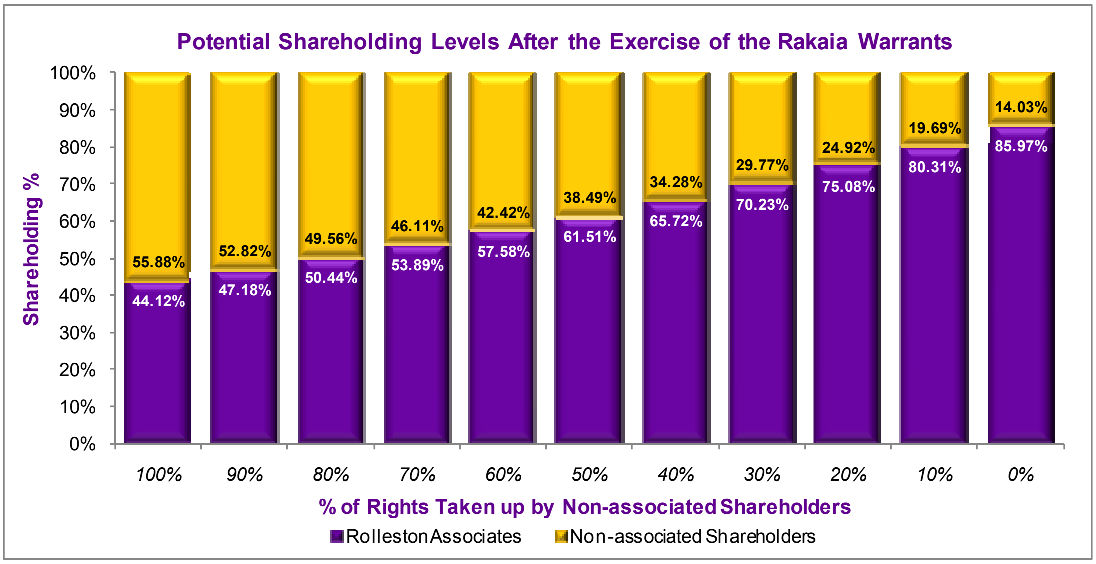
The graph below shows the potential shareholding levels for the Rolleston Associates after the Rights Issue but before the exercise of any Rakaia Warrants, depending on the levels of take-up by the Non-associated Shareholders of their entitlements.



After the Rights Issue and the Exercise of the Rakaia Warrants

The number of Rakaia Warrants to be granted will range between 7,791,590 and 100,000,000 warrants, depending on the levels of take-up by the Non-associated Shareholders of their entitlements under the Rights Issue.

The graph below shows the potential shareholding levels for the Rolleston Associates depending upon the levels of take-up by the Non-associated Shareholders of their entitlements and assumes that all of the Rakaia Warrants are exercised.



There are a wide range of possible outcomes with respect to the Rolleston Associates' eventual shareholding in Mercer Group. Assuming that all of the Rakaia Warrants are exercised, the Rolleston Associates will collectively hold a minimum shareholding of 44.12%. However, it is highly likely that they will increase their shareholding above that level, as it is often the case that some shareholders do not take up their entitlements. This is particularly likely given the uncertainty regarding whether the Hubbard Associates will take up their entitlements.

The maximum shareholding level that the Rolleston Associates could hold after the exercise of all of the Rakaia Warrants is 85.97%. However, we consider this scenario is unlikely to eventuate as it is based on the Non-associated Shareholders taking up none of their entitlements under the Rights Issue.

Shareholding Voting

Following the Rights Issue and the exercise of all of the Rakaia Warrants, the Rolleston Associates will have the ability to influence the outcome of all shareholder voting (where they are entitled to vote) if they reach the maximum possible shareholding level of 85.97% as they will be able to pass or block both ordinary resolutions (which require the approval of more than 50% of the votes cast by shareholders) and special resolutions (which require the approval of 75% of the votes cast by shareholders).

The minimum shareholding level of 44.12% will be able to block special resolutions. While a 44.12% interest will technically not be sufficient to singlehandedly pass or block ordinary resolutions, in reality, it most likely will be in a listed company with more than 400 shareholders (as Mercer Group currently has). This is because a number of shareholders in listed companies tend not to vote on resolutions and hence the relative weight of the 44.12% interest increases.

If the Non-associated Shareholders take up 50% of their entitlements under the Rights Issue, the Rolleston Associates will collectively hold 61.51% of the Company's shares. This will enable them to block special resolutions, pass or block ordinary resolutions and significantly influence the passing of special resolutions.

The ability for any shareholder to influence the outcome of voting on the Company's ordinary resolutions or special resolutions may be reduced by external factors such as the Company's constitution, the Listing Rules and the Companies Act 1993.

Given the above, we are of the view that the allotment of shares to the Rolleston Associates under the Underwriting Arrangements will significantly increase their ability to exert shareholder control over Mercer Group as the Rolleston Associates will, at a minimum, be able to block special resolutions and pass or block ordinary resolutions and may be able to collectively pass special resolutions.

Board Control

We are advised by the Independent Directors that at this point in time, no agreements have been made with the Rolleston Associates as to future Board representation following the Rights Issue. However, we would expect that the Rakaia Fund would seek representation on the Board following the Rights Issue at a level proportionate to its shareholding.

Operations

We are advised by the Independent Directors that the Rolleston Associates currently do not have any influence over the operations of the Company other than through Mr Rolleston's representation on the Board. The impact on the Company's operations arising from the increase in the Rolleston Associates' shareholding will mainly be through any increased Rolleston Associates representation on the Board.

2.12 Dilutionary Impact

The Underwriting Arrangements will result in the Non-associated Shareholders' proportionate shareholdings in the Company being diluted, depending on the extent to which they take up their entitlements under the Rights Issue. The dilutionary impact will range from 31% to 83%.

Non-associated Shareholders who do not take up their entitlements under the Rights Issue will see their shareholding interests in the Company diluted by 82% immediately after the Rights Issue.

While the potential level of dilution is significant, the actual level of dilution is in the hands of the Non-associated Shareholders as it is a function of whether they take up their entitlements. If Non-associated Shareholders take up their entitlements, they will not suffer any dilution immediately after the Rights Issue.

However, the exercise of all of the Rakaia Warrants will result in the Non-associated Shareholders' proportionate interest in the Company being diluted. The cumulative effect of the Underwriting Arrangements and the exercise of the Rakaia Warrants is that the Non-associated Shareholders' proportionate interest in the Company will be diluted by:

- 31% if all the Non-associated Shareholders take up all of their entitlements under the Rights Issue
- 83% if the Non-associated Shareholders do not take up any of their entitlements.

Dilutionary Impact of the Rights Issue

	Current	Post Rights Issue	Post Exercise of Rakaia Warrants
Shareholders Take Up 100% of Their Entitlements			
Rolleston Associates	7,286,515	40,804,484	140,804,484 [1]
	18.62%	*18.62%*	*44.12%*
Non-associated Shareholders	31,845,748	178,336,189	178,336,189
	81.38%	*81.38%*	*55.88%*
Total	39,132,263	219,140,673	319,140,673
Dilutionary impact		0%	31.3%
Shareholders Take Up 0% of Their Entitlements			
Rolleston Associates	7,286,515	187,294,925	195,086,515 [2]
	18.62%	*85.47%*	*85.97%*
Non-associated Shareholders	31,845,748	31,845,748	31,845,748
	81.38%	*14.53%*	*13.05%*
Total	39,132,263	219,140,673	226,932,263
Dilutionary impact		82.1%	3.4%
Cumulative dilutionary impact			82.8%

1 Assumes 100,000,000 Rakaia Warrants are exercised
2 Assumes 7,791,590 Rakaia Warrants are exercised

However, due to the order in which the Shortfall Shares are to be subscribed for between Asset Management and the Rakaia Fund (as set out in section 2.8), if some Non-associated Shareholders fully subscribe for their entitlements and the total of such subscriptions are for no more than 14,000,000 new ordinary shares, then those Non-associated Shareholders will only be diluted by 4%.

2.13 Impact on Share Price and Liquidity

Share Price

A summary of Mercer Group's daily closing share price and daily volume of shares traded from 3 January 2008 is set out in section 4.10. Trading in the Company's shares is extremely thin. The shares have only traded on 2 days in the past year at a VWAP of $0.24.

An indication that the Company was contemplating some form of capital raising was announced on 30 September 2010 when the Company's 2010 financial results were released. Details of the Rights Issue were announced on 16 November 2010. Mercer Group's closing share price on that date was $0.25 (based on a last trade on 30 June 2010). Since then, 2,000 shares have traded at $0.12.

We consider the Rights Issue is likely to have a material impact on the Company's share price. Given the size of the Rights Issue, we would expect any future trading of the Company's shares to more likely be at the $0.05 subscription price level rather than at the historic price of $0.25.

The Rakaia Warrants will have a similar effect on the Company's share price. If a significant number of warrants are issued, then the existence of such warrants with an exercise price of $0.05 per share is likely to maintain Mercer Group's share price around that level.

Liquidity

Trading in the Company's shares is extremely thin. Only 0.1% of the Company's shares have traded in the past year on 2 days.

The size of the pool of shares held by the Non-associated Shareholders (the **Public Pool**) will increase under the Rights Issue to the extent by which the Non-associated Shareholders take up their entitlements. However, the size of the Public Pool will not change as a result of the Underwriting Arrangements.

In our view, the Underwriting Arrangements on their own are unlikely to have a positive or negative effect on the liquidity of Mercer Group's shares.

2.14 Benefits to the Rolleston Associates

The Underwriting Arrangements provide the Rolleston Associates with the opportunity to significantly increase their shareholding (and level of control) in Mercer Group at an issue price of $0.05 per share under the Underwriting Arrangements and the Rakaia Warrants.

The structure of the Rakaia Warrants ensures that the Rakaia Fund will have the right, but not the obligation, to invest up to $5.0 million in Mercer Group by subscribing for up to 100,000,000 new ordinary shares at $0.05 per share.

However, the shareholding level that the Rakaia Fund (and the Rolleston Associates) will hold following the subscription for up to 100,000,000 new ordinary shares will be dependent on the extent to which the Non-associated Shareholders take up their entitlements under the Rights Issue. Assuming the Rakaia Fund does subscribe for 100,000,000 new ordinary shares, it will hold between 31.33% and 44.07% of the Company's shares and the Rolleston Associates will collectively hold between 44.12% and 85.97% of the Company's shares.

2.15 Disadvantages to the Rolleston Associates

Increased Exposure to the Risks of Mercer Group

The key issues and risks that are likely to impact upon the business operations of Mercer Group are set out in section 4.6.

As the Rolleston Associates' ownership in Mercer Group increases, so does their exposure to these risks. The level of ownership for the Rolleston Associates will increase from 18.62% to a shareholding of between 44.12% and 85.97%. The Rolleston Associates have little control over the uptake of the Rights Issue by the Non-associated Shareholders and hence their ultimate shareholding in Mercer Group.

Significant Financial Commitment

If the Rakaia Fund and Asset Management are required to subscribe for Shortfall Shares under the Underwriting Arrangements, they may need to invest up to $9.0 million in Mercer Group (assuming the Non-associated Shareholders do not take up any of their entitlements and the Rakaia Fund and Asset Management do not enter into any sub-underwrite arrangements).

The maximum underwriting exposure of $9.0 million is almost double the estimated market value of the Rolleston Associates' current equity investment of approximately $0.4 million (based on 7,286,515 shares at $0.05 per share) plus the $4.4 million of loans they have provided to the Company through Gresham.

2.16 Benefits for the Non-associated Shareholders

All Shareholders Participate in the Rights Issue

The Rights Issue is pro rata. All Non-associated Shareholders have the opportunity to take up their entitlements to acquire ordinary shares. If all Non-associated Shareholders take up their entitlements, then the Rolleston Associates will only be able to increase their shareholding through the exercise of the Rakaia Warrants from their current shareholding level of 18.62% to 44.12%.

The Rights Issue is Renounceable

The Rights Issue is renounceable, which means Non-associated Shareholders who do not wish to take up their entitlements may transfer or sell their rights.

Benefits to Mercer Group of the Rolleston Associates as a Cornerstone Shareholder

The major benefit to Mercer Group of the Underwriting Arrangements is that the Company is certain to obtain $9.0 million of equity capital (before costs) under the Rights Issue. The Company may receive an additional $0.4 million to $5.0 million of equity capital in the next 3 years, depending on the number of Rakaia Warrants granted and whether they are exercised.

In addition, the Rolleston Associates will enhance their position as an important cornerstone investor in the Company. This is particularly important as the Company's current largest shareholders - Mr and Mrs Hubbard - are in statutory management and their ability to contribute to the Company's capital requirements is uncertain at this point in time.

The Underwriting Arrangements also further signals the Rolleston Associates' confidence in the future prospects of Mercer Group.

Non-associated Shareholder Approval is Required

Pursuant to Rule 7(d) of the Code, the Non-associated Shareholders must approve by ordinary resolution the Rights Issue, the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee.

The Rights Issue will not proceed unless the Non-associated Shareholders approve the Rights Issue Resolutions.

2.17 Disadvantages to the Non-associated Shareholders

Non-associated Shareholders not Taking up Their Entitlements will be Diluted

Non-associated Shareholders who choose not to take up their rights will ultimately be diluted by those shareholders, including the Rolleston Associates, who subscribe for new ordinary shares. Their proportionate interests in the Company will reduce by 82%.

Dilutionary Impact of the Rakaia Warrants

The exercise of the Rakaia Warrants will result in the Non-associated Shareholders' proportionate interests in the Company being further diluted.

May Reduce the Likelihood of a Takeover Offer from the Rolleston Associates

The Underwriting Arrangements will result in the Rolleston Associates' shareholding in the Company increasing from 18.62% to between 44.12% and 85.97%.

An increase in the Rolleston Associates' shareholding to 85.97% will reduce the likelihood of a takeover offer for the Company from the Rolleston Associates as they may consider that they have sufficient control over the Company.

An increase in the Rolleston Associates' shareholding to 44.12% may also reduce the likelihood of a takeover offer for the Company from the Rolleston Associates. However, they will hold less than 50% of the Company's shares and therefore may consider a takeover offer to still represent the best means of achieving control of the Company if so desired.

It is possible that if the Rolleston Associates did make a takeover offer for further shares in the Company, they may offer a control premium that is lower than would otherwise be expected as they may value their offer on the basis that they already has significant control of the Company and hence do not need to pay a control premium of any significance.

Assuming all of the Rakaia Warrants are exercised, the Rakaia Fund will be the largest single shareholder amongst the Rolleston Associates, holding between 31.33% and 44.07% of the Company's shares (depending on the number of Rakaia Warrants granted). The Rakaia Fund (or any of the Rolleston Associates) will not be able to increase the level of its shareholding in Mercer Group unless it complies with the provisions of the Code. It will only be able to acquire more shares in the Company if:

- it makes a full or partial takeover offer or
- the acquisition is approved by way of an ordinary resolution of the Non-associated Shareholders or
- the Company makes an allotment of shares which is approved by way of an ordinary resolution of the Non-associated Shareholders.

The Rakaia Fund, or any of the Rolleston Associates, could also increase their level of shareholding in the Company if Mercer Group undertook a share buyback that was approved by the Company's shareholders and the Rakaia Fund, or any of the Rolleston Associates, did not accept the offer of the buyback.

The Rakaia Fund, or any of the Rolleston Associates, will not be able to increase their shareholding under the *creep* provisions of Rule 7(e) of the Code as these provisions are only available to entities that hold between 50% and 90% of the voting securities in a code company.

Likelihood of Other Takeover Offers does not Change Significantly

With the Hubbard Associates currently holding 45.13% of the shares in the Company and the Rolleston Associates currently holding 18.62%, any bidder looking to fully take over the Company would need to ensure that both the Hubbard Associates and the Rolleston Associates would accept its offer.

Following the Rights Issue and the exercise of all of the Rakaia Warrants, the Rolleston Associates will hold between 44.12% and 85.97% of the shares in the Company. The Hubbard Associates would still hold a substantial shareholding in the Company of between 7.78% and 30.99%. Accordingly, the position for any bidder would be the same – it would still need to ensure that 1 or possibly 2 significant shareholders would accept its offer.

Similarly, in the event that a bidder made a partial takeover offer for (say) 50.1% of the Company, it would currently need to ensure that the Hubbard Associates would accept its offer to ensure the success of its offer, whereas following the Rights Issue and the exercise of all of the Rakaia Warrants, it would need to ensure that the Rolleston Associates would accept its offer.

In our view, the increase in the Rolleston Associates' shareholding from 18.62% to between 44.12% and 85.97% under the Underwriting Arrangements will not have a material impact on the attraction of Mercer Group as a takeover target to other parties.

2.18 Implications of the Resolutions not Being Approved

As the Rights Issue Resolutions are interdependent, if any resolution is not approved then the Rights Issue cannot proceed.

As stated in section 2.5, we are of the view that alternative forms of raising a similar level of capital for the Company in the near term are extremely limited.

In the absence of additional capital in the near term, the Company will be unable to repay debts owing to Westpac, Gresham and Mr Hewitson or fund its working capital requirements. The Company's Westpac facility has recently been extended to 31 December 2010 and is currently being renegotiated. The Independent Directors expect that if Westpac were to extend the facility, it would insist on a substantial reduction in the level of the facility. Therefore the Rights Issue is essential to the Company to ensure that it has an adequate level of bank funding.

In the event that the Company cannot renegotiate its facility with Westpac and cannot refinance the facility, it is likely that it would need to undertake large scale asset / business sales or, in the extreme case, be placed into receivership or voluntary administration.

2.19 Voting For or Against the Rights Issue Resolutions

Voting for or against the Rights Issue Resolutions are a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

Shareholders should be cognisant that the 4 Rights Issue Resolutions are interdependent in that all 4 resolutions must be approved in order for the Rights Issue to proceed. If any 1 of the resolutions is not approved, then the Rights Issue will not proceed.

3. Evaluation of the Fairness of the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee

3.1 Basis of Evaluation

Listing Rule 1.7.2 requires an Appraisal Report to consider whether the consideration and the terms and conditions of the proposed issue are *fair* to the Non-associated Shareholders.

There is no legal definition of the term *fair* in New Zealand in either the Listing Rules or in any statute dealing with securities or commercial law.

We are of the view that an assessment of the merits of a transaction is a broader test than the fairness of the transaction and encompasses a wider range of issues associated with the transaction. The assessment of the merits of the allotment of shares under the Underwriting Arrangements must consider the fairness of the likely increase in effective control by the Rolleston Associates in Mercer Group as well as the fairness of the terms and conditions of the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

3.2 Evaluation of the Fairness of the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee for the Purposes of Listing Rule 1.7.2

In our opinion, after having regard to all relevant factors, the consideration and the terms and conditions of the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee are fair to the Non-associated Shareholders.

The basis for our opinion is set out in detail in sections 2.4 to 2.18. In summary, the key factors leading to our opinion are:

- the rationale for the Rights Issue is sound
- alternative capital raising options to the Rights Issue are limited and are unlikely to provide the same level of capital within a similar timeframe
- the structure of the Rights Issue is reasonable
- the terms and conditions of the Underwriting Arrangements are reasonable
- the structure of the Rakaia Warrants means that irrespective of the level of entitlements taken up by shareholders under the Rights Issue, the Rakaia Fund will hold 100,000,000 ordinary shares in the Company if it exercises all of the Rakaia Warrants
- the Rights Issue will have a positive impact on the Company's financial position
- the full exercise of the Rakaia Warrants will further increase the Company’s equity by between approximately $0.4 million and $5.0 million, depending on the number of Rakaia Warrants granted
- the Underwriting Arrangements will significantly increase the Rolleston Associates’ ability to influence the outcome of shareholding voting

- the Underwriting Arrangements will possibly increase the Rolleston Associates' influence over the Company's Board and operations
- Non-associated Shareholders not taking up their entitlements under the Rights Issue will see their shareholding interests diluted by 82%
- the exercise of all of the Rakaia Warrants will result in the Non-associated Shareholders' proportionate interests in the Company reducing by between 4% and 83%, depending on the levels of entitlements taken up in the Rights Issue
- the Rights Issue will likely have a material negative impact on the Company's share price
- the Underwriting Arrangements are unlikely to have any material impact on the liquidity of Mercer Group's shares
- the Underwriting Arrangements will likely reduce the attraction of Mercer Group as a takeover target to the Rolleston Associates but not necessarily to other bidders
- the implications of the Rights Issue not being approved by the Non-associated Shareholders are significant. Alternative capital raising initiatives will need to be undertaken but there is no guarantee that such initiatives will deliver the level of capital sought or provide capital within the desired timeframes.

3.3 Voting For or Against the Resolutions

Voting for or against the Rights Issue Resolutions are a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

Shareholders should be cognisant that the 4 Rights Issue Resolutions are interdependent in that all 4 resolutions must be approved in order for the Rights Issue to proceed. If any 1 of the resolutions is not approved, then the Rights Issue will not proceed.

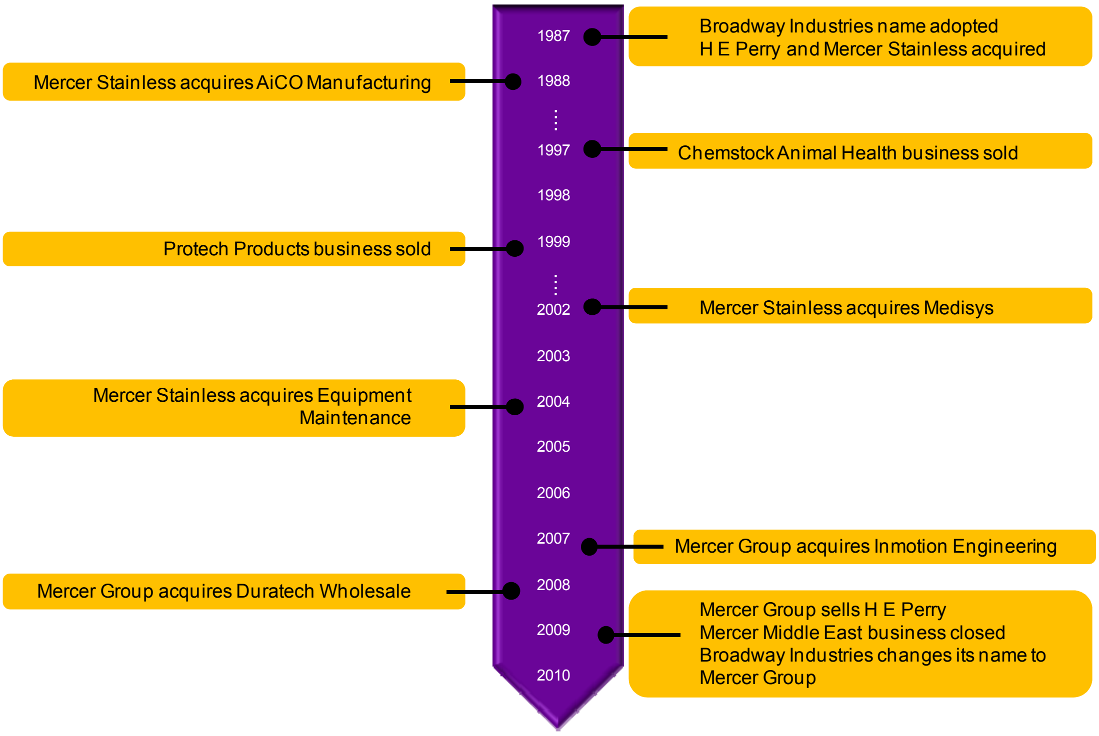
4. Profile of Mercer Group

4.1 Background

Mercer Group was incorporated on 20 November 1957 as Brother Sewing Machine Corporation (New Zealand) Limited. It subsequently traded as Brother Distributors Limited and then Brother Holdings Limited, selling knitting machines and typewriters.

The Company adopted the Broadway Industries Limited name on 2 October 1987 when the Company became an industrial investment company.

Key events since then are set out below.



4.2 Nature of Operations

The principal activities of Mercer Group today are:

- the manufacture and supply of kitchen, bathroom and laundry products in New Zealand and Australia by Mercer Products
- stainless steel fabrication and equipment manufacture and supply by Mercer Stainless workshops in Christchurch, New Plymouth and Brisbane
- the supply of specialist equipment and related products and services for sterilisation, washing and disinfection by Mercer Medical.

Mercer Products

Mercer Products operates a factory / press shop in Christchurch and a warehouse / customer services operation in Hamilton.

Its product range includes:

- imported sinks – *Reginox* (sourced from the Netherlands) and *Mercer*
- pressed sinks, tubs and bowls – *Mercer*
- laminate – *Bisonne* (sourced from Australia)
- solid surface – *Advante* and *Borelli* (sourced from Australia).

Mercer Products' key strategies are:

- aggressive growth in the Australian market through increased sales and marketing efforts
- growth in New Zealand of laminate and solid surface products
- new products
- acquisitions to achieve more rapid penetration into Australia or access to products eg taps.

Mercer Stainless

Mercer Stainless operates fabrication workshops in Christchurch, New Plymouth and Brisbane.

Its product range includes:

- bulk materials handling
- conveyors
- packaging equipment
- processing equipment
- tanks, silos and pressure vessels
- transport equipment including pressure valves
- cooler and freezer equipment
- general fabrication
- custom benching.

Mercer Stainless' key strategies are:

- build capability in sales and marketing in New Zealand and Australia
- expand into new market areas
- develop new products.

Mercer Medical

Mercer Medical operates an office / warehouse in Auckland.

Its product range includes:

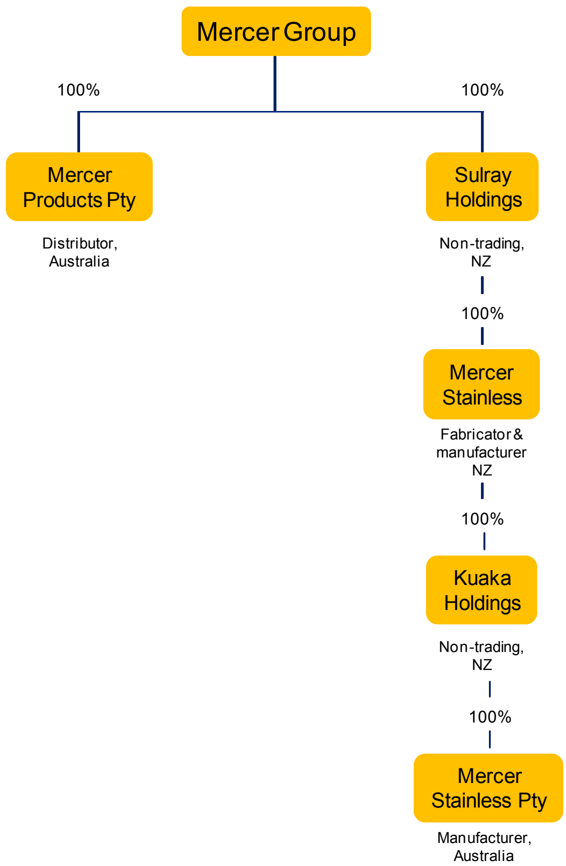
- sterilizers - *Belimed* (sourced from Switzerland) and *Matachana* (sourced from Spain)
- washers - *Steelco* (sourced from Italy) and *Labcaire* (sourced from the UK)
- detergent - *Dr Weigert* (sourced from Germany)
- blueware - *Warwick Sasco* (sourced from the UK)
- service, validation and spares.

Mercer Medical's key strategies are:

- promote its product offering
- add other products
- target new market such as laboratories.

4.3 Organisation Structure

The Company's organisation structure (excluding a number of non-trading wholly owned subsidiary companies) is set out below.



4.4 Directors

The directors of Mercer Group are:

- Ian Farrant, chairman, substantial security holder
- Stuart Heal, independent director
- Paul Hewitson, independent director
- Humphry Rolleston, substantial security holder.

We are advised that Mr Farrant, Mr Heal and Mr Hewitson are not deemed to be associates of Mr Rolleston, as defined in the Code or the Listing Rules.

4.5 Capital Structure and Shareholders

Mercer Group currently has 39,132,263 ordinary shares on issue held by 404 shareholders.

The Company undertook a 4 for 3 rights issue in November 2008, issuing 14,267,177 shares. It issued a further 4,781,243 shares to Mr and Mrs Hubbard in January 2009, following shareholder approval of the placement.

The names, number of shares and percentage holding of the 10 largest shareholders as at 26 November 2010 are set out below.

Mercer Group's 10 Largest Shareholders

Shareholder	No. of Shares Held	%
Humphry Rolleston and Graham Riley	6,372,855	16.29%
Allan Hubbard and Jean Hubbard	4,663,425	11.92%
Allan Hubbard and Jean Hubbard	4,279,804	10.94%
Allan Hubbard and Jean Hubbard	3,759,259	9.61%
Russell Field and Anthony Palmer	3,104,030	7.93%
Parvenu Holdings Limited (**Parvenu**)	2,880,317	7.36%
Allan Hubbard and Jean Hubbard	2,202,757	5.63%
Jones MacKay Limited (**Jones MacKay**)	1,570,002	4.01%
Rangitata Plains Farm Limited (**Rangitata**)	1,183,492	3.02%
Barry Lobb	886,666	2.27%
Subtotal	30,902,607	78.97%
Others (394 shareholders)	8,229,656	21.03%
Total	39,132,263	100.00%

Source: NZX Data

The Rolleston Associates collectively hold 18.62% of the Company's shares.

The Hubbard Associates include Jones MacKay and Rangitata. Collectively they hold 45.13% of the Company's shares.

Parvenu is associated with Mr Farrant, the Company's chairman.

4.6 Key Issues Affecting Mercer Group

The main industry and specific business factors and risks that Mercer Group faces include:

- reduction in demand for products and / or services
- loss of the key agencies or changes to the distribution rights under these agreements
- material changes in input costs (especially stainless steel prices) for manufactured products
- material changes in the value of the New Zealand dollar against other currencies
- disruption to manufacturing operations by industrial disputes
- claims for faulty workmanship and / or faulty product supplied
- claims for liquidated damages due to delayed supply of product
- inability to retain sufficient skilled tradesman in workshops
- the loss of key staff
- the inability to adequately finance the Company's operations.

4.7 Financial Performance

A summary of Mercer Group's recent financial performance and forecast for the current financial year is set out below.

Summary of Mercer Group Financial Performance

Continuing Operations	Year to 30 Jun 08 (Audited) $000	Year to 30 Jun 09 (Audited) $000	Year to 30 Jun 10 (Audited) $000	Year to 30 Jun 11 (Forecast) $000
Operating revenue	36,475	35,666	37,167	39,942
EBITDA	251	332	(22)	1,605
EBIT	(711)	(683)	(1,730)	315
Net surplus / (deficit) before taxation	(1,610)	(1,777)	(2,582)	(396)
Net surplus / (deficit) after taxation	(1,503)	(1,591)	(2,542)	(296)
(Deficit) from discontinued operations[1]	(358)	(1,012)	(804)	-
Net surplus / (deficit) after taxation attributable to shareholders	(1,861)	(2,603)	(3,346)	(296)
EPS (cents)	(9.5)	(8.6)	(8.6)	(0.8) [2]

EBITDA: Earnings before interest, tax, depreciation and amortisation
EBIT: Earnings before interest and tax
EPS: Earnings per share

1 H E Perry and Mercer Middle East
2 Based on 39,132,263 shares currently on issue

Source: Mercer Group audited financial statements and Mercer Group projections

The Company recorded an increase in operating revenue in the 2008 financial year, mainly attributable to acquisitions such as Inmotion Engineering in the previous year.

The downturn in earnings in the 2009 financial year was mainly due to adverse trading performance by the Company's overseas subsidiaries.

The deficit of $2.6 million in the 2009 financial year included a deficit of $1.0 million attributable to discontinued activities – the H E Perry business that was sold in June 2009 and the Mercer Middle East business that was closed in 2010.

The deficit of $3.3 million in the 2010 financial year included a deficit of $0.8 million attributable to discontinued activities and impairment of capitalised development costs of $0.6 million.

Over 60% of the Company's revenue in the 2010 financial year was from Mercer Stainless. Revenue for Mercer Stainless' New Zealand activities reduced in 2010, reflecting a substantial reduction in workloads caused by the postponement and cancellation of dairy industry capital projects. Dairy industry spending is now recovering and the business has secured good workloads for the current year. The Australian branch of Mercer Stainless recorded a significant increase in revenue in the 2010 financial year but traded at a loss.

Mercer Products accounted for approximately 30% of the Company's revenue in the 2010 financial year. Revenue remained relatively steady in 2010 as residential building activity remained static. However, an improvement in gross margins resulted in improved earnings for the business.

Mercer Group is forecasting an improvement in its financial performance in the 2011 financial year, with revenue increasing 7% to $39.9 million, EBITDA of $1.6 million and a net deficit after tax of $0.3 million. The key assumptions underlying the forecast are:

- Mercer Stainless revenue to remain relatively constant at $21.8 million, although the revenue mix between New Zealand and Australia changes with New Zealand revenue increasing by 29% to $16.2 million (driven by increased demand from the dairy industry) and Australian revenue decreasing by 45% to $5.6 million
- Mercer Products revenue to increase by 23% to $12.8 million, driven mainly by growth in Australian revenue
- Mercer Medical revenue to increase by 22% to $5.3 million
- EBITDA to improve significantly to $1.6 million, due mainly to a significant improvement in Mercer Stainless New Zealand EBITDA arising from higher revenue levels
- corporate overheads to reduce by 19% to $1.0 million (excluding internal rent recharges).

4.8 Financial Position

A summary of Mercer Group's recent financial position is set out below.

Summary of Mercer Group Financial Position				
	As at 30 Jun 08 (Audited) $000	As at 30 Jun 09 (Audited) $000	As at 30 Jun 10 (Audited) $000	As at 30 Sep 10 (Unaudited) $000
Current assets	19,502	19,857	12,669	13,871
Non current assets	13,112	13,574	16,321	15,321
Intangible assets	7,468	7,810	7,321	7,614
Total assets	40,082	41,241	36,311	36,806
Current liabilities	(23,944)	(20,647)	(19,004)	(19,809)
Term liabilities	(192)	(231)	(311)	(543)
Total liabilities	(24,136)	(20,878)	(19,315)	(20,352)
Total equity	15,946	20,363	16,996	16,454

Source: Mercer Group audited financial statements and 30 September 2010 consolidated balance sheet

The Company's main current assets are accounts receivable and inventories.

Non-current assets consist mainly of plant and equipment, land and buildings and deferred tax assets (largely arising from tax losses).

Included in assets as at 30 September 2010 was a $2.5 million receivable owing to Mercer Middle East Limited under bank letters of credit (the **MME Receivable**). The proceeds are due in July 2011 and November 2011. The letters of credit are denominated in US dollars and United Arab Emirates dirham.

Intangible assets consist mainly of acquired goodwill, development assets and acquired patents, trademarks and licences.

The Company's main liabilities are trade and other payables and borrowings.

Total borrowings amounted to $13.1 million as at 30 September 2010:

- $8.0 million owing to Westpac
- $4.4 million owing to Gresham
- $0.2 million owing to Mr Hewitson
- $0.5 million owing to hire purchase finance providers.

The Company also had $0.2 million of cash on hand as at 30 September 2010.

4.9 Cash Flows

A summary of Mercer Group's recent cash flows is set out below.

Summary of Mercer Group Cash Flows

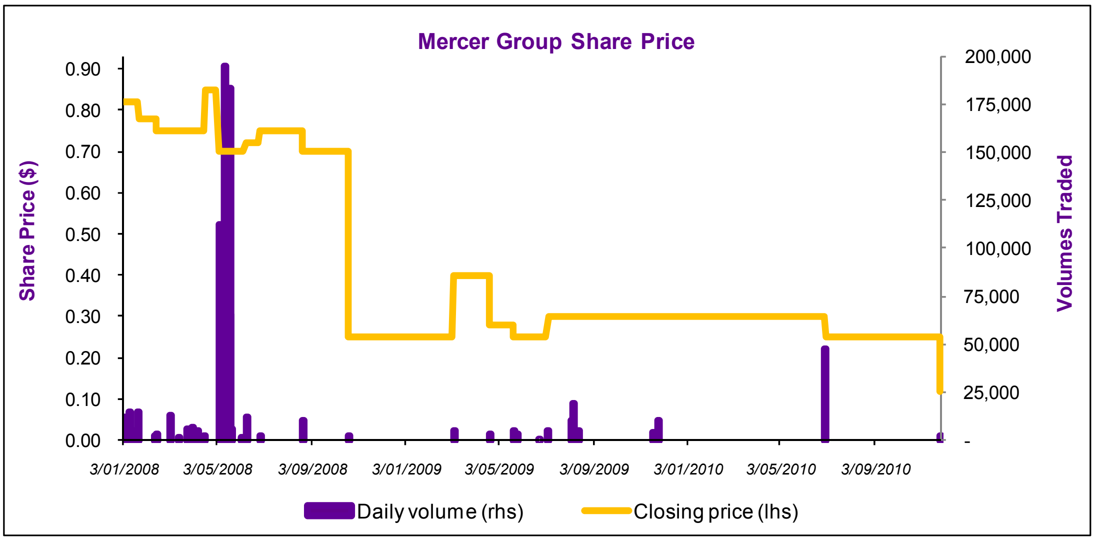
	Year to 30 Jun 08 (Audited) $000	Year to 30 Jun 09 (Audited) $000	Year to 30 Jun 10 (Audited) $000
Net cash flow from / (used in) operating activities	(654)	(3,941)	(316)
Net cash from / (used in) investing activities	(573)	(766)	542
Net cash from / (used in) financing activities	2,178	3,829	125
Net increase/(decrease) in cash held	951	(878)	351
Opening cash balance	(83)	232	(594)
Effect of exchange rate fluctuations	16	52	(18)
Cash on purchase of business	(652)	-	-
Closing cash balance	232	(594)	(261)

Source: Mercer Group audited financial statements

Acquisitions have been funded primarily by bank borrowings. $5.6 million was raised from a rights issue in November 2008. Proceeds from the sale of H E Perry of $1.0 million were received in July 2010.

4.10 Share Price History

Set out below is a summary of Mercer Group's daily closing share price and daily volumes of shares traded from 3 January 2008 to 26 November 2010.



During the period, Mercer Group's shares have traded between $0.12 and $0.85 at a VWAP of $0.66.

The Company's share price dropped significantly from $0.70 to $0.25 on 21 October 2008 on a volume of 2,000 shares following the announcement of a profit downgrade and a rights issue.

Trading in the Company's shares is extremely thin, reflecting that 63.75% of the shares are currently held by cornerstone shareholders the Hubbard Associates and the Rolleston Associates and the top 10 shareholders hold 78.97% of the shares.

An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of shares outstanding) is set out below.

Share Trading					
Period	**Low [1]**	**High [1]**	**VWAP [1]**	**Volume Traded [1] (000)**	**Liquidity**
1 month	0.12	0.12	0.12	2	0.0%
3 months	0.12	0.12	0.12	2	0.0%
6 months	0.12	0.25	0.24	50	0.1%
12 months	0.12	0.25	0.24	50	0.1%

n/a: Not applicable as there were no trades

1 To 26 November 2010

The Company's shares have only traded on 2 days (30 June 2010 and 26 November 2010) in the past year at a VWAP of $0.24.

5. Valuation of Mercer Group

5.1 Standard of Value

Following the completion of the Rights Issue, the Rolleston Associates' shareholding level will be between 44.12% and 85.97% (assuming all of the Rakaia Warrants are exercised).

We have assessed the fair market value of 100% of the shares in Mercer Group. Fair market value is defined as the price that a willing but not anxious buyer, with access to all relevant information and acting on an arm's length basis, would be prepared to pay to a willing but not anxious seller in an open, unrestricted and stable market.

5.2 Basis of Valuation

In general terms it is recognised that the value of a share represents the present value of the net cash flows expected therefrom. Cash flows can be in the form of either dividends and share sale proceeds or a residual sum derived from the liquidation of the business.

There are a number of methodologies used in valuing shares and businesses. The most commonly applied methodologies include:

- discounted cash flow (**DCF**)
- capitalisation of earnings
- net assets or estimated proceeds from an orderly realisation of assets.

Each of these valuation methodologies is applicable in different circumstances. The appropriate methodology is determined by a number of factors including the future prospects of the business, the stage of development of the business and the valuation practice or benchmark usually adopted by purchasers of the type of business involved.

The DCF method is the fundamental valuation approach used to assess the present value of future cash flows, recognising the time value of money and risk. The value of an investment is equal to the value of future free cash flows arising from the investment, discounted at the investor's required rate of return.

The capitalisation of earnings method is an adaptation of the DCF method. It requires an assessment of the maintainable earnings of the business and a selection of a capitalisation rate (or earnings multiple) appropriate to that particular business for the purpose of capitalising the earnings figure.

An assets based methodology is often used in circumstances where the assets of a company have a market value independent of the profitability of the company that owns them. A valuation based on an orderly realisation of assets is normally restricted to instances where the investor holds sufficient control to effect a sale of the assets and / or there is some indication that an orderly realisation is contemplated.

5.3 Valuation Approach

Our preferred valuation approach to assess the fair market value of Mercer Group is the DCF method. However, Mercer Group has not prepared detailed financial projections beyond the 2013 financial year and hence it is not possible to undertake any meaningful DCF analysis.

We have therefore assessed the fair market value of Mercer Group using the capitalisation of earnings method.

The capitalisation of earnings method that we have applied derives an assessment of the value of the core operating business, prior to considering how the business is financed or whether it has any significant surplus assets. This ungeared business value is commonly referred to as the enterprise value and represents the market value of the operating assets (i.e. operating working capital, fixed assets and intangible assets such as brand names, software, licences, know-how and general business goodwill) that generate the operating income of the business.

We have assessed the value of the Company's land and buildings separately from the core operating business, as an investment in land and buildings has a lower risk profile (and hence a lower required rate of return) than that of the core operating business.

To derive the value of the Mercer Group shares, it is necessary to add the value of any surplus (or non-operating) assets (including land and buildings) and deduct the value of net IBD from the assessed enterprise value.

We have also undertaken a high level DCF assessment and as assets assessment to determine the reasonableness of the valuation outcomes from the capitalisation of earnings assessment.

5.4 Capitalisation of Earnings Valuation

Introduction

We have assessed Mercer Group's future maintainable earnings and have reviewed the market valuation and operational performance of comparable companies to derive a range of earnings multiples to apply to our assessed level of maintainable earnings.

Future Maintainable Earnings

The evaluation of maintainable earnings involves an assessment of the level of profitability which (on average) the business can expect to generate in the future, notwithstanding the vagaries of the economic cycle.

The assessment of maintainable earnings is made after considering such factors as the risk profile of the business, the characteristics of the market in which it operates, its historical and forecast performance, non-recurring items of income and expenditure and known factors likely to impact on future operating performance.

We have used EBITDA as the measure of earnings. The use of EBITDA and EBITDA multiples is more common in valuing businesses for acquisition purposes as it eliminates the effect of financial leverage which is ultimately in the control of the acquirer and also eliminates any distortions from the tax position of the business and differing accounting policies in respect of depreciation and the amortisation of intangible assets.

The analysis of Mercer Group's financial performance set out in section 4.7 shows that the Company has recorded annual revenues of approximately $36 million from its current operations in the past 3 years. EBITDA over the past 3 years has ranged from nil to $0.3 million. The Company is forecasting to achieve revenue of $40 million in the 2011 financial year and EBITDA of $1.6 million. This is dependent upon Mercer Group successfully executing its key strategies (discussed in section 4.2) and successfully completing the Rights Issue.

Having evaluated the Company's business strategy, we are of the view that the most appropriate basis for assessing Mercer Group's maintainable EBITDA is its 2011 forecast. Basing maintainable EBITDA on historic earnings levels is likely to understate the value of the Company.

We assess Mercer Group's future maintainable EBITDA (prior to notional rent) to be in the vicinity of $1.6 million. In doing so, we recognise that Mercer Group has not achieved such a level of earnings in its recent past. The key risks to Mercer Group achieving its 2011 forecast are discussed in section 4.6. We have taken these risks into account when assessing an appropriate EBITDA multiple.

We have valued the Company's land and buildings separately from the core operating business. We have therefore adjusted maintainable EBITDA for $0.5 million of notional market rent on the land and buildings.

This results in maintainable EBITDA (after notional rent) of $1.1 million.

Earnings Multiple

Actual sales of comparable businesses can provide reliable support for the selection of an appropriate earnings multiple. In addition, we can infer multiples from other evidence such as minority shareholding trades for listed companies with similar characteristics to Mercer Group or transactions involving businesses in the same industry.

Given that future maintainable EBITDA represents prospective earnings, the EBITDA multiple applied must be a prospective multiple.

There is limited information available on transactions involving businesses that are truly comparable with Mercer Group's businesses to enable firm conclusions to be drawn on appropriate transaction EBITDA multiples.

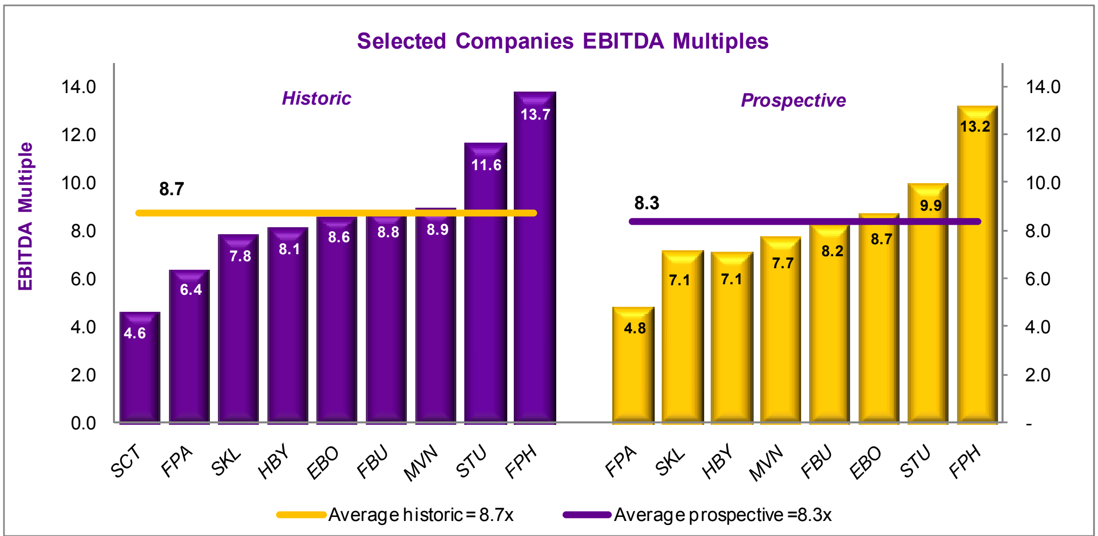
An alternative approach to assessing an appropriate EBITDA multiple is to examine the trading multiples for comparable companies. Given that Mercer Group operates 3 distinct businesses, there are no companies listed on the NZSX that are directly comparable with the Company.

In the absence of truly comparable companies, we have reviewed the trading multiples for companies listed on the NZSX that have some similarities to aspects of Mercer Group in that they operate in similar industries and / or their earnings are influenced by similar economic factors.

We have reviewed the trading multiples for the following NZSX listed companies:

- Methven Limited (**MVN**) – design, manufacture and distribution of shower, tapware and valve products for homeowners and developers in New Zealand, Australia and the United Kingdom
- Fletcher Building Limited (**FBU**) – manufacture and distribution of a wide range of building products (including steel related products), predominantly focussed on the New Zealand and Australian markets. Also operates as a construction contractor and residential builder
- Steel & Tube Holdings Limited (**STU**) – distribution, processing and fabrication of steel products in New Zealand
- Skellerup Holdings Limited (**SKL**) – manufacture and distribution of dairy and industrial rubber products, moulded and extruded technical polymer products, vacuum pumps and rural supplies in New Zealand, Australia and the United States
- Fisher & Paykel Appliances Holdings Limited (**FPA**) – design, manufacture and marketing of household appliances primarily in New Zealand, Australia, North America and Europe
- Scott Technology Limited (**SCT**) – design and manufacture of automated production and process machinery for the appliance and meat processing industries
- EBOS Group Limited (**EBO**) – supplier of a range of medical, surgical, retail, dental and scientific products to the healthcare markets in New Zealand and Australia
- Fisher & Paykel Healthcare Corporation Limited (**FPH**) – design, manufacture and marketing of medical device products and systems for use in respiratory care, acute care and the treatment of obstructive sleep apnea
- Hellaby Holdings Limited (**HBY**) – an investment company engaged in industrial, distribution and retail businesses in New Zealand and Australia.

The graph below summarises the historic and prospective trading EBITDA multiples for the selected companies.



Source: Capital IQ, data as at 26 November 2010

The analysis shows a wide range of prospective EBITDA multiples for the selected companies ranging from 4.8x to 13.2x at an average of 8.3x.

The observed EBITDA multiples are based on trading prices for minority parcels of shares. It is common for a premium for control to be paid when acquiring a controlling interest in a company. In such circumstances, a higher earnings multiple may be applied against the assessed maintainable earnings figure. However, this would be offset by a discount for size as Mercer Group is considerably smaller than the selected companies and an investment in Mercer Group is not as liquid as an investment in most of the selected companies. Furthermore, as previously stated, the level of assessed maintainable earnings is based on the Company's forecast 2011 EBITDA which is significantly higher than historic levels of EBITDA. In this instance, we are of the view that adjustment to the observed EBITDA multiples in respect of a discount for size, illiquidity and uncertainty regarding the achievability of the 2011 forecast exceeds an adjustment in respect of a control premium.

We consider an appropriate prospective EBITDA multiple for Mercer Group to be in the range of 6.0x to 7.0x.

Capitalisation of EBITDA Valuation

Based on the above, we assess the enterprise value of Mercer Group to be in the range of $6.6 million to $7.7 million.

Capitalisation of EBITDA Valuation

	Low	High
Future maintainable EBITDA ($000)	1,100	1,100
EBITDA multiple	6.0 x	7.0 x
Mercer Group enterprise value ($000)	6,600	7,700

5.5 Value of 100% of the Shares

To derive the value of the Mercer Group shares, it is necessary to add the value of surplus assets and land and buildings and deduct the value of Mercer Group's net IBD from its enterprise value.

Mercer Group has $2.5 million owing to it under the MME Receivable. We have treated this as a surplus asset. We assess the value of the receivable to be in the vicinity of $2.4 million based on current exchange rates and taking into account the time value of money.

The market value of the Company's land and buildings was assessed at $5.3 million in 2009.

Valuation of Land and Buildings		
	53 Lunns Road, Christchurch	**73 Corbett Road, New Plymouth**
Date of valuation	5 May 2009	23 March 2009
Valuer	TelferYoung (Canterbury) Limited	TelferYoung (Taranaki) Limited
Valuation	$3,350,000	$1,950,000
Valuation approaches	Depreciated replacement cost Direct capitalisation DCF	Depreciated replacement cost Direct capitalisation
Market rent	$315,354	$162,000
Market return (yield)	9.25%	9.00% - 10.00%

We consider the 2009 assessed values to be a reasonable proxy for the current market value of the land and buildings.

Mercer Group's net IBD as at 30 September 2010 was $12.9 million.

Based on the above, we assess the fair market value of all the shares in Mercer Group to be in the range of $1.4 million to $2.5 million. This equates to $0.04 to $0.06 per share.

Value of 100% of the Shares		
	Low $000	**High $000**
Mercer Group enterprise value	6,600	7,700
Surplus assets – MME Receivable	2,418	2,418
Land and buildings	5,300	5,300
Net IBD	(12,876)	(12,876)
Value of Mercer Group shares	1,442	2,542
No. of shares on issue (000)	39,132.3	39,132.3
Value per share ($)	$0.04	$0.06

5.6 Reasonableness Tests

DCF Assessment

We have incorporated the Company's 3 year projections for the 2011 to 2013 financial years into a high level DCF model to determine the reasonableness of the valuation outcomes from the capitalisation of earnings assessment.

Based on a series of assumptions that we believe are reasonable in the circumstances, the values implied by the DCF model are generally consistent with the valuation outcomes from the capitalisation of earnings assessment. The DCF assessment is predicated on the Company receiving the additional capital from the Rights Issue.

Assets Assessment

The Company's NTA per share as at 30 September 2010 was $0.23 (including $0.09 attributable to deferred tax assets), which is significantly higher than the values assessed under the capitalisation of earnings approach and indicated by the DCF assessment.

We have therefore assessed the value of the shares by applying an assets basis, assuming an orderly realisation of the Company's assets.

Taking into account the specialised nature of the Company's plant and equipment and its inventory, we would not expect that the carrying values of those assets could be fully realised under an orderly realisation process. The deferred tax assets largely relate to tax losses and hence would have no value if the Company was liquidated. When realisation costs and closure costs are taken into account, the values implied by the assets approach are below the upper end of the capitalisation of earnings valuation range.

5.7 Valuation Conclusion

In our view, the fair market value of all of the shares in Mercer Group is in the range of $1.4 million to $2.5 million as at the present date. This equates to $0.04 to $0.06 per share.

6. Valuation of the Rakaia Warrants

6.1 Methodology and Valuation Approach

The Rakaia Warrants can be exercised on the last business day of any month during the 3 year exercise period (subject, however, to the ability of the Rakaia Fund to exercise the Rakaia Warrants immediately should the Company be subject to a takeover offer or a change in effective control). Therefore the Rakaia Warrants are American options (as opposed to European options which can only be exercised on one particular day).

The Binomial option-valuation model (**Binomial Model**) and the Black-Scholes option-valuation formula (**Black-Scholes Formula**) are commonly used in commercial practice to value options. The Binomial Model is more appropriate for the valuation of American options and options over shares which are expected to pay dividends during the exercise period, although variants of the Black-Scholes Formula exist to handle the valuation of such options.

The key variables in determining the value of an American Option are:

- the exercise price of the option
- the risk free rate
- the current spot price or market value of the underlying instrument
- the volatility of the returns on the underlying instrument
- the time to expiry
- the expected distributions to be made on the underlying instrument.

The values derived from the Binomial Model and Black-Scholes Formula represent the value of options over existing shares. The Rakaia Warrants will require Mercer Group to issue new shares when they are exercised. Accordingly, an adjustment must be made to the values derived from the Binomial Model and Black-Scholes Formula to take into account the dilutionary effect of the Rakaia Warrants.

Furthermore, the values derived from the Binomial Model and Black-Scholes Formula represent the value of options which are freely tradable. Given that the Rakaia Warrants will not be freely traded, we have further adjusted the values derived from the Binomial Model and Black-Scholes Formula to allow for the lack of marketability of the Rakaia Warrants.

6.2 Valuation Assessment

Valuation Parameters

The key variables applied in our assessment of the value of the Rakaia Warrants are:

- valuation date – 17 December 2010, being the expected grant date of the Rakaia Warrants
- exercise price - $0.05 per share
- the risk free rate – 4.2% based on the current yield on New Zealand Government 3 year bonds
- the current market value of Mercer Group shares – $0.05, being the subscription price under the Rights Issue. As the Rights Issue will result in the number of shares on issue increasing by 460%, we consider the Rights Issue subscription price to be a reasonable indicator of the value that the Company's shares may trade at immediately post the Rights Issue
- volatility – 30%, based on the observed volatility levels of movements in Mercer Group's share price and for comparable companies
- the time to expiry – 17 December 2013, being the last day that the Rakaia Warrants may be exercised
- expected distributions – assumed to be nil.

Dilutionary Effect

The Binomial Model and Black-Scholes Formula assume that the options are over existing shares. However, Mercer Group will need to issue 7,791,590 to 100,000,000 new shares if the Rakaia Warrants are exercised and therefore the new shares will have a dilutionary effect. This is taken into account in our valuation.

We have assumed that the number of shares on issue prior to the exercise of the Rakaia Warrants is 219,140,673, being the 39,132,263 shares currently on issue and the 180,008,410 shares to be issued under the Rights Issue.

Discount for Lack of Marketability

The Binomial Model and Black-Scholes Formula assume that the options being valued can be sold on a secondary market. While the Rakaia Warrants can be transferred or assigned by the Rakaia Fund, they will not be listed on the NZSX. Accordingly, a discount to the values derived from the Binomial Model and Black-Scholes Formula is required to reflect the lack of marketability. We have applied a discount of 20% to the values assessed under the Binomial Model and Black-Scholes Formula (adjusted for dilution).

Conclusion

Based on the above, we assess the fair market value of each Rakaia Warrant to be in the range of $0.004 (based on the maximum 100,000,000 warrants being granted) to $0.01 (based on the minimum 7,791,590 warrants being granted). Accordingly, we assess the fair market value of the Rakaia Warrants to total $78,000 to $400,000.

7. Sources of Information, Reliance on Information, Disclaimer and Indemnity

7.1 Sources of Information

The statements and opinions expressed in this report are based on the following main sources of information:

- the draft notice of annual meeting
- the Mercer Group annual reports for the years ended 30 June, 2008 to 2010
- the Mercer Group consolidated balance sheet as at 30 September 2010
- the Mercer Group budget for the year ended 30 June 2011
- the Mercer Group projections for the 2011 to 2013 financial years prepared for the Rakaia Fund's due diligence review of the Company and submitted to Westpac
- the draft Prospectus
- the Underwriting Agreement
- the Warrant Subscription Agreement
- the TelferYoung land and buildings valuation reports dated 11 May 2009 and 13 May 2009
- data in respect of Mercer Group and comparable companies from NZX Data and Capital IQ.

During the course of preparing this report, we have had discussions with and/or received information from the directors and executive management of Mercer Group and Mercer Group's legal advisers.

The Independent Directors have confirmed that we have been provided for the purpose of this Independent Adviser's Report and Appraisal Report with all information relevant to the Rights Issue, the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee that is known to them and that all the information is true and accurate in all material aspects and is not misleading by reason of omission or otherwise.

Including this confirmation, we have obtained all the information that we believe is desirable for the purpose of preparing this Independent Adviser's Report and Appraisal Report.

In our opinion, the information to be provided by Mercer Group to the Non-associated Shareholders is sufficient to enable the Independent Directors and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the Rights Issue, the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee.

7.2 Reliance on Information

In preparing this report we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by Mercer Group and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of Mercer Group. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

7.3 Disclaimer

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of Mercer Group will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of Mercer Group and its directors and management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

Our evaluation has been arrived at based on economic, exchange rate, market and other conditions prevailing at the date of this report. Such conditions may change significantly over relatively short periods of time. We have no obligation or undertaking to advise any person of any change in circumstances which comes to our attention after the date of this report or to review, revise or update our report.

We have had no involvement in the preparation of the notice of annual meeting issued by Mercer Group and have not verified or approved the contents of the notice of annual meeting. We do not accept any responsibility for the contents of the notice of annual meeting except for this report.

7.4 Indemnity

Mercer Group has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. Mercer Group has also agreed to indemnify Simmons Corporate Finance and its directors and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where Simmons Corporate Finance or its directors and employees are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, Simmons Corporate Finance shall reimburse such costs.

8. Qualifications and Expertise, Independence, Declarations and Consents

8.1 Qualifications and Expertise

Simmons Corporate Finance is a New Zealand owned specialist corporate finance advisory practice. It advises on mergers and acquisitions, prepares independent expert's reports and provides valuation advice.

The person in the company responsible for issuing this report is Peter Simmons, B.Com, DipBus (Finance), CFIP.

Simmons Corporate Finance and Mr Simmons have significant experience in the independent investigation of transactions and issuing opinions on the merits and fairness of the terms and financial conditions of the transactions.

8.2 Independence

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with Mercer Group, Mr Rolleston, the Rakaia Fund or Asset Management or any conflicts of interest that could affect our ability to provide an unbiased opinion in relation to these transactions.

Simmons Corporate Finance has not had any part in the formulation of the Rights Issue, the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee or any aspects thereof. Our sole involvement has been the preparation of this report.

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the voting in respect of the Rights Issue, the Underwriting Arrangements, the Rakaia Warrants and the Arrangement Fee. We will receive no other benefit from the preparation of this report.

8.3 Declarations

An advance draft of this report was provided to the Independent Directors for their comments as to the factual accuracy of the contents of the report. Changes made to the report as a result of the circulation of the draft have not changed the methodology or our conclusions.

Our terms of reference for this engagement did not contain any term which materially restricted the scope of the report.

8.4 Consents

We consent to the issuing of this report in the form and context in which it is to be included in the notice of annual meeting to be sent to Mercer Group's shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without our prior written consent as to the form and context in which it appears.

Peter Simmons
Director
Simmons Corporate Finance Limited
29 November 2010