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DOCUMENT THAT
REQUIRES YOUR
IMMEDIATE ATTENTION**

DO NOT SELL Recommendation

KIRKCALDIE & STAINS LIMITED

Target Company Statement

In relation to a full takeover offer by Mercantile NZ Limited

1 April 2016

Prepared in accordance with rule 46 and schedule 2 of the Takeovers Code

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Letter to shareholders (from the Directors)

1 April 2016

Dear shareholders

The Directors of Kirkcaldie & Stains unanimously recommend that you DO NOT SELL your shares in the Company to Mercantile NZ Limited and that you should REJECT Mercantile's Offer.

On 15 March 2016, Mercantile NZ Limited ('Mercantile') made a conditional full takeover offer ('Offer') to purchase all of the fully paid ordinary shares in Kirkcaldie & Stains Limited ('Kirkcaldie & Stains' or 'the Company').

We recommend that you do not sell your shares to Mercantile and you should reject Mercantile's Offer.

The reasons for this recommendation are set out in this Target Company Statement (see in particular the discussion at section 18) but, in short, we believe that shareholders (in the absence of the special circumstances of any particular shareholder) will receive greater value by waiting for a distribution of the assets of the Company as a consequence of it being wound up.

We have calculated a High and Low Scenario which we believe to be realistically achievable in a winding up. These will enable you to consider the alternative to accepting the Mercantile Offer.

The High Scenario contemplates a distribution to shareholders of \$3.49 per share in a shareholder approved winding up of the Company and the Low Scenario a distribution of \$2.99 per share¹. The basis and assumptions on which these scenarios have been prepared is discussed in detail in section 18.

Mercantile has offered **NZD\$2.75 per share, payable in cash** (subject to potential adjustments as detailed at clause 6 in the Offer).

The Mercantile Offer is accordingly 24 cents per share less than the Board's assessed Low Scenario and 74 cents less than the High Scenario.

The main factor which will determine whether the High or Low Scenario eventuates is whether the announced transaction in connection with the Petone lease is confirmed. If it is confirmed, we are confident of achieving the High Scenario. We hope to be able to advise you of this within the coming week, and an announcement will be made to NZX just as soon as the position becomes clear.

While the Mercantile Offer provides a known fixed sum, and while there are some other uncertainties associated with both the High and Low Scenarios, and there will be some delay in moving to a winding up and making a distribution, we do not believe those uncertainties, or the delay, are such that the Mercantile Offer can be considered attractive.

We discuss these issues in more detail in this document.

To review the Offer and to discharge Kirkcaldie & Stains' obligations under the New Zealand Takeovers Code, each of the Directors gave consideration to whether they were independent of the

¹ Note: The Board's High and Low Scenarios have not applied a discount for the time value of money, whereas the Independent Adviser's Report uses a post-tax discount rate of 5%. Shareholders should consider their own circumstances and alternative investments to adjust for the time value of money.

Offer and concluded that all of them were independent of the Offer and could therefore all assess the Offer. The Directors then appointed Northington Partners as the Independent Adviser.

The Independent Adviser has also concluded that the Mercantile Offer is not fully priced (see clause 2.2.1 of the Independent Adviser's Report).

The Independent Adviser has also made a high and low assessment of value. Their high assessment is \$3.44 and their low assessment is \$3.26. The Board has reservations about the low assessment, but can see that if the current Petone lease deal does not proceed, but an alternative transaction occurs (albeit at a later date), then a figure above the Board's Low Scenario will eventuate.

We encourage you to read the Target Company Statement and Independent Adviser's Report (see in particular sections 2.3 and 2.7) that accompany this letter and to seek your own professional advice so as to be able to consider the Offer in the context of your own circumstances.

The Offer is due to close on 13 May 2016. The independent Directors will keep shareholders informed of any new information or changes in circumstances relevant to the Offer that arise before the Offer closes. The best place to access the latest such information is NZX's website www.nzx.com and search on the Company using its name or code 'KRK'.

For further information please contact Orsola Del Sante-Bland at Orsola.DelSante-Bland@kirkcaldies.co.nz.

Yours sincerely



Falcon Clouston
Chairman
On behalf of all the Directors

SUMMARISED TABLES

Board's High Scenario	Board's Low Scenario	Mercantile's Offer
\$3.49 74 cents higher than the Mercantile Offer	\$2.99 24 cents higher than the Mercantile Offer	\$2.75

Independent Adviser's High Scenario	Independent Adviser's Low Scenario	Independent Adviser's Midpoint	Mercantile's Offer
\$3.44 69 cents higher than the Mercantile Offer	\$3.26 51 cents higher than the Mercantile Offer	\$3.35 60 cents higher than the Mercantile Offer	\$2.75

Target Company Statement

(prepared pursuant to rule 46 and schedule 2 of the Takeovers Code Approval Order 2000)

1 Date

1.1 This Target Company Statement ('Statement') is dated 1 April 2016.

2 Offer

2.1 This Statement relates to a full takeover offer ('Offer') by Mercantile NZ Limited ('Mercantile') to purchase all of the fully paid ordinary shares ('Shares') of Kirkcaldie & Stains Limited ('Kirkcaldie & Stains' or 'the Company').

2.2 Mercantile has offered NZD\$2.75 per share, payable in cash.

2.3 The Offer closes at 7.00pm (NZ time) on 13 May 2016.

2.4 The terms of the Offer are set out in the offer document dated 15 March 2016 ('Offer Document'), which was despatched to shareholders on 18 March 2016.

3 Target company

3.1 The name of the target company is Kirkcaldie & Stains Limited (in this document either 'Kirkcaldie & Stains' or 'the Company').

4 Directors of Kirkcaldie & Stains

4.1 The Directors of Kirkcaldie & Stains are:

- a Falcon Clouston;
- b Michael Gerard Curtis; and
- c Kerry Leigh Prendergast.

5 Ownership of equity securities of Kirkcaldie & Stains

5.1 None of the Directors or senior officers² of Kirkcaldie & Stains ('Director' or 'Senior Officer' respectively) hold equity securities in Kirkcaldie & Stains.

5.2 An associate of Director Michael Gerard Curtis, LQ Investments Limited holds 398,000 shares in Kirkcaldie & Stains, being 19.48% of the total shares on issue.

5.3 Schedule 1 sets out:

- a the number, designation, and percentage of the equity securities³ of any class of Kirkcaldie & Stains held or controlled by LQ Investments Limited as the only associate of a Director or Senior Officer of Kirkcaldie & Stains that holds equity securities in Kirkcaldie & Stains; and
- b the number, designation, and percentage of the equity securities of any class of Kirkcaldie & Stains held or controlled by any other persons who hold or control 5% or

² For the purposes of the Takeovers Code and this Statement, the senior officer of Kirkcaldie & Stains is Orsola Del Sante-Bland (Acting CEO and Company Secretary).

³ For the purposes of the Takeovers Code and this Statement, the equity securities of Kirkcaldie & Stains are the Shares.

more of any class of equity securities of Kirkcaldie & Stains, to the knowledge of Kirkcaldie & Stains.

- 5.4 Other than as set out in paragraphs 5.1, 5.2 and Schedule 1, to the knowledge of Kirkcaldie & Stains, no other person holds or controls 5% or more of any class of equity security of Kirkcaldie & Stains.
- 5.5 Other than as set out in paragraph 5.1, 5.2 and Schedule 1, no Director or Senior Officer, and no associate of any Director or Senior Officer, holds or controls any equity securities of Kirkcaldie & Stains.
- 5.6 There have been no equity securities of Kirkcaldie & Stains that have, during the two year period ending on 1 April 2016 (the date of this Statement), been issued to the Directors or Senior Officers or their associates. The Board notes that LQ Investments Limited's shareholding has not changed since 15 March 2006.
- 5.7 No Directors and Senior Officers or their associates have, during the two year period ending on 1 April 2016 (the date of this Statement), obtained a beneficial interest under any employee share scheme or other remuneration arrangement.

6 Trading in Kirkcaldie & Stains equity securities

- 6.1 No person referred to in paragraphs 5.1 and 5.2 has, during the six month period before 29 March 2016, acquired or disposed of any equity securities of Kirkcaldie & Stains. No such person has a relevant interest in any derivative relating to the ordinary shares of the Company, nor in that six month period traded in any such derivative.

7 Acceptance of the Offer

- 7.1 If either LQ Investments Limited or H & G Limited does not accept the Offer, but Mercantile receives acceptances for more than 50% of all the ordinary shares, and Mercantile waives the condition at paragraph 4(a) of the Offer that it receives acceptances for 90% of the voting rights, Mercantile could not in that event move to compulsorily acquire the outstanding shares as it will not be the holder of 90% or more of the voting rights in the Company.
- 7.2 Shareholders are also referred to section 2.3 of the Independent Adviser's Report which discusses their view of the implications of Mercantile receiving acceptances for more than 50% but less than 90% of the voting rights in the Company.
- 7.3 The Board has received a communication which indicates that LQ Investments Limited, the only associate of a Director or Senior Officer (that associate being Mike Curtis), does not intend to accept the Offer (in its present form) in respect of all of the equity securities in Kirkcaldie & Stains held or controlled by LQ Investments Limited as set out in Schedule 1. The Directors are unaware of the intentions of any other shareholder.

8 Ownership of equity securities of Mercantile

- 8.1 Mercantile Investment Company Limited (an Australian company) holds all 100 shares in Mercantile.
- 8.2 Neither Kirkcaldie & Stains, nor any Director or Senior Officer, nor any of their associates, hold or control any equity securities in Mercantile.
- 8.3 Mercantile Investment Company Limited is currently the beneficial owner of 203,137 shares in Kirkcaldie & Stains, being 9.94% of the total shares on issue in Kirkcaldie & Stains.

9 Trading in equity securities of Mercantile

- 9.1 None of Kirkcaldie & Stains, or any Director or Senior Officer, or any of their associates, has acquired or disposed of any equity securities of Mercantile during the six month period before 29 March 2016.

10 Arrangements between Mercantile and Kirkcaldie & Stains

- 10.1 There are no agreements or arrangements (whether legally enforceable or not) made, or proposed to be made, between Mercantile (or any associates of Mercantile) and Kirkcaldie & Stains (or any related company of Kirkcaldie & Stains) in connection with, in anticipation of, or in response to, the Offer.

11 Relationship between Mercantile and Directors and Senior Officers

- 11.1 There are no agreements or arrangements (whether legally enforceable or not) which have been made, or are proposed to be made, between Mercantile (or any associates of Mercantile) and any of the Directors or Senior Officers or any directors or senior officers of any related company of Kirkcaldie & Stains (including any payment or other benefit proposed to be made or given by way of compensation for loss of office, or as to their remaining in or retiring from office) in connection with, in anticipation of, or in response to, the Offer.
- 11.2 None of the Directors or Senior Officers are directors or senior officers of Mercantile or any related company of Mercantile.

12 Agreement between Kirkcaldie & Stains and Directors and Senior Officers

- 12.1 There are no agreements or arrangements (whether legally enforceable or not) that have been made, or are proposed to be made, between Kirkcaldie & Stains (or any related company of Kirkcaldie & Stains) and:
- a any Directors or Senior Officers (or their associates); or
 - b any directors or senior officers (or their associates) of any related company of Kirkcaldie & Stains,
- under which a payment or other benefit may be made or given by way of compensation for loss of office, or as to their remaining in or retiring from office in connection with, in anticipation of, or in response to, the Offer.

13 Interests of Directors and Senior Officers in contracts of Mercantile or related company

- 13.1 No Director or Senior Officer nor their respective associates, has any interest in any contract to which Mercantile (or any related company of Mercantile) is a party.

13A Interests of substantial security holders in material contracts of Mercantile or related company

- 13A.1 No person who, to the knowledge of the Directors and Senior Officers, holds or controls 5% or more of any class of equity securities of Kirkcaldie & Stains, has to the knowledge of the Board any interest in any material contract to which Mercantile (or any related company of Mercantile) is a party.

14 Additional Information

- 14.1 In the opinion of the Directors, no additional information is required to be added to the Offer Document to make the information in the Offer Document correct or not misleading.
- 14.2 The Directors note however that the statement in the letter from Mercantile's Chairman appearing on page 1 of the Offer that *'There are three leases outstanding'* is not technically correct. There are in fact four possible lease exposures, as a residual liability remains under the Store lease notwithstanding its assignment to David Jones. The Directors do not consider this possible liability as one which would likely eventuate, nor one which would hinder a winding up of the Company. This matter, along with the other leases, is discussed in more detail below at section 18. Shareholders are urged to read this section carefully.

15 Recommendation

- 15.1 The Directors of Kirkcaldie & Stains (Falcon Clouston, Michael Gerard Curtis, and Kerry Leigh Prendergast) **unanimously recommend that security holders reject the Offer from Mercantile in the absence of a superior proposal.**
- 15.2 The principal reasons for making this recommendation include:
- a The Mercantile Offer of \$2.75 per share contrasts with our High Scenario of \$3.49 per share and our Low Scenario of \$2.99 per share;
 - b The Mercantile Offer is accordingly 24 cents less than the Low Scenario and 74 cents less than the High Scenario;
 - c We accept that there are some uncertainties associated with the timing and achievement of the High and Low Scenarios, and there will be some delay in moving to a winding up and making a distribution, but we do not believe those uncertainties, or the delay, are such that the Mercantile Offer can be considered attractive;
 - d The Directors' views are supported by the views of the Independent Adviser.
- 15.3 Shareholders are urged to read section 18 of this Target Company Statement carefully.
- 15.4 None of the Directors are associates of Mercantile, and therefore none of the Directors have a conflict of interest in respect of the Offer which requires them to abstain from making any recommendation as to whether to accept or reject the Offer.

16 Actions of Kirkcaldie & Stains

- 16.1 Kirkcaldie & Stains entered into an agreement with the Independent Adviser, dated 1 March 2016, as a consequence of, in response to, and in connection with, the Offer, under which the Independent Adviser was appointed as the independent adviser for the purposes of preparing an independent adviser's report for the purposes of complying with rule 21 of the Takeovers Code.
- 16.2 Other than as set out in paragraph 16.1, there are no material agreements or arrangements (whether legally enforceable or not) of Kirkcaldie & Stains (or any related company of Kirkcaldie & Stains) entered into as a consequence of, in response to, or in connection with, the Offer.
- 16.3 There are no negotiations underway as a consequence of, in response to, or in connection with, the Offer that relate to or could result in:

- a an extraordinary transaction, such as a merger, amalgamation, or reorganisation, involving Kirkcaldie & Stains (or any related company of Kirkcaldie & Stains);
 - b the acquisition or disposition of material assets by Kirkcaldie & Stains (or any related company of Kirkcaldie & Stains);
 - c an acquisition of equity securities by, or of, Kirkcaldie & Stains (or any related company of Kirkcaldie & Stains); or
 - d any material change in the equity securities on issue, or policy relating to distributions, of Kirkcaldie & Stains.
- 16.4 The High and Low Scenarios assume that no such actions occur prior to a winding up of the Company (see paragraph 21.2 for a list of the other assumptions on which these Scenarios are based).

17 Equity Securities of Kirkcaldie & Stains

- 17.1 Kirkcaldie & Stains only has one class of equity securities on issue, being 2,042,942 Ordinary Shares. These are all fully paid ordinary shares. Subject to the constitution of Kirkcaldie & Stains and the NZSX Listing Rules, the Ordinary Shares confer on the holders of the Ordinary Shares the right to:
- a one vote on a poll at a meeting of Kirkcaldie & Stains on any resolution, including any resolution to:
 - i appoint or remove a director or auditor;
 - ii alter Kirkcaldie & Stains' constitution;
 - iii approve a major transaction;
 - iv approve an amalgamation of Kirkcaldie & Stains under the Companies Act 1993;
 - v put Kirkcaldie & Stains into liquidation;
 - b the right to an equal share in dividends authorised by the board of Kirkcaldie & Stains; and
 - c the right to an equal share in the distribution of the surplus assets of Kirkcaldie & Stains.

18 Financial Information

- 18.1 **Shareholders are urged to read this section carefully. It contains important information relevant to your consideration of Mercantile's Offer and your alternatives.**
- 18.2 Every person to whom the Offer is made is entitled to obtain from Kirkcaldie & Stains a copy of Kirkcaldie & Stains' most recent annual report (being the annual report for the period ended 30 August 2015 (the 'Annual Report') by making a written request to the address set out below. The half yearly report (being the half yearly report for the period ended 28 February 2016) (the 'Half Yearly Report') will be available on the website referred to below in the week commencing 4 April 2016 and you will likewise be entitled to obtain a copy of this report by making a written request to:

Kirkcaldie & Stains Limited
19 Regent Street
Petone, Lower Hutt 5012
New Zealand

or to: Orsola.DelSante-Bland@kirkcaldies.co.nz

A copy of the Annual Report is also available on the NZX website:
<https://www.nzx.com/companies/KRK/announcements/273988>

- 18.3 Since the 2015 Annual Report, Kirkcaldie & Stains has sold or otherwise disposed of most of its assets with a number of receivables outstanding. In particular:
- a Kirkcaldie & Stains discontinued its retail operations on 16 January 2016. It now has no other business and the Board does not intend to commence any business or enter into any new commitment.
 - b Kirkcaldie & Stains settled its sale and purchase agreement with David Jones Pty Limited ('David Jones') on 1 February 2016 and the Store lease was assigned to David Jones.
 - c Kirkcaldie & Stains made the Share Cancellation under which the Company cancelled four out of every five ordinary shares and made a total distribution of \$19,353,376 (\$2.3602 per share cancelled) to all shareholders on 29 February 2016.
 - d As at 29 March 2016 the Company held cash or cash equivalents of \$6,172,000.
 - e In addition to the above, \$2 million in cash is being held by Kensington Swan in escrow on interest bearing deposit until 1 February 2017 in case of any claim made against Kirkcaldie & Stains under the sale and purchase agreement. The Board has not been notified by David Jones of any claim and is not aware of any circumstances which would result in such a claim being likely.
 - f The remaining cash of the Company is likewise being held on interest bearing terms subject to the need to make provision for payments under the lease commitments discussed below and other sundry creditors.
 - g The Company has few available imputation credits and all its available subscribed capital has been returned to shareholders as a consequence of the distribution in February 2016.
 - h This means that the Company cannot presently make any further material distributions of its cash to shareholders in a tax effective manner. This could only occur in the course of a winding up of the Company (see further below at paragraph 18.18).
 - i Shareholders should accordingly presently assume that there will be no distributions to shareholders from the Company except on the winding up of the Company. This may, but is not presently considered likely, to occur before 1 February 2017.
 - j The Board's present intention is to move promptly to a formal winding up following 1 February 2017 and seek an early distribution of the bulk of the remaining cash of the Company.
- 18.4 At the same time as the Company has been realising its assets into cash or cash equivalents, the Company's material liabilities have been reduced to those arising from its outstanding lease commitments. It is these liabilities which could reasonably be expected to be material to the making of a decision by shareholders to accept or reject the Offer.
- 18.5 The Company has lease liabilities (direct or contingent) arising from four outstanding lease commitments:
- a The 'Store lease' for the main store premises assigned to David Jones Pty Limited

- b The 'Petone lease' for the Company's former warehouse and administrative office space
- c The 'Thorndon Quay lease' for the Company's former home furnishings outlet
- d The 'Pantry lease' which was part of the main store premises but in fact located in an adjacent building and subject to a separate sublease from the owner of the ground floor of Central House, which was not assigned to David Jones

Each lease requires a comment.

- 18.6 **The Store lease:** As shareholders are aware the Company has assigned the Store lease to David Jones under the David Jones Agreement. When a lessee assigns its interest in a lease, the lessee remains liable for the ongoing performance of the obligations of the assignee under the lease in the event that the assignee does not perform those obligations. In this case Kirkcaldie & Stains could be liable to the lessor (Jones Cooper Partners Limited) in the event that David Jones failed to perform its obligations under the Store lease at any stage in the future during the current term of the lease. The Directors consider the likelihood of such an occurrence as low, and also note that even in that event, the Company would have contractual rights against David Jones to recover any loss suffered. The Company has no reason to doubt the financial strength of David Jones and its ability to meet its obligations under the Store lease and the David Jones Agreement.

More importantly, Robt. Jones Holdings Limited has written to the Company and confirmed that neither it nor Jones Cooper Partners Limited (the lessor of the Store lease) 'will oppose the voluntary liquidation of Kirkcaldie & Stains.'

Robt. Jones Holdings Limited in the same letter noted that: 'Should Kirkcaldie & Stains Limited continue as an entity (including under a different name or ownership) the contingent liability...in the event of David Jones default shall remain'.

On the basis of this communication from Robt. Jones Holdings Limited the Directors do not believe shareholders need make any allowance for a possible liability in respect of the Store lease maturing into an actual liability in the event the Company is wound up within the timeframes expected (i.e. during the course of 2017).

- 18.7 **The Petone lease:** In the Board's view the Petone lease represents the Company's most significant ongoing liability, and how this lease is dealt with will largely determine the achievement of the High or Low Scenarios.

This lease expires on 30 April 2023. If left to run to its expiry date the total rent and outgoings are assessed to be approximately \$1,446,000.

Kirkcaldie & Stains has, however, entered into a conditional Deed of Surrender of Lease of the Petone lease. Under this deed Kirkcaldie & Stains will pay the landlord a surrender payment of \$400,000 and a real estate agent's commission of \$50,000 plus GST and be released from the lease. The date on which this will occur has been extended from the original date of 1 April 2016 to 4 April 2016. In order for the deed to become unconditional the landlord's agreement to sell the Petone premises must go unconditional. The date for satisfaction of this condition has been extended from 29 March 2016 to 1 April 2016. Kirkcaldie & Stains is not able to influence the satisfaction of this condition.

This Target Company Statement has been prepared and finalised before this transaction has gone unconditional. As soon as the position is clarified the Board will advise NZX and shareholders. The Board's High Scenario has been prepared on the basis that this transaction proceeds and its Low Scenario on the basis that it does not.

If this transaction does not proceed, the Board will nevertheless seek to conclude an alternative transaction to mitigate the residual obligations under the Petone lease. Any alternative transaction will impact the Low Scenario positively.

- 18.8 **The Thorndon Quay lease:** This lease expires on 31 May 2017. If left to run to its expiry date the total rent and outgoings are assessed to be approximately \$175,000.

There is presently no proposed transaction under which the Company will be relieved of its obligations in respect of this lease, but options continue to be explored with the landlord and a range of parties. The Board is optimistic that the full liability of this lease will be reduced, but cannot be certain. The Board has accordingly assumed in both its High and Low Scenarios that this lease runs its full term and that the Company continues to pay the contracted rent over this period.

A more favourable outcome will impact both the High Scenario and the Low Scenario positively.

- 18.9 **The Pantry lease:** This lease expires on 22 December 2017. If left to run to its expiry date the total rent and outgoings are assessed to be approximately \$210,000.

The premises of the Pantry lease are immediately adjacent to the premises of the Store lease. At the date of completion under the David Jones Agreement there was a void between the two premises and customers walked between the two spaces, with most unaware that they were in a different building held under separate leases with different landlords.

Under the David Jones Agreement, David Jones did not take an assignment of the Pantry lease, but agreed to reinstate the wall between the two premises within one month of completion. This would enable the Company to then assign those premises or otherwise deal with the premises in a manner similar to that proposed for the Thorndon Quay and Petone leases.

David Jones has failed to reinstate the wall as required by the David Jones Agreement as at the date of this Target Company Statement. Discussions are continuing with both David Jones and the Company's landlord under this lease.

The Board is optimistic that the full liability of this lease will be reduced, but cannot be certain. The Board has accordingly assumed in both its High and Low Scenarios that this lease runs its full term and that the Company continues to pay the contracted rent over this period.

A more favourable outcome will impact both the High Scenario and the Low Scenario positively.

- 18.10 Assuming:

- a no claim is made prior to 1 February 2017 under the David Jones Agreement;
- b the Company's lease commitments have been resolved (see above); and
- c no other proposal is put before shareholders or other event occurring which would involve the Company continuing,

the Board expects that shortly following 1 February 2017 it would move to promptly appoint liquidators to the Company in order that they conduct a solvent wind up the Company and make an early distribution of surplus cash to shareholders.

- 18.11 A special resolution of shareholders would be required to facilitate the winding up of the Company, that is to say a resolution passed by 75% of those entitled to vote and voting on the issue.
- 18.12 In this respect shareholders' attention is drawn to the statement appearing at paragraph 11.3 of Schedule A on page 23 of the Mercantile Offer that:
- 'Mercantile intends to support the continuation of the winding up process, alongside the efficient investment and utilisation of K&S' cash assets. Ultimately, Mercantile may seek a return of capital to shareholders, if an efficient and appropriate structure for such a return can be developed'
- 18.13 Mercantile has also stated at paragraph 11.4 of the Mercantile Offer that:
- 'Other than as set out in paragraphs 11.1 to 11.3 above, Mercantile does not currently intend to make any material changes in the business activities, material assets, or capital structure [of the Company]
- 18.14 Mercantile has reserved the right to make changes to this stated intention (see paragraph 11.4) but as at the last practicable date before date of this Target Company Statement (being 29 March 2016) the Board has not received any indication from Mercantile that it intends to make any such changes to its stated intention.
- 18.15 From these statements it appears to the Board that Mercantile does not intend to use the Company as a vehicle for the undertaking of a new venture (which is often the case for listed shell companies).
- 18.16 The Board accordingly assumes that whether the Offer succeeds or fails Mercantile supports a winding up of the Company and the Board's present intention to make distribution of its cash to shareholders as soon as possible in 2017 as part of a winding up of Kirkcaldie & Stains.
- 18.17 Because there is no available subscribed capital and the Company has few imputation credits (see above at paragraphs 18.3f and 18.3g), at this stage the Board believes the most efficient means to return the Company's surplus cash to shareholders is in the course of a solvent winding up of the Company.
- 18.18 In this respect the Board has received advice from PricewaterhouseCoopers confirming the Company's opinion that the sale of the Harbour City Centre generated a capital gain of \$7,475,000 which would be classified as an 'available capital distribution' (and not a dividend) in a winding up. Accordingly any such distribution would be tax-free to shareholders with the exception of non-resident corporate shareholders (capital gains distributed to non-resident corporate shareholders are subject to non-resident withholding tax). This level of capital profit means that the Board's estimate of both the High Scenario and the Low Scenario referred to below could be distributed in a winding up without any liability to retain any withholding tax (except for non-resident corporate shareholders) and that for shareholders who are not non-resident corporate shareholders and hold their shares on 'capital account' this distribution would be received free of any tax liability in their hands.
- 18.19 Based on the above, the Board is able to make an estimate of the amount of cash likely to be available to shareholders for distribution in a shareholder approved winding up of the Company commencing in the first half of calendar year 2017, and to compare those estimates against the price offered for your shares by Mercantile. The Board has produced two estimates – the first assuming that the Petone lease transaction proceeds as described in paragraph 18.7 above (the 'High Scenario') and the second assuming it does not (the 'Low

Scenario'). Each scenario assumes that no transaction will be entered into which relieves the Company of any ongoing liability for rent and outgoings in respect of the Thorndon Quay lease and the Pantry lease.

- 18.20 The Board's previously announced estimates of the range of NTA per share of \$3.18 and \$3.67 have each assumed that at some stage in the following 12 months transactions will be entered into in respect of the three outstanding leases. The Board remains optimistic that this will be the case.
- 18.21 The High Scenario contemplates the Company having approximately \$7,130,000 in cash and on hand at 1 February 2017. The Low Scenario contemplates approximately \$6,108,000.
- 18.22 When applied on a per share basis the High Scenario, the Low Scenario and the price offered by Mercantile can be compared as set out in the table below.

Board's High Scenario	Board's Low Scenario	Mercantile's Offer
\$3.49	\$2.99	\$2.75
74 cents higher than the Mercantile Offer	24 cents higher than the Mercantile Offer	

- 18.23 The assumptions on which these Scenarios are based are set out in paragraph 21.2 below.
- 18.24 In making their recommendation not to sell, the Board has carefully considered the differential between the Mercantile Offer and the High and Low Scenarios, the assumptions underlying the Scenarios and the likelihood of those assumptions not being correct.
- 18.25 Other than as set out at 18.3 above, elsewhere in this Statement or contained in the Independent Adviser's Report:
- a there have been no known material changes in the financial or trading position or prospects of Kirkcaldie & Stains since the 2015 Annual Report except for a better than expected realisation of the Company's retail stock; and
 - b there is no further information about the assets, liabilities, profitability and financial affairs of Kirkcaldie & Stains that could reasonably be expected to be material to the making of a decision by offerees to accept or reject the Offer.

19 Independent advice on merits of the Offer

- 19.1 Northington Partners was appointed the independent adviser to provide a report on the merits of the Offer as required by rule 21 of the Takeovers Code.
- 19.2 A copy of the Independent Adviser's Report is **attached** to this Statement.
- 19.3 The Independent Adviser's Report concludes that the Mercantile Offer is not fully priced (see section 2.2.1 of that report) and the Independent Adviser has an assessed value range of \$3.26 (low) to \$3.44 (high).

20 No Asset Valuation

- 20.1 Neither this Target Company Statement nor the Independent Adviser's Report refers to the valuation of any asset by a valuer.

21 Prospective financial information

- 21.1 This Target Company Statement contains prospective financial information in relation to the High Scenario and the Low Scenario of cash available for distribution to shareholders in a shareholder approved winding up of the Company in the first half of calendar year 2017.
- 21.2 Both the High Scenario and the Low Scenario have been calculated using the following material assumptions:
- a the Company will continue to pay rent on the Thorndon Quay and Pantry leases until the expiry of their terms;
 - b no claim arises under the David Jones Agreement;
 - c David Jones fulfils its obligation under the David Jones Agreement in respect of the wall reinstatement under the Pantry lease;
 - d no other adverse claim is made, or proceeding brought, against the Company;
 - e the Mercantile Offer is not successful and Mercantile meets all the Company's costs associated with the Offer as required by the Takeovers Code;
 - f shareholders will support the winding up of the Company at the earliest opportunity following 1 February 2017 by the requisite majority;
 - g the Company has correctly calculated the capital gain on the sale of the Harbour City Centre;
 - h the Company's income tax obligations have otherwise been correctly calculated, and the Inland Revenue Department raises no objection to either those calculations or the treatment of the capital gain on the sale of the Harbour City Centre;
 - i the costs of a winding up do not exceed \$100,000 (including professional fees, liquidators' fees, NZX fees and meeting costs);
 - j the Company commences no other business activity, makes no distribution to any shareholder(s), issues no new securities, and does not buy back or cancel any of its own securities;
 - k no event described in paragraph 16.3 occurs; and
 - l no event beyond the control of the Company occurs which would adversely affect either the Company's assets or its ability to make a distribution to shareholders in the course of a winding up.
- 21.3 The Board has no reason to believe that any of the above assumptions is not a fair and reasonable assumption to make based on the information available to them at the date of this document. While the Board has made the assumption at paragraph 21.2a above that the Company will continue to pay rent on the Thorndon Quay and Pantry leases until the expiry of their terms, the Board is optimistic that a transaction would be concluded in respect of these premises which would result in the Company being relieved of its rent obligations in respect of these leases at some stage in the next 12 months and that in that event there would be a positive impact on both the High and Low Scenarios.

22 Sales of unquoted equity securities under the Offer

- 22.1 The Ordinary Shares are quoted on the NZSX. Accordingly the Takeovers Code does not require any disclosure to be made in respect of clause 22 of Schedule 2 of the Code (which applies only to unquoted securities).

23 Market Prices of quoted equity securities under the Offer

- 23.1 The closing price on the NZSX of Kirkcaldie & Stains' Ordinary Shares:
- a on 29 March 2016 (being the latest practicable working day before the date on which this Statement is sent) was NZD\$3.11 on the NZSX; and
 - b on 25 February 2016 (being the last day on which the NZX was open for business before the date on which Kirkcaldie & Stains received Mercantile's takeover notice) was NZD\$2.20 per Ordinary Share on the NZSX.
- 23.2 The highest and lowest closing market prices on the NZSX of Kirkcaldie & Stains' Ordinary Shares (and the relevant dates) during the six months before 26 February 2016 (being the date on which Kirkcaldie & Stains received Mercantile's takeover notice), were as follows:
- a highest closing market price was NZD\$2.25 per Ordinary Share (on 16-29 October 2015 and 18-28 January 2016); and
 - b lowest closing market price was NZD\$2.20 per Ordinary Share (on 27-31 August 2015, 5-15 October 2015, 30 November 2015-15 January 2016, 1-4 February 2016, 19-25 February 2016).
- 23.3 During the periods referred to in this section 23, Kirkcaldie & Stains did not issue any equity securities or make any changes in any equity securities on issue or make any distributions which could have affected the market prices of Kirkcaldie & Stains' Ordinary Shares referred to above except in respect of the Share Cancellation detailed at paragraph 18.3c.
- 23.4 On 26 February 2016, (the date of Kirkcaldie & Stains' receipt of the draft Offer) Kirkcaldie & Stains' share price rose to \$2.87. The price has continued to rise to \$3.00 per share on 1 March 2016 and to \$3.11 per share on 29 March 2016 (being the last practicable working day before the date on which this statement is sent).
- 23.5 There is no other information about the market price of the equity security that would reasonably be expected to be material to the making of a decision by the offerees to accept or reject the Offer. Shareholders are referred back to the discussion in section 18 above.

24 Other Information

- 24.1 Subject to the information set out elsewhere in this Statement (see in particular section 18) the Directors do not consider there is any other information that could reasonably be expected to be material to the making of a decision by the offerees to accept or reject the Offer.

25 Approval of target company statement

- 25.1 This Statement has been approved by the Directors of Kirkcaldie & Stains.

26 Interpretation

26.1 Words and expressions defined in the Takeovers Act or the Takeovers Code and not otherwise defined in this Statement have the same meaning when used in this Statement.

In this Statement:

'Board' means the board of Directors of Kirkcaldie & Stains;

'David Jones Agreement' means the agreement for sale and purchase of assets between David Jones Pty Limited as purchaser and Kirkcaldie & Stains Limited as vendor dated 4 June 2015;

'Director' means a director of Kirkcaldie & Stains;

'High Scenario' has the meaning in paragraph 18.19;

'Independent Adviser' means Northington Partners;

'Independent Adviser's Report' means the report referred to in paragraph 19.1;

'Low Scenario' has the meaning in paragraph 18.19;

'NZD\$' means New Zealand dollars;

'NZX' means NZX Limited;

'NZSX' means the New Zealand Stock Exchange;

'NZSX Listing Rules' means the listing rules of the NZX;

'Offer' means the full takeover offer dated 15 March 2016 by Mercantile to purchase all the securities of Kirkcaldie & Stains;

'Offer Document' means the offer document dated 15 March 2016 despatched to security holders of Kirkcaldie & Stains by Mercantile on 18 March 2016;

'Offer Period' means the period commencing on 15 March 2016 and ending at 7.00pm (NZ time) on 13 May 2016;

'Offer Price' means the consideration offered for the equity securities of Kirkcaldie & Stains outlined in paragraph 2.2;

'Ordinary Shares' means the ordinary shares of Kirkcaldie & Stains;

'Pantry lease' means the lease of the premises at 26 Brandon Street, Wellington from the landlord Nicholas Guy Miller, Ronald Thornton Muir and Michael Jacobson (as trustees of the Nick Miller Family Trust) to Kirkcaldie & Stains;

'Petone lease' means the lease of the premises at 19 Regent Street from the now-current landlord Regent Rhubarb Limited to Kirkcaldie & Stains dated 6 August 2013;

'Senior Officer' means a senior officer of Kirkcaldie & Stains;

'Share Cancellation' means the cancellation by Kirkcaldie & Stains of four-fifths of all of its ordinary shares on issue which completed on 29 February 2016;

'Store lease' means the lease of the premises at 165-177 Lambton Quay from the landlord Jones Cooper Partners Limited to Kirkcaldie & Stains Limited which was assigned to David Jones under the David Jones Agreement;

'Takeovers Act' means the Takeovers Act 1993;

'Takeovers Code' means the Takeovers Code approved by the Takeovers Code Approval Order 2000; and

'Thorndon Quay lease' means the lease of the premises at 262 Thorndon Quay from the landlord Paulemas Properties Limited to Kirkcaldie & Stains dated 24 February 2015.

Where any information required by schedule 2 of the Takeovers Code is not applicable, no statement is made regarding that information.

27 Certificate

27.1 To the best of our knowledge and belief, after making proper enquiry, the information contained in or accompanying this Statement is, in all material respects, true and correct and not misleading, whether by omission of any information or otherwise, and includes all the information required to be disclosed by Kirkcaldie & Stains under the Takeovers Code.

Signed by:



Orsola Del Sante-Bland
Acting Chief Executive Officer and the
person fulfilling the role of Chief Financial
Officer



Director
Falcon Clouston



Director
Kerry Prendergast

**Schedule 1 Ownership of equity securities of Kirkcaldie & Stains
(paragraph 5.1)**

Name	Holder ('H') or Controller ('C')	Number of equity securities held or controlled	Designation of equity security	Percentage of total number of equity securities in class
Directors - none				
Senior Officer - none				
Associates				
LQ Investments Limited	H	398,000	Ordinary Shares	19.48%
Other persons holding or controlling 5% or more of a class				
H & G Limited	H	400,673	Ordinary Shares	19.61%
Mercantile Investment Company Limited	H & C	203,137	Ordinary Shares	9.94%

DIRECTORY

Registered Office

19 Regent Street
Petone
Lower Hutt 5012
New Zealand

Postal Address

PO Box 1494
Wellington 6140

Independent Adviser

Northington Partners
Level 14, 52 Swanson Street
PO Box 105-384
Auckland 1143

Share Registrar

Link Market Services Limited
21 Queen Street
Auckland Central
Auckland 1010
New Zealand

Solicitors

Kensington Swan
Level 9, 89 The Terrace
P O Box 10-246
Wellington 6143
New Zealand



Statement of Independence

Northington Partners Limited confirms that it:

- Has no conflict of interest that could affect its ability to provide an unbiased report; and
- Has no direct or indirect pecuniary or other interest in the proposed transaction considered in this report, including any success or contingency fee or remuneration, other than to receive the cash fee for providing this report.

Northington Partners Limited has satisfied the Takeovers Panel, on the basis of the material provided to the Panel, that it is independent under the Takeovers Code for the purposes of preparing this report.



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Abbreviations and Definitions

Code	The Takeovers Code
David Jones	David Jones Pty Limited
FY	Financial Year
KRK or Company	Kirkcaldie & Stains Limited
Mercantile	Mercantile NZ Limited
Northington Partners	Northington Partners Limited
NZ\$	New Zealand dollars
NZX	NZX Limited
Offer	The offer from Mercantile dated 15 March 2016 for all of the equity securities on issue in KRK
Offer Price	NZ\$2.75 in cash for each KRK share
Residual Liabilities	Residual liabilities of KRK following the cessation of the Company's retail operations in January 2016
VWAP	Volume weighted average price
Takeover Notice	The notice from Mercantile on 26 February 2016 setting out Mercantile's intention to make the Offer



1.0 Background

1.1. Introduction

Kirkcaldie & Stains Limited (“**KRK**” or “**Company**”) is a shell company with cash assets and a number of residual liabilities following the exit from its retail business operations earlier this year. The Company’s shares are quoted on the NZX Main Board, being the main board equity securities market operated by NZX Limited (“**NZX**”).

Mercantile NZ Limited (“**Mercantile**”) is a wholly-owned subsidiary of Mercantile Investment Company Limited, an investment company dual listed on the ASX and NZX. An entity associated with Sir Ron Brierley is the largest shareholder in Mercantile Investment Company Limited.

On 26 February 2016, Mercantile sent KRK a notice (“**Takeover Notice**”) setting out its intention to make a takeover offer for all the shares in KRK it does not already own (“**Offer**”). The Offer is at a cash price of \$2.75 per KRK share (“**Offer Price**”).

The Offer from Mercantile was formally made on 15 March 2016, with an original closing date for acceptances of 15 April 2016. Following a notice of variation from Mercantile dated 29 March 2016, the Offer will now remain open for acceptance until 13 May 2016 (unless that date is further extended by Mercantile or the Takeovers Panel in accordance with the provisions of the Takeovers Code (“**Code**”).

1.2. Key Conditions

The Offer is subject to a number of conditions, the full details of which are set out in Offer documents that have been sent to KRK shareholders. A summary of the key conditions is as follows:

- Mercantile achieving acceptances that will allow it to hold or control 90% or more of the total voting rights in KRK. Mercantile has the discretion to waive this condition in accordance with the Code.
- In the event that Mercantile waives the 90% acceptance condition noted above, Mercantile achieving acceptances that will allow it to hold or control 50% or more of the total voting rights in KRK.

The other Offer conditions (which are standard in a takeover offer of this type) are solely for the benefit of Mercantile and are designed to protect Mercantile from substantial changes to matters such as KRK’s financial, commercial or legal position while the Offer is open for acceptance.

1.3. Regulatory Requirements and Scope of this Report

KRK is a “Code Company” for the purposes of the Code. Mercantile’s Offer and the Company’s response to the Offer must therefore comply with the provisions set out in the Code.

Rule 21 of the Code requires the directors of KRK to obtain a report from an independent adviser on the merits of the Offer. The Company’s directors requested Northington Partners Limited (“**Northington Partners**”) to prepare the Rule 21 report, and our appointment was subsequently approved by the Takeovers Panel. Further details on the regulatory requirements and scope of this report are set out in Appendix 1.

This report will accompany the Target Company Statement to be sent to all KRK shareholders and sets out our opinion on the merits of Mercantile’s Offer. This report should not be used for any other purpose and should be read in conjunction with the declarations, qualifications and consents set out in Appendix 5.



2.0 Assessment of the Merits of the Offer

2.1. KRK's Current Position

During the last 18 months, KRK embarked on a number of transformative transactions:

- On 7 October 2014, the Harbour City Centre building was sold (netting the Company approximately \$17.1 million after repaying bank debt);
- On 1 February 2016, the lease for the Lambton Quay premises was assigned to David Jones Pty Limited ("**David Jones**"), together with the sale to David Jones of the name "Kirkcaldie & Stains"; and
- On 29 February 2016, the Company completed a court approved distribution of \$19.353 million to the Company's shareholders (which involved the cancellation of four out of every five shares on issue in the Company).

Following the transactions noted above and the cessation of the Company's retail operations, KRK is essentially a listed shell company with cash assets and a number of residual liabilities that relate mainly to existing or past lease obligations ("**Residual Liabilities**"). A description of the key Residual Liabilities is set out in Section 3.1.

The Company is currently negotiating with its landlords in respect of its remaining leases with a view to disposing of its obligations (e.g. via a surrender payment or the assignment of the relevant lease to another tenant). As detailed further in Section 3.1, KRK is expected to incur various costs associated with extinguishing its Residual Liabilities. The precise quantum of these costs and the timeframe for concluding the various negotiations remains uncertain.

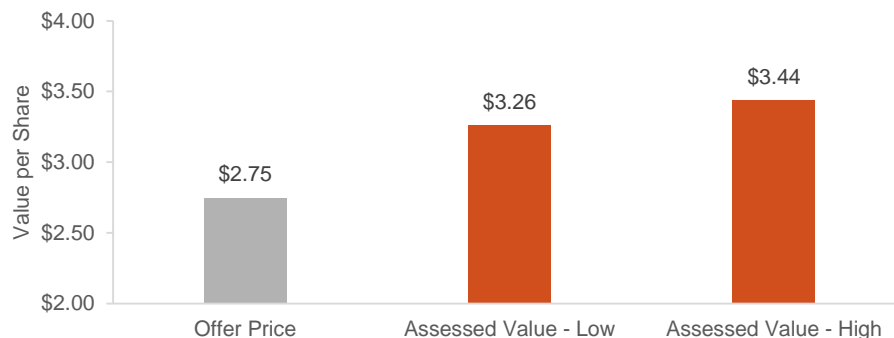
Once all of KRK's Residual Liabilities have been definitively quantified and/or extinguished, the Company will be left with residual cash assets. KRK's current intention is for the residual cash to be distributed to shareholders via a liquidation of the Company. At this stage, the Company's best estimate is that the liquidation process will be completed in the first half of calendar year 2017.

2.2. Value of Mercantile's Offer

2.2.1. Assessed Value Range

Our valuation range is determined primarily on the basis of a liquidation scenario. Full details of our valuation approach and conclusions are set out in Section 3.0. In our opinion, the full underlying value of KRK's shares is in a range between \$3.26 and \$3.44 per share, with a mid-point value of \$3.35 per share. Our valuation is based on 100% of the equity in KRK and therefore includes a premium for control.

Figure 1: Comparison of Mercantile Offer Price and our Assessed Valuation Range



Sources: Northington Partners' analysis, KRK



Figure 1 compares Mercantile's Offer Price with our assessment of the full underlying value of KRK's shares. The Offer Price of \$2.75 is approximately 16% lower than the low end of our value range (\$3.26 per share) and we therefore conclude that Mercantile's Offer is not fully priced.

2.2.2. Offer Price Relative to Recent Share Price Performance

The Offer Price represents:

- A 25% premium to the closing price of \$2.20 per KRK share as reported on 25 February 2016, being the last trading day before Mercantile's Takeover Notice was filed with the NZX on 26 February 2016.
- A 25% premium to the volume weighted average price ("VWAP") of \$2.20 per share for the month to 25 February 2016, and a 24% premium to the three month VWAP to 25 February 2016 of \$2.21 per share.

We note that the Offer premium is broadly consistent with the offer premiums evidenced in other recent takeover offers. However, we believe the significance of the comparison is relatively limited in this case given KRK is in the process of preparing for an orderly liquidation of the Company and the business should not be viewed as a going concern.

We also note that KRK's shares are extremely illiquid, and the observed transaction prices for KRK's shares are unlikely to consistently represent an accurate representation of the market's view on underlying value. Further details on KRK's share price movements over the last 9 months and the liquidity of the Company's shares are set out in Appendix 2.

2.3. Possible Impacts on KRK's Control Position

2.3.1. Majority Control Between 50.0% and 75.0%

If all the conditions of the Offer are satisfied or waived by Mercantile and the Offer is declared unconditional, Mercantile will hold or control a minimum of 50.0% of the shares in KRK. Pursuant to the terms of the Offer, it is not possible for Mercantile to increase its current shareholding to a level less than 50% of the shares outstanding. If Mercantile did not receive acceptances to the Offer that allowed it to hold or control 50.0% or more of the total voting rights in KRK, then the Offer would lapse and any person who had accepted the Offer would be released from the obligation to sell their shares.

If Mercantile ends up with a shareholding level in the Company greater than 50.0% but less than 75.0%, then:

- Pending any decision (if ultimately made) to liquidate the Company, KRK will continue to be listed on the NZX with Mercantile as a majority shareholder controlling more than half of the shares on issue.
- Provided Mercantile is permitted to vote, Mercantile will have effective day-to-day control of the Company by being able to pass ordinary resolutions unilaterally. Ordinary resolutions require support from more than 50.0% of the shareholders entitled to vote and voting on the resolution.
- Provided Mercantile is permitted to vote, Mercantile will be in a position to veto special resolutions of the Company (which require support from at least 75.0% of shareholders entitled to vote and voting on the relevant matter).
- Mercantile will have the ability to appoint a majority of directors to the board of KRK. Mercantile has indicated in its Offer that it intends to seek Board representation in the event it does not attain sufficient acceptances to enable it to invoke the compulsory acquisition provisions of the Code (see Section 2.3.3 below).
- Although the liquidity of KRK's shares has historically been low, liquidity would likely reduce even further, particularly if Mercantile was to end up with a shareholding level closer to the 75.0% end of the range.



- Pending any decision (if ultimately made) to liquidate the Company, Mercantile will be permitted to “creep” towards a 90% shareholding in KRK over time by buying up to a further 5% of the shares on issue each year, commencing 12 months after the Offer closes.

Special resolutions typically relate to what can be thought of as “major transactions” for the subject company, and include proposals such as changes to the company constitution and acquisitions or divestments with transaction values that exceed certain thresholds. Of particular relevance to KRK given its current intentions, a special resolution is required to liquidate the Company.

Under KRK’s current shareholding structure, no single shareholder is in a position to unilaterally determine if a special resolution is passed or not, although we note that the top two shareholders control 19.61% and 19.48%, respectively (see Appendix 3 for details of the top 10 shareholders). With a combined 39.09% shareholding, if the top two shareholders were to act in concert they could vote against and veto a special resolution.

In terms of passing special resolutions, the extent to which Mercantile would require support from other shareholders will depend on the size of its ultimate shareholding and the make-up of those shareholders who elect to accept the Offer.

For a scenario where Mercantile ends up with a shareholding level closer to the 50.0% end of the range:

- If both the current two largest shareholders accept the Offer in respect of their entire shareholding, then Mercantile would require relatively widespread support from a range of other shareholders (who decided not to accept the Offer) to pass special resolutions.
- If only one of the current two largest shareholders accepts the Offer in respect of its entire shareholding (with the other large shareholder electing not to accept the Offer in respect of any of its shares), in practice it would likely become difficult for Mercantile to pass a special resolution without the support of the other remaining large shareholder. That is, that other large shareholder would only require the support of around 5.5% of the Company’s shareholding base to vote with it against a special resolution in order for the special resolution to be defeated.

The closer Mercantile’s shareholding is to 75.0%, the lower the level of support that will be required from other shareholders in order to pass special resolutions.

2.3.2. Majority Control Between 75.0% and 90.0%

If all the conditions of the Offer are satisfied or waived by Mercantile (so that the Offer is declared unconditional) and Mercantile ends up with a shareholding level in the Company greater than 75.0% but less than 90.0%, then:

- Pending any decision (if ultimately made) to liquidate the Company, KRK will continue to be listed on the NZX Main Board, with Mercantile as a majority shareholder controlling more than 75.0% of the shares on issue but less than 90.0%.
- Mercantile will have effective control over the day-to-day operations of KRK.
- Provided Mercantile is permitted to vote, Mercantile would control the outcome of any ordinary resolutions and special resolutions put to shareholders.
- Mercantile will have the ability to appoint a majority of directors to the board of KRK.
- The liquidity of KRK’s shares would reduce significantly. The closer Mercantile gets to a 90.0% shareholding, the lower the liquidity of KRK shares will be.
- Pending any decision (if ultimately made) to liquidate the Company, Mercantile will be permitted to “creep” towards a 90% shareholding in KRK over time by buying up to a further 5% of the shares on issue each year, commencing 12 months after the Offer closes.



2.3.3. 90.0% Compulsory Acquisition Threshold

The Offer from Mercantile is for all the shares in KRK. If the 90.0% threshold is reached, Mercantile will be entitled to effect the compulsory acquisition provisions of the Code to acquire the remaining shares it was not able to acquire under the Offer. Mercantile has indicated in its Offer that it intends to exercise this right if the compulsory acquisition threshold is reached. In this circumstance, the Company's shareholders who did not sell their shares into the Offer can require Mercantile to acquire them at the Offer Price.

After the compulsory acquisition procedure is completed, KRK would be wholly owned by Mercantile and would delist from the NZX Main Board.

2.4. Factors that May Affect the Outcome of the Offer

The likely level of acceptances of the Offer is difficult to predict. However, we make the following observations:

- The ability of Mercantile to reach the 90% compulsory acquisition threshold (which is a condition of the Offer, albeit one that Mercantile can elect to waive) will depend on the attitude of the Company's largest shareholders. If either one of the current two largest shareholders (both of whom hold more than 19% of KRK's shares) rejects the Offer, then it will not be possible for Mercantile to attain a 90% shareholding.
- If both of the current two largest shareholders reject the Offer in respect of their entire shareholding, then the maximum shareholding level Mercantile would be able to attain would be 60.91% if all other shareholders accepted the Offer.
- If both of the current two largest shareholders reject the Offer in respect of their entire shareholding and other shareholders representing more than 10.91% also reject the Offer, then the Offer will lapse. This would be on the basis that the minimum acceptance condition (which requires Mercantile to hold or control 50.0% or more of the voting rights in KRK) would not have been satisfied. Outside of the top two shareholders, we note that other shareholders comprising the top 10 shareholders of the Company (excluding Mercantile) hold between them more than 10.91% of KRK's issued shares. Accordingly, if the top two shareholders and a number of the Company's other large shareholders were to reject the Offer, then the Offer would lapse.

Mercantile has limited ability to vary the Offer in response to low acceptance levels. While it could elect to increase the Offer Price above \$2.75 per share while the Offer remains open, the increased price would be available to all KRK shareholders whether or not those shareholders had already accepted the Offer. In our view, an increase in the Offer Price is possible but unlikely.

The Offer will close on 13 May 2016, unless the Offer is extended in accordance with the rules of the Code. The "maximum period" for which the Offer could remain open if extended by virtue of a variation of the Offer terms under Rule 24A of the Code is 90 days. This means Mercantile could not extend the Offer beyond 12 June 2016 if acceptances before that date are lower than targeted.

2.5. Likelihood of Alternative Offers

The most likely time for an alternative offer to emerge is while the Offer remains open. Another possibility is for an alternative offer to emerge if the Mercantile Offer lapsed (e.g. if minimum acceptance conditions were not satisfied). However, in our view, the likelihood of an alternative offer emerging is low. Key reasons for this opinion are as follows:

- For an alternative offer to be more attractive than the Mercantile Offer, the value offered to KRK shareholders would have to be higher than the Offer's \$2.75 Offer Price. Indeed, we believe an alternative offer would have to offer a price at least equal to the bottom end of our value range for the Company (which represents our assessment of the present value of the proceeds from a liquidation of the Company under a downside scenario). If the alternative offer was not at or close to this level, then there would seem little incentive for KRK shareholders to accept the alternative offer as they could simply wait to collect the proceeds



from the planned liquidation. Although it is possible that an alternative offer could be made for value at or slightly above the low end of our value range, the attractiveness of making an offer at this level would likely only exist for an offeror who wished to utilise KRK as a means of achieving a “back-door” listing on the NZX.

- If Mercantile declares the Offer unconditional, Mercantile will hold or control a minimum of 50.0% of the shares in KRK as a result of terms of the Offer (and the rules of the Code). Any alternative partial or full takeover offer after the point where the Offer was declared unconditional would require the support of KRK shareholders, particularly Mercantile. For Mercantile to sell into such an alternative offer would constitute a significant about-turn given it has clearly signalled through the Offer that it wishes to acquire 100% of the shares in KRK.

2.6. Prospects for KRK Under Mercantile Control

If the Offer is declared unconditional, Mercantile will hold or control a minimum of 50.0% of the shares in KRK. In the event that Mercantile does not reach the compulsory acquisition threshold of 90.0%, then KRK will remain listed on the NZX. In this circumstance, we expect (as indicated in Mercantile’s Offer):

- Mercantile will seek representation on KRK’s Board of Directors and will participate in decisions relating to the Company’s future;
- Mercantile will continue to support the planned liquidation process for the Company once all of KRK’s Residual Liabilities have been definitively quantified and/or extinguished; and
- Mercantile will not make material changes to KRK’s business activity, assets or capital structure.

Accordingly, unless Mercantile was to change its mind from what it has indicated in the Offer, the prospects for KRK under Mercantile’s control would be the same as they are currently.

2.7. Summary of Our Assessment

In our view, the key factors that KRK shareholders should consider are as follows:

- We believe that the Offer Price is considerably lower than the value shareholders are likely to receive from an orderly liquidation of the Company, even after allowance for the anticipated delay before the net liquidation proceeds will be distributed. We have assessed a current value range of \$3.26 to \$3.44 per share, representing a 19% – 25% premium over the \$2.75 Offer Price.
- The Company is confident that the costs of the liquidation process will not exceed the totals incorporated into our assessment (including our allowance for contingent costs). We therefore suggest that the likelihood of a final payment below the bottom end of our estimated range is low.
- Based on information provided in the Offer documents, Mercantile hopes to receive acceptances for over 90% of KRK’s shares on issue, at which point it will enforce the compulsory acquisition provisions of the Code, delist the shares from the NZX and pursue an orderly liquidation process. As such, we presume that the main motivation for the Offer is to generate a margin between the Offer Price paid to accepting shareholders and the net proceeds that will be available after the liquidation is completed by Mercantile.
- We suggest that apart from those shareholders that have an immediate need for cash, the Offer has limited merit. Even for those shareholders who have a strong desire to convert their shares into cash before the completion of the liquidation process (currently expected in the first half of calendar year 2017), it may be possible to sell the shares on market at a price higher than the Offer Price.
- For those shareholders looking to maximise value from their KRK shares, we suggest the best course of action is to reject the Offer and wait for the distribution of the residual net proceeds when the anticipated liquidation process is completed by the Company.



2.8. Acceptance or Rejection of the Offer

This report represents one source of information that KRK shareholders may wish to consider when forming their own view on whether to accept or reject the Offer. It is not possible to contemplate all shareholders' personal circumstances or investment objectives and our assessment is therefore general in nature. The appropriate course of action for each shareholder is dependent on their own unique situation. If appropriate, shareholders should consult their own professional adviser(s).



3.0 Valuation of Kirkcaldie & Stains

3.1. Valuation Framework

Following the transaction with David Jones and the sale of the Harbour City Centre building, KRK has become a non-operating company which has very few remaining assets other than the residual cash which has yet to be distributed to shareholders. The Company is no longer a going concern and we believe that the best way to maximise value is to pursue a liquidation process and return the net proceeds to shareholders. Our valuation framework is therefore based on a liquidation scenario.

A liquidation process effectively involves the collection of cash owed to the Company, the sale of any residual assets and the payment of all outstanding liabilities (including amounts owed to suppliers, employees, lessors and the IRD). KRK also needs to meet any contingent obligations that it may have in relation to the transaction with David Jones.

Table 1 sets out the key assets and liabilities of the Company, along with some commentary on the likely value outcomes and the timeframe needed to conclude the process. This information is primarily sourced from projections prepared by KRK.

Table 1: Summary of KRK's Key Assets and Liabilities

Asset / Liability	Commentary
Assets	
Cash Balance	The Company held a balance of approximately \$6.1m after the capital return to shareholders on 29 February 2016.
Cash held in Escrow Account	Pursuant to the David Jones transaction, KRK also deposited \$2.0m in an escrow account to cover potential warranty claims by David Jones. The warranty period expires on 1 February 2017, with allowance for a review after the completion of the David Jones fit-out works (expected in July 2016). KRK believes that the probability of a claim is low, and therefore expects to recover the full \$2.0m.
Receivables	Valued at just over \$500,000 at the end of February 2016. The Company expects full collection over the next three months.
Tax Refund	The company expects to receive total tax refunds of approximately \$500,000, with three payments anticipated before March 2017.
Liabilities	
Creditors	As at 29 February, a total of approximately \$500,000 was owed to a range of suppliers. Full payment will be made over the next few months.
Operating Costs	The Company will incur a number of ongoing operating costs during the wind-down period. These include staff costs, insurance, lease costs (see below), professional services and Board costs. Costs are expected to reduce significantly by August 2016, at which point most of the key tasks will be completed.
Property Costs	The Company has three remaining leases in place, with outstanding terms ranging between 15 months and seven years. KRK is attempting to negotiate early exits for each lease. <ul style="list-style-type: none">• Petone: Annual lease cost of approximately \$204,000, with expiry scheduled for April 2023. KRK is working on a lease surrender as at 4 April 2016 for a net total payment of \$450,000 and the Company is very confident that agreement will be reached.



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- Thorndon Quay: Annual lease cost of \$150,000, with expiry scheduled for May 2017. KRK is exploring options to secure an early lease termination to reduce the exit costs.
 - Brandon Street: Annual lease cost of \$120,000, with expiry scheduled for December 2017. KRK expects to negotiate a surrender of this lease soon in return for a relatively low fee.

We note that KRK also has a contingent liability in relation to the assignment of the main store lease to David Jones. If David Jones does not perform its obligations under the lease, the lessor can potentially seek redress from KRK.

However, the Company believes that there is little likelihood of any liability being realised. The lessor has also confirmed in writing that if the Company pursues an orderly liquidation process, it will be released from any remaining obligations in relation to the lease assignment.

Liquidation Costs	Liquidation costs mostly relate to professional fees and will be dependent on the amount of time and effort needed to complete the process. The Company has made an allowance of \$100,000 to complete the process.
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Source: KRK Management, Northington Partners' analysis

3.2. Valuation Conclusion

Our valuation is based on a projection of the residual cash that will be available for distribution to shareholders at the completion of the liquidation process, and assumes the following:

- **Timeframe:** KRK expects that the process will be completed in the first half of calendar year 2017. This reflects that the escrow period for the David Jones transaction terminates on 1 February 2017, and allows sufficient time for the collection of all other outstanding payments. As there is no tax-efficient way to distribute any of the remaining cash in the intervening period, we assume only one payment is made on the completion of the liquidation process. We conservatively assume a payment date of 1 June 2017.
- **Taxation:** KRK expects that it can distribute approximately \$7.5m of residual cash as a tax free capital gain. Based on our modelling of the likely amount of cash that will be available for distribution, we assume that shareholders (other than non-resident corporate shareholders) will not have any tax liability associated with the liquidation payment¹. Our valuation assessment therefore makes no allowance for tax.
- **Discount Rate:** The projected cash payment in June 2017 has been discounted back to 20 May 2016, the approximate payment date under the Offer (reflecting the extension to the closing date for the Offer). This discounting process takes account of the difference in payment dates between the liquidation scenario and acceptance of the Offer. We have applied a post-tax discount rate of 5.0%, which we believe represents a conservative estimate of the risk profile of the projected cash flows under a liquidation scenario.

Table 2 summarises our valuation assessment, based on the forecast level of cash available for distribution at the completion of the liquidation process and after an allowance for the assumed delay before the payment can be made. Our contingency estimates relate primarily to uncertainties over the cost of lease surrenders, tax liabilities and the level of operating costs that will be incurred before the liquidation is completed.

¹ Distributions to non-resident corporate shareholders may be subject to non-resident withholding tax.



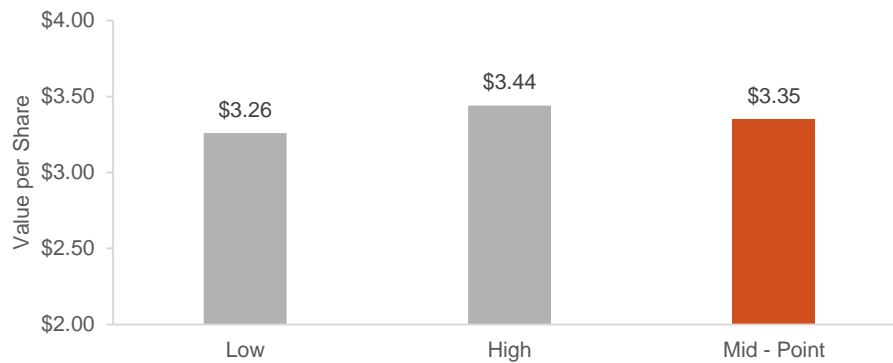
Table 2: Valuation Summary

	Low	High
Projected Cash Balance on 1 June 2017 (000s)	\$7,595	\$7,595
<i>less</i> Allowance for Contingent Costs (000s)	(\$600)	(\$200)
Value Available for Distribution (000s)	\$6,995	\$7,395
Number of Shares on Issue (000s)	2,043	2,043
Distribution per Share	\$3.42	\$3.62
Discount Factor (Approx. 12 months at 5.0%)	0.9509	0.9509
Current Value per Share	\$3.26	\$3.44

Source: Northington Partners' analysis

We conclude that the current value of the KRK shares is between \$3.26 and \$3.44, with a mid-point of \$3.35 per share.

Figure 2: Summary of Assessed KRK Value per Share



Sources: Northington Partners' analysis, KRK

We note that the low end of the assessed share price range assumes a total contingency of \$0.60m (or approximately \$0.29 per share). While it is difficult to be too prescriptive as to the final outcome, we believe that this contingency allowance is relatively conservative and that the risk of further downside is limited. We also note that the actual realised costs during the liquidation process would need to reach approximately \$1.68m before the net proceeds from the liquidation process matched the Offer price of \$2.75 (including an allowance for the time delay). Based on information provided by the Company, we suggest that there is a low probability of actual costs approaching this level.

Appendix 1: Regulatory Requirements and Scope of this Report

Role of Takeovers Panel

The Takeovers Code (“**Code**”) sets out rules governing the conduct of company takeovers in New Zealand. The provisions of the Code apply to any company that is a “Code Company” (as defined in the Code). KRK is a “Code Company” by virtue of it being listed on the NZX Main Board and by having more than 50 shareholders.

The fundamental rule of the Code is set out in Rule 6 and prevents any entity (together with its associates) from becoming the holder or controller of 20% or more of the voting rights in a “Code Company” other than via one of several courses of action prescribed in Rule 7 of the Code.

Pursuant to Rule 7 of the Code, a person may (among other exceptions) become the holder or controller of 20% or more of a Code Company “by an acquisition under a full offer”. A “full offer” requires the offeror to make an offer for all the equity securities in the Code Company that it does not already own.

Mercantile’s Offer is a “full offer” for the purposes of the Code. The Offer and the response by KRK to the Offer must comply with the provisions set out in the Code. Rule 21 of the Code requires the directors of KRK to obtain a report from an independent adviser on the merits of the Offer.

KRK’s independent directors requested Northington Partners Limited (“**Northington Partners**”) to prepare the independent adviser’s report required by Rule 21 of the Code. Our appointment was approved by the Takeovers Panel on 3 March 2016.

Basis of Assessment

The exact meaning of the word “merits” is not prescribed in the Code and there is no well accepted, authoritative New Zealand reference that clearly establishes what should be considered when assessing the merits of a takeover offer. Although the Takeovers Panel has published a guidance note about the role of an Independent Adviser, it has been careful not to limit the scope of the assessment and states that the relevant factors that should be taken into consideration will depend on the features of the proposed transaction as well as the prevailing circumstances of the parties involved. However, the Takeovers Panel suggests that a merits assessment is broader than a valuation assessment and will include other positive and negative aspects of a transaction.

Northington Partners has assessed the merits of the Offer by taking into account the following factors:

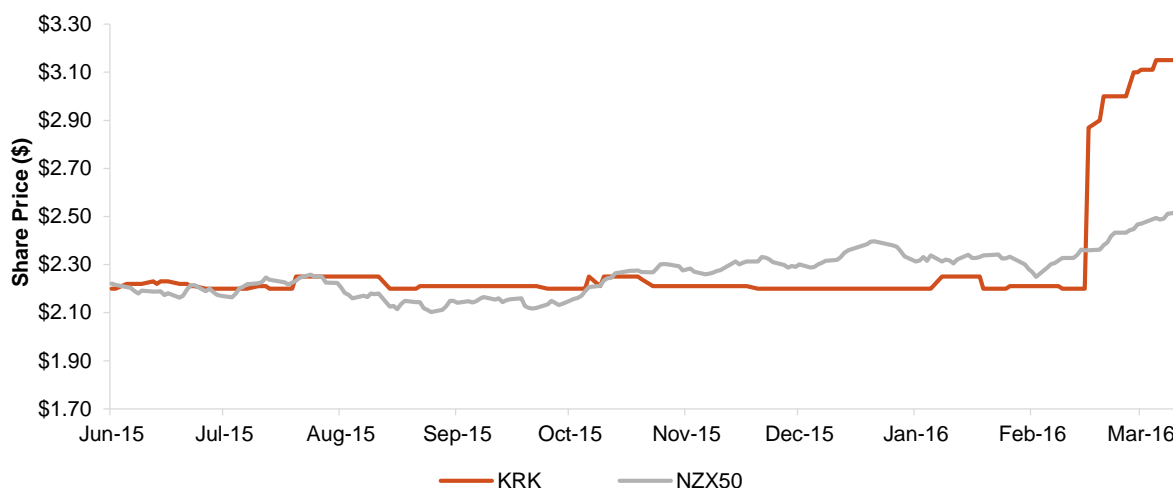
- A comparison of the Offer Price to the potential realisable value under the likely counterfactual, which we understand is an orderly liquidation process for KRK. An assessment of the counterfactual will consider:
 - Cash on hand;
 - The potential costs of the liquidation process, including settlement of residual lease liabilities and warranty claims from the David Jones transaction;
 - Likely timing for the liquidation process, taking account of the uncertainties around the Residual Liabilities;
 - Any implied value for the listed shell after the cash distribution (which would be lost under a successful Offer from Mercantile); and
 - The risk that the eventual proceeds from the liquidation will be lower than the Offer Price due to delays and higher than expected contingent costs.
- Potential outcomes under the Mercantile Offer given the 90% minimum acceptance condition, and Mercantile’s ability to waive that condition if it receives greater than 50% acceptances.
- Possible consequences for shareholders if Mercantile holds more than 50% but less than 90% of the shares at the conclusion of the Offer process.
- The likelihood of alternative offers being made and the potential for shareholders to receive greater consideration for their shares than may be possible under either the Mercantile Offer or a liquidation process.
- Such other financial and non-financial considerations as may be appropriate in the circumstances.

Appendix 2: Share Price and Liquidity Analysis

The performance of KRK's shares since June 2015 relative to the NZX50 Index is shown in Figure 3 below.

The impact of the Takeover Notice on the Company's share price can clearly be seen with the sharp spike on 26 February 2016. Further increases in the share price continued into March, potentially implying that the market does not view the Offer Price from Mercantile as representing full value. This view is likely to have been informed by the market announcement made by KRK shortly before the Takeover Notice was received setting out the directors' estimated range of residual net asset values.

Figure 3: KRK Share Price Performance Relative to NZX50 Index over the last 9 months



Sources: Capital IQ, Northington Partners' analysis.

Details on the volume weighted average price of KRK's shares during the 1 and 3 month periods preceding receipt of the Takeover Notice and in the nearly 4 week period after the Takeover Notice are set out in Table 3 below.

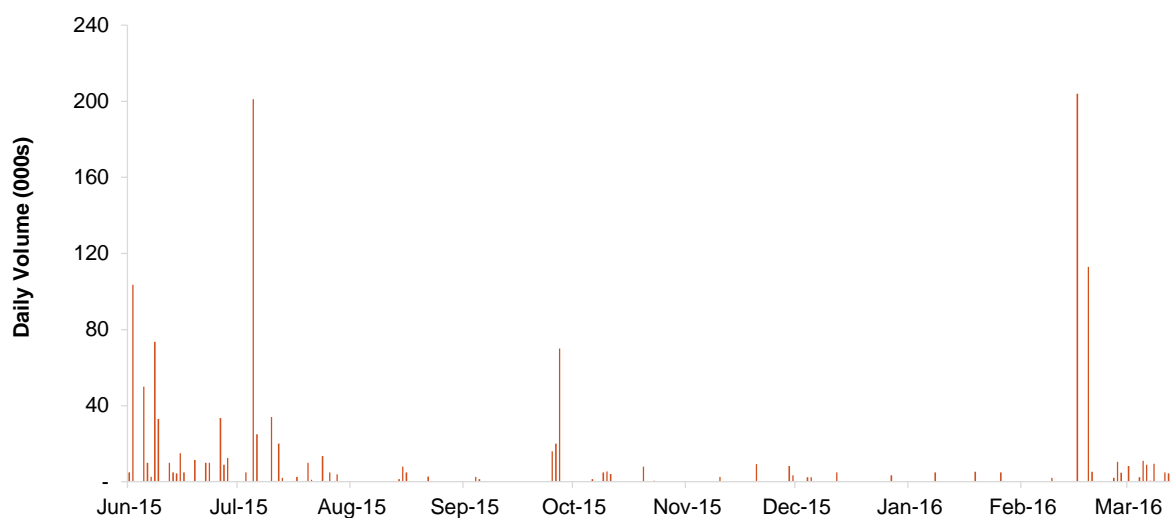
Table 3: KRK Volume Weighted Average Price of Shares

	<i>3 months to 25 February 2016</i>	<i>1 month to 25 February 2016</i>	<i>From 26 February 2016 to 22 March 2016</i>
VWAP	\$2.21	\$2.20	\$2.92

Sources: Capital IQ, Northington Partners' analysis.

The Company's shares have historically suffered from low liquidity. Figure 4 below sets out the daily trading volumes in KRK's shares during the last 9 months, showing numerous days without any trades and typically low volumes on the days when trading did take place.

Figure 4: KRK Share Volume over the last 9 months



Source: Capital IQ.

Further details on the liquidity of KRK's in the 3 months period prior to the Takeover Notice being received and a period of nearly 4 weeks since the date of the Takeover Notice are set out in Table 4 below. Liquidity has materially increased following receipt of the Takeover Notice.

Table 4: KRK Share Liquidity

	<i>3 months to 25 February 2016</i>	<i>From 26 February 2016 to 22 March 2016</i>
Total Shares on Issue	10,250,000	2,042,942
Average Daily Trading Volume	826	21,652
Average Share Turnover Ratio	0.008%	1.060%
Total Shares Traded	51,230	389,740
Total Share Turnover Ratio	0.50%	19.08%

Note. Takeover Notice was issued on 26 February 2016. Sources: Capital IQ, Northington Partners' analysis.

Appendix 3: Company Shareholder Details

Details on the top 10 shareholders in KRK are set out in Table 5 below.

Table 5: Top 10 Company Shareholders

Shareholder	Number of Shares held	Shareholding percentage
H & G Limited	400,673	19.61%
LQ Investments Limited	398,000	19.48%
Mercantile Investment Company ¹	122,717	6.01%
New Zealand Central Securities	96,543	4.73%
Custodial Services Limited	79,177	3.88%
Paul Morton Ridley Smith	66,000	3.23%
Milford Trust Limited	50,000	2.45%
UBS New Zealand Limited	34,108	1.67%
Kumototo Nominees Limited	32,185	1.58%
Frances Elizabeth Dixon	28,000	1.37%
Top 10 Shareholders	1,307,403	64.00%
Remaining 1057 shareholders	735,539	36.00%
Total Shares on Issue	2,042,942	100.00%

Source: KRK.

1. Including beneficial interests not held directly, Mercantile Investment Company has an interest in a total of 203,137 shares, which constitutes a controlling interest of 9.94%.

Appendix 4: Sources of Information Used in this Report

Other than the information sources referenced directly in the body of the report, this assessment is also reliant on the following sources of information:

- Discussions with senior management personnel of KRK.
- Tax opinions provided to KRK by PwC.
- Analysis provided by management of KRK on the estimated residual net assets of the Company once all Residual Liabilities have been definitively quantified or extinguished.
- Mercantile's Takeover Notice dated 26 February 2016 and the subsequent Offer document dated 15 March 2016.
- Mercantile's Notice of Variation dated 29 March 2016, extending the closing date for acceptances of the Offer from 15 April 2016 to 13 May 2016.

Appendix 5: Declarations, Qualifications and Consents

Declarations

This report is dated 30 March 2016 and has been prepared by Northington Partners at the request of the independent directors of KRK to fulfil the reporting requirements of Rule 21 of the Code. This report, or any part of it, should not be reproduced or used for any other purpose. Northington Partners specifically disclaims any obligation or liability to any party whatsoever in the event that this report is supplied or applied for any purpose other than that for which it is intended.

Prior drafts of this report were provided to KRK for review and discussion. Although minor factual changes to the report were made after the release of the first draft, there were no changes to our methodology, analysis, or conclusions.

This report is provided for the benefit of all of the shareholders of KRK (other than any shareholder who is associated with Mercantile) that are being asked to consider the Offer, and Northington Partners consents to the distribution of this report to those people. Our engagement terms did not contain any term which materially restricted the scope of our work.

Qualifications

Northington Partners provides an independent corporate advisory service to companies operating throughout New Zealand. The company specialises in mergers and acquisitions, capital raising support, expert opinions, financial instrument valuations, and business and share valuations. Northington Partners is retained by a mix of publicly listed companies, substantial privately held companies, and state owned enterprises.

The individuals responsible for preparing this report are Greg Anderson B.Com, M.Com (Hons), Ph.D and Steven Grant B.Com, LLB (Hons). Each individual has a wealth of experience in providing independent advice to clients relating to the value of business assets and equity instruments, as well as the choice of appropriate financial structures and governance issues.

Northington Partners has been responsible for the preparation of numerous independent reports in relation to takeovers, mergers, and a range of other transactions subject to the Takeovers Code and NZX Listing Rules.

Independence

Northington Partners has not been previously engaged on any matter by KRK or (to the best of our knowledge) by any other party to the proposed Offer that could affect our independence. None of the Directors or employees of Northington Partners have any other relationship with any of the directors or substantial security holders of the parties involved in the Offer.

The preparation of this independent report will be Northington Partners' only involvement in relation to the Offer. Northington Partners will be paid a fixed fee for its services which is in no way contingent on the outcome of our analysis or the content of our report.

Northington Partners does not have any conflict of interest that could affect its ability to provide an unbiased report.

Disclaimer and Restrictions on the Scope of Our Work

In preparing this report, Northington Partners has relied on information provided by KRK. Northington Partners has not performed anything in the nature of an audit of that information, and does not express any opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

Northington Partners has used the provided information on the basis that it is true and accurate in material respects and not misleading by reason of omission or otherwise. Accordingly, neither Northington Partners nor its directors, employees or agents, accept any responsibility or liability for any such information being inaccurate, incomplete, unreliable or not soundly based or for any errors in the analysis, statements and opinions provided in this report resulting directly or indirectly from any such circumstances or from any assumptions upon which this report is based proving unjustified.

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

Indemnity

KRK has agreed to indemnify Northington Partners (to the maximum extent permitted by law) for all claims, proceedings, damages, losses (including consequential losses), fines, penalties, costs, charges and expenses (including legal fees and disbursements) suffered or incurred by Northington Partners in relation to the preparation of this report, except to the extent resulting from any act or omission of Northington Partners finally determined by a New Zealand Court of competent jurisdiction to constitute negligence or bad faith by Northington Partners.

KRK has also agreed to promptly fund Northington Partners for its reasonable costs and expenses (including legal fees and expenses) in dealing with such claims or proceedings upon presentation by Northington Partners of the relevant invoices.

