Simmons
CORPORATE FINANCE

Dorchester Pacific Limited

Independent Adviser's Report and Appraisal Report

In Respect of the Issue of Convertible Notes and the Exercise of Options

September 2011

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1. Introduction

1.1 Background

Dorchester Pacific Limited (**Dorchester** or the **Company**) is a financial services company offering loans, reverse mortgages, insurance and savings products.

Dorchester is listed on the main board equity security market (**NZSX**) operated by NZX Limited (**NZX**) with a market capitalisation of $14 million as at 8 September 2011 and total equity of $26 million as at 31 March 2011.

A profile of Dorchester is set out in section 4.

1.2 Issue of Convertible Notes

Dorchester announced on 22 August 2011 that it proposes to make a placement of up to 120,000,000 $0.10 Convertible Notes (the **CNs**) to raise up to $12 million, subject to shareholder approval.

Subscribers

100,000,000 CNs will be subscribed for by parties associated with the Company's 3 largest shareholders, raising $10 million.

Hugh Green Investments Limited (**Hugh Green Investments**) currently holds 47,173,401 ordinary shares in the Company (26.88%) and 40,000,000 options issued by the Company (25.84%). Hugh Green Investments is a privately owned investment company owned by family interests associated with property and sharemarket investor Hugh Green. Hugh Green Investments has been a long standing substantial security holder in Dorchester.

The Business Bakery LP (**The Bakery**) currently holds 47,117,226 ordinary shares in the Company (26.85%) and 40,000,000 options issued by the Company (25.84%). The Bakery is a private investment vehicle owned by interests associated with Grant Baker, Geoff Ross and Stephen Sinclair. The Bakery acquired its initial shareholding in the Company through the purchase of shares previously held by Auguste Finance Limited (formerly known as St Laurence Mortgage Holdings Limited) on 30 August 2009.

Paul Byrnes is an executive director of the Company. He currently holds 6,748,937 ordinary shares in the Company (3.85%) and 5,000,000 options issued by the Company (3.23%).

Up to 20,000,000 CNs will be offered to other unrelated professional investors to raise up to a further $2 million. This requires the consent of CNs holders owning 67% of the CNs by value (the **Majority Holders**).

The subscribers for the CNs are set out below.

CN Subscribers		
Subscriber	**No. of CNs**	**$000**
Hugh Green Investments Limited	40,000,000	4,000
The Bakery	10,000,000	1,000
Trustees of the Baker Investment Trust No. 2	20,000,000	2,000
Trustees of the Ross Venture Trust	5,000,000	500
Trustees of the Sinclair Investment Trust	5,000,000	500
Paul Byrnes	20,000,000	2,000
Allocated	100,000,000	10,000
Other unrelated professional investors	20,000,000	2,000
Total	120,000,000	12,000

The Baker Investment Trust No. 2, the Ross Venture Trust and the Sinclair Investment Trust are associates of The Bakery. We refer to The Bakery and its associates, consisting of the 3 trusts and the St Albans Trust (associated with Mr Sinclair and a holder of 6,072 ordinary shares in Dorchester) as **The Bakery Associates**.

Terms and Conditions

The terms and conditions of the CNs are set out in the draft Subscription Agreement Relating to Convertible Notes between Dorchester and the subscribers (the **CN Subscription Agreement**) and the draft Convertible Note Deed Poll (the **CN Deed Poll**).

The terms and conditions of the CNs are set out in detail in the notice of annual meeting. The key terms are:

- Dorchester may issue up to a maximum of 120,000,000 CNs
- the CNs will have an issue price of $0.10 per CN, payable upon issuance
- the CNs will be issued in 4 tranches of equal value in October 2011, November 2011, February 2012 and March 2012, provided there is no unremedied event of default, the representations given by the Company are accurate and that no material adverse event (being the issuance of a profit downgrade by the Company or the NZX 50 Gross Index falling below 3,000 basis points) occurs prior to the issuance of a tranche
- the CNs shall bear interest, payable monthly in arrears in cash, at the following rates:
  - from first drawdown to 31 March 2012, at a fixed rate of 8.95%
  - from 1 April 2012 until such time as the Company secures bank funding, at the higher of 8.95% or the aggregate of the 30 day BNZ Committed Cash Advance prime rate (the **30 Day Prime Rate**) plus a margin of 4.95%
  - from such time as the Company secures bank funding, at the higher of 9.95% or the aggregate of the 30 Day Prime Rate plus a margin of 5.95%

- the CNs will mature on 31 March 2015 (the **Maturity Date**), on which date the Company will be required to repay to the holders the issue price of $0.10 per CN plus all accrued unpaid interest unless the CNs are converted into ordinary shares
- a holder of CNs may elect to convert its CNs into shares on the Maturity Date. The CNs may at any time, at the option of a holder, be converted into shares if a takeover offer is made in respect of the Company's shares or a scheme of arrangement or amalgamation is entered into in respect of, or is promoted by, the Company
- if and when converted, each CN will convert into one ordinary share. The conversion rate will be adjusted to account for any accrued, unpaid interest, the potential prejudicial impact of any rights issues or any reconstruction or adjustment to the Company's capital structure
- holders of CNs will be entitled to participate in any rights issues undertaken by the Company as if they held shares equal in number to their holding of CNs
- the CNs will be transferrable in whole blocks of $500,000, or such lesser amount as may be agreed by the Company and a holder
- all the CNs may be redeemed early in whole or part for cash, with the agreement of the Company and the Majority Holders
- the CNs will be secured by a first-ranking general security agreement over the assets of the Company and its subsidiaries (excluding Dorchester Life Limited (**DLL**), which will provide a limited guarantee to CN holders), provided that the Company may at any time borrow funds from a registered bank on terms acceptable to the Company and consented to by the Majority Holders up to a maximum of $18 million (provided the aggregate of such borrowings and the amount owing under the CNs does not exceed 50% of the Company and its subsidiaries' (the **Group**) total tangible assets or $30 million, whichever is less), and, if the Company does so, the Group may grant first ranking security to the bank to secure those borrowings with a priority amount of not more than $18 million, in which case the security granted to the holders of the CNs shall become second ranking
- the Company will, in connection with the issue of the CNs, agree to abide by a number of covenants, including:
  - a number of financial covenants, to be complied with at all times and tested on a quarterly basis (commencing 31 December 2011), including:
    - the Group's ratio of tangible net worth to total tangible assets shall be greater than 20%
    - the largest single loan receivable shall be no greater than 5% of the Group's tangible net worth
    - no related party lending
    - impaired assets shall not exceed 5% of all finance receivables
    - property investment and development lending shall be capped at 15% of all loans and finance receivables (after any provisions), excluding reverse annuity mortgages

- actual net income for the 12 month period ending on each quarterly date shall be:
  - for each quarterly date falling on or before 31 December 2012, at least 75% of the budgeted net income for the same period as set out in the Company's annual financial forecasts
  - for each quarterly date falling after 31 December 2012 and on or before 31 December 2013, at least 80% of the budgeted net income for the same period as set out in the Company's annual financial forecasts
  - for each quarterly date thereafter, at least 85% of the budgeted net income for the same period as set out in the Company's annual financial forecasts
- capital expenditure shall be limited to 110% of the budgeted amount of capital expenditure as set out in the Company's annual financial forecasts (except with the prior consent of the Majority Holders)

- other covenants include:
  - no member of the Group shall dispose of assets which comprise more than 50% of the Group's total tangible assets except with the prior consent of the Majority Holders
  - no member of the Group shall grant security over any of its assets other than:
    - to secure permitted bank funding
    - security interests arising by operation of law, out of set off or netting of accounts or as a result of section 17(1)(b) of the Personal Property Securities Act 1999 or a purchase money security interest, in each case in the ordinary course of business
  - except with the prior consent of the Majority Holders, no member of the Group shall pay any dividends or make any distributions, other than payment of interest on the CNs and interest on the Company's outstanding secured interest bearing notes
  - no further debt security issuance other than pursuant to permitted bank funding
  - the Group undertaking no major transactions (in terms of the Companies Act 1993) without Majority Holder consent

- following an event of default, the Majority Holders may declare the CNs to be immediately due and payable or, where such event of default results from a change of control of the Company, a CN holder may elect to convert its CNs into shares

- events of default include:
  - non-payment of any amount payable on the CNs or the security
  - breach of covenant or any material obligation in relation to the CNs or the security that is not remedied within 10 business days
  - breach of representation
  - avoidance or repudiation
  - insolvency
  - other security enforced / enforceable
  - cross default (including in respect of future bank covenants)
  - cessation of, or material change in the nature of, the business
  - change of control of the Company (including person or persons acting in concert gaining control of a board majority / more than 50% of the voting securities of the Company)
- the issue of the CNs is subject to the following conditions:
  - the negotiation and agreement of final definitive legal documentation
  - no profit downgrade announcement is made by the Company and the NZX 50 Gross Index does not fall below 3,000 basis points (this condition must be satisfied prior to the issue of each tranche of CNs)
  - approval of the Company's shareholders
  - approval by the Company's independent directors
  - approval by The Bakery and Hugh Green Investments.

1.3 Variation of Options

Dorchester currently has 154,807,557 options on issue. The options have an exercise price of $0.125 and an exercise date of 15 June 2013. Optionholders are required to give notice of exercise between 1 April 2013 and 31 May 2013.

In conjunction with the proposed issue of the CNs, Dorchester proposes to amend the terms of the options as follows:

- reduce the exercise price to $0.10
- bring forward the exercise date to 20 July 2012, with optionholders required to give notice of exercise between 1 June 2012 and 29 June 2012.

Options not exercised on 20 July 2012 would continue to be exercisable at $0.125 on 15 June 2013.

The amendment of the terms of the options is subject to shareholder and optionholder approval.

1.4 Annual Meeting

The Company's shareholders other than Hugh Green Investments and The Bakery Associates (the **Non-associated Shareholders**) will vote on an ordinary resolution (resolution 5) in respect of the CNs at the Company's annual meeting (the **CN Resolution**). Mr Byrnes is not permitted to vote on the CN Resolution.

The CN Resolution is required under the Takeovers Code (the **Code**), the Takeovers Code (Dorchester Pacific Limited) Exemption Notice 2010 (the **Exemption Notice**) and the NZSX Listing Rules (the **Listing Rules**).

The Non-associated Shareholders will vote on an ordinary resolution in respect of the allotment of up to 40,000,000 ordinary shares to each of Hugh Green Investments and The Bakery pursuant to the exercise by Hugh Green Investments and The Bakery of their respective options (resolution 8) (the **Options Resolution**).

The Options Resolution is required under the Code.

Shareholders will vote on 2 resolutions in respect of the variation of the terms of the options:

- resolution 6 is a special resolution required under the terms of the options. All shareholders may vote on the resolution
- resolution 7 is an ordinary resolution required under the Listing Rules. Only the Non-associated Shareholders may vote on the resolution.

Shareholders will also vote on ordinary resolutions in respect of:

- the reappointment of Staples Rodway as the auditors of the Company and authorising the Company's board of directors (the **Board**) to fix the auditor's remuneration (resolution 1)
- the re-election of Michael Fisher as a director of the Company (resolution 2)
- the re-election of Stephen Sinclair as a director of the Company (resolution 3)
- the re-election of Gregory Peebles as a director of the Company (resolution 4).

1.5 Special Meeting of Optionholders

Immediately following the Company's annual meeting, Dorchester will hold a special meeting of optionholders to vote on a special resolution identical to resolution 6 in respect of the variation of the terms of the options.

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 (together with its associates) beyond 20%
- a person holding or controlling 20% or more of the voting rights in a code company from increasing its holding or 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 conversion of the CNs and / or the exercise of options will result in:

- Hugh Green Investments' control of the voting rights in Dorchester changing from 26.88% to between 18.46% and 49.78% (depending on the number of CNs converted and options exercised)
- The Bakery Associates' control of the voting rights in Dorchester changing from 26.85% to between 18.44% and 49.76% (depending on the number of CNs converted and options exercised).

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on ordinary resolutions in respect of the allotment of shares upon the conversion of the CNs (the CN Resolution) and the exercise of the options (the Options Resolution) in accordance with the Code and the Exemption Notice.

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).

Takeovers Code (Dorchester Pacific Limited) Exemption Notice 2010

The issue of the CNs to Hugh Green Investments and The Bakery Associates will be an *other-means increase* for the purposes of the Exemption Notice. Under the terms of the Exemption Notice, the issue of further shares in the Company (or securities such as the CNs) to Hugh Green Investments, The Bakery and their respective associates is permitted, if approved by shareholders in accordance with the Code or another exemption to the Code, provided certain information is provided to shareholders in connection with that issue. Such required information is set out in the notice of annual meeting.

The issue of shares to Hugh Green Investments and The Bakery pursuant to any future exercise of their respective options will, if the terms of the options are amended as proposed, be an *other-means increase* for the purposes of the Exemption Notice. Under the terms of the Exemption Notice, variation of the terms of the options and the issue of shares to Hugh Green Investments and The Bakery pursuant to any exercise of their respective options (as varied) is permitted if approved by shareholders in accordance with the Code or another exemption to the Code, provided certain information is provided to shareholders in connection with that variation. Such required information is set out in the notice of annual meeting.

NZSX Listing Rules

Listing Rule 7.3.1 of 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 CNs represent an issue of equity securities and such issue will materially increase Hugh Green Investments' and The Bakery's 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 issue of the CNs is a Material Transaction and Hugh Green Investments and The Bakery Associates are Related Parties of the Company.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on an ordinary resolution in respect of the CNs 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 Dorchester not associated with Hugh Green Investments, The Bakery Associates or Mr Byrnes, being John Gosney and Gregory Peebles (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 conversion of the CNs and the exercise of options in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 11 August 2011 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 issue of the CNs 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 12 August 2011 to prepare the Appraisal Report.

Simmons Corporate Finance issues this Independent Adviser's Report and Appraisal Report to the Independent Directors of Dorchester for the benefit of the Non-associated Shareholders to assist them in forming their own opinion on whether to vote for or against the CN Resolution and the Options Resolution.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits of the allotment of shares following the conversion of the CNs and / or the exercise of options and the fairness of the CNs in relation to each shareholder. This report on the merits of the allotment of shares following the conversion of the CNs and / or the exercise of options and the fairness of the CNs 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 Upon the Conversion of the Convertible Notes and / or the Exercise of the Options

2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the allotment of shares to Hugh Green Investments and The Bakery Associates upon the conversion of the CNs and / or the exercise of the options that they hold.

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 Hugh Green Investments and The Bakery upon the conversion of the CNs and / or the exercise of the options should focus on:

- the rationale for the CNs
- the rationale for the variation of the terms of the options
- the terms and conditions of the CNs
- the impact of the CNs and the exercise of the options on Dorchester's financial position
- the impact of the CNs and the exercise of the options on the control of the Company
- the impact of the CNs and the exercise of the options on Dorchester's share price
- other benefits and disadvantages to Hugh Green Investments and The Bakery Associates of the CNs and the variation of the terms of the options
- the benefits and disadvantages to the Non-associated Shareholders of the CNs and the variation of the terms of the options
- the implications if the resolutions in respect of the issue of the CNs and the exercise of the options 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 Summary of the Evaluation of the Merits of the Allotment of Shares

In our opinion, on balance the positive aspects of the allotment of shares to Hugh Green Investments and The Bakery Associates upon the conversion of the CNs and / or the exercise of the options that they hold outweigh the negative aspects from the perspective of the Non-associated Shareholders.

The basis for our opinion is set out in detail in sections 2.3 to 2.14. In summary, the key factors leading to our opinion are:

- the rationale for the issue of the CNs is sound
- the rationale for the variation of the terms of the options is sound
- this issue price of $0.10 per CN is reasonable as it is within our valuation range of $0.10 to $0.11 per CN
- the initial coupon of 8.95% per annum on the CNs is in line with market yields
- the conversion price of $0.10 per share is above the Company's current share price, thereby avoiding any transfer of value from the Non-associated Shareholders to the holders of the CNs through the conversion process at present
- the CNs will have negligible immediate impact on the Company's financial position but will have a positive impact if the CNs are converted into ordinary shares on the Maturity Date
- the exercise of the options will have a positive impact on the Company's financial position
- the issue and conversion of the CNs will most likely not significantly increase Hugh Green Investments' and The Bakery Associates' respective levels of shareholding control, although in theory they could significantly increase their level of shareholding control if no other CNs holders converted their CNs and no other optionholders exercised their options
- the dilutionary impact of the issue and conversion of the CNs on Non-associated Shareholders will be significant and could result in their proportionate shareholding in the Company reducing by up to 41%. This is a major negative impact of the issue of the CNs. The exercise of the options could further dilute Non-associated Shareholders' proportionate shareholding to a cumulative level of up to 61%
- the issue of the CNs is unlikely to have any material impact on Dorchester's share price or the liquidity of its shares in the near term. However, the conversion of the CNs and / or the exercise of the options will result in a significant increase in the number of shares on issue in the longer term and any large scale selling of the new shares may place downward pressure on the Company's share price
- the implications of the CN Resolution not being approved by the Non-associated Shareholders are significant. Dorchester has not been able to secure bank funding at present and requires additional capital to be invested in its operating subsidiaries to grow its receivables book and meet its financial obligations. If the CNs are not issued, the Company will need to seek alternate sources of capital and these may not be available within the same timeframe or at the same cost as the CNs.

2.3 Rationale for the Issue of the Convertible Notes

The Company's subsidiary Dorchester Finance Limited (**DFL**) was one of a number of New Zealand finance companies that found itself in financial difficulties during the 2006 to 2008 period. On 25 June 2008, Dorchester announced that DFL would withdraw and not renew its prospectus and would seek approval for a plan to defer principal repayments on its debt securities.

On 17 December 2008, DFL received approval from its secured debenture stock holders (the **Stockholders**) and subordinated unsecured note holders (the **Noteholders**) for a plan to defer principal repayments under a deferred repayment plan (the **DRP**).

Due to a number of factors, the Company was not able to meet DRP scheduled payments and required additional capital to be raised.

On 30 June 2010, a capital reconstruction plan (the **CRP**) was approved by the Stockholders, Noteholders and the Company's shareholders.

The CRP provided for full settlement with the Stockholders and Noteholders in exchange for their existing debenture stock and subordinated notes:

- Stockholders exchanged their debenture stock for:
    - 3 year 5% secured capital notes. The notes rank behind borrowings of up to $30 million which the Company projected would be raised to fund the growth of Dorchester following the proposed capital raising (the **2010 Capital Raising**)
    - 33,074,216 units in the Dorchester Property Trust. This trust owns 4 properties that were previously owned or controlled by DFL
    - 36,512,702 new ordinary shares
    - 56,489,027 options exercisable on 15 June 2013 at an exercise price of $0.125 per option
- Noteholders forgave all remaining debt owing in exchange for:
    - a cash payment of $0.15 in the dollar in full and final settlement or
    - 2.3 ordinary shares for every $1 of original principal or
    - a combination of the 2 alternatives.

Settlements with the Stockholders and Noteholders were conditional on (amongst other things) the 2010 Capital Raising, which involved Dorchester raising between $8 million to $11 million of new capital prior to 31 August 2010 from an entitlement offer of new ordinary shares at $0.10 per share.

The 2010 Capital Raising raised $10.3 million through the issue of 102,919,330 shares and an identical number of options were issued.

One of the key assumptions of the CRP was that the Company would obtain wholesale / bank funding of up to $30 million to finance growth. References to this key assumption were set out in the 2010 Offer Document issued to shareholders in support of the CRP and the 2010 Capital Raising.

The Company had intended to have in place a $10 million facility from a bank within one year of the CRP and the 2010 Capital Raising being completed. However, despite extensive negotiations with Bank of New Zealand (**BNZ**), Dorchester has not been able to secure such bank funding at this point in time.

The issue of the CNs is therefore in place of the bank funding contemplated under the CRP. The interest rate on the CNs is similar to the interest rates that Dorchester believes it would incur on any bank funding that it could secure. Furthermore, the terms and conditions of the CNs contemplate that further wholesale / bank borrowings, up to the balance of the $30 million, are granted first ranking security ahead of the CNs.

Dorchester will use the funds raised from the issue of the CNs to provide further capital to DFL and DLL, fund the growth of DFL's receivables book and repay existing indebtedness.

We are advised by the Independent Directors that a number of capital raising alternatives were considered by the Board. Given the modest contribution to the 2010 Capital Raising from shareholders other than Hugh Green Investments and The Bakery and the current economic environment, the Independent Directors are of the view that a further $10 million equity raising at this time would not be successful, especially given that Hugh Green Investments and The Bakery are not prepared to underwrite a further $10 million equity raising at this time.

Furthermore, the Independent Directors are of the view that it would be extremely difficult in the current economic environment to issue $10 million of CNs to parties other than Hugh Green Investments, The Bakery Associates and Mr Byrnes on the same terms as those proposed at this point in time.

In our view, the rationale for the issue of the CNs is sound. The Company requires capital in order to grow its business and to meet its financial obligations. It has not been able to secure bank funding at the present time. The issue of the CNs will provide an adequate level of capital for the Company's operations while it continues to seek additional wholesale / bank funding.

2.4 Rationale for the Variation of the Terms of the Options

The Company currently has 154,807,557 options on issue held by 5,550 optionholders. The options currently have an exercise price of $0.125 and an exercise date of 15 June 2013. Optionholders are required to give notice of exercise between 1 April 2013 and 31 May 2013.

The Company is seeking shareholder and optionholder approval to amend the terms of the options to an exercise price of $0.10 and an exercise date of 20 July 2012. Optionholders will be required to give notice of exercise between 1 June 2012 and 29 June 2012. Any options not exercised on 20 July 2012 would continue to be exercisable at $0.125 on 15 June 2013.

The rationale for changing the exercise price is to align the exercise price of the options with the $0.10 subscription price of the CNs. In this way, optionholders will be able to invest in new shares in the Company at the same price as the CNs subscribers.

The rationale for changing the exercise date is to bring forward the timing of when the Company would receive funds from the exercise of the options, thereby strengthening Dorchester's financial position.

In the event that optionholders do not choose to exercise their options at $0.10 on 20 July 2012, they will still have the right to exercise their options at $0.125 on 15 June 2013.

We are of the view that the variation in the terms of the options is unlikely to result in any significant change in the value of the options. This is because any gain in value from the lower exercise price is largely offset by the decrease in value arising from the shorter exercise period.

We consider the rationale for the variation of the terms of the options to be sound. However, we note that given that the Hugh Green Investments, The Bakery Associates and Mr Byrnes collectively hold 54.91% of the options, they collectively stand to benefit the most from the gains (if any) arising from the variation of the terms. In saying that, the proportion of their benefit is identical to that of the Non-associated Shareholders and there is no value transfer from the Non-associated Shareholders to Hugh Green Investments, The Bakery Associates or Mr Byrnes.

2.5 Value of the Convertible Notes

Our assessment of the value of the CNs is set out in section 5.

We assess the value of each CN to be in the range of $0.10 to $0.11.

In our view, the issue price of $0.10 per CN is reasonable, as it is within our assessed value range.

2.6 Terms of the Convertible Notes

The Independent Directors have advised us that the terms of the CNs were arrived at based on negotiations between the Independent Directors and Hugh Green Investments and The Bakery.

Positive Features

8.95% Coupon is in Line with Market Yields

In general terms, the higher the perceived risk of default on a debt security the higher the required rate of return (yield).

The CNs are secured by a first ranking general security agreement over the assets of the Group and as such have priority ranking over the secured capital notes.

Based on current yields in the market for first ranking secured borrowings and taking into account the nature of the Group's assets and Dorchester's financial prospects, we are of the view that the initial coupon of 8.95% per annum on the CNs is in line with market yields for a debt instrument with the features of the CNs.

Conversion Price is Above the Current Share Price

Holders of the CNs may elect to convert their CNs into ordinary shares at the Maturity Date.

The conversion price of $0.10 per share is above the Company's one month volume weighted average share price (**VWAP**) of $0.091 and the current price of $0.080 per share as at 8 September 2011.

As the conversion price is not at a discount to the current share price, there is no transfer of value from the Non-associated Shareholders to the holders of the CNs through the conversion process at this point in time.

Negative Features

Covenants Provide the Majority Holders With a High Level of Control

The Majority Holders are defined as the holders of 67% of the CNs by value. Due to the size of their respective holdings of CNs, Hugh Green Investments and The Bakery Associates will form part of the Majority Holders.

The Company will provide a number of covenants in connection with the issue of the CNs. Certain of these covenants will provide the Majority Holders with a high level of control over the affairs of the Company. The Majority Holders' consent will be required for:

- any capital expenditure in excess of 110% of the budget amount of capital expenditure
- the disposal of assets which comprise more than 50% of the Group's total tangible assets
- the payment of dividends
- any other distributions (other than interest on the CNs and the secured capital notes)
- major transactions.

While the level of control conferred upon the Majority Holders is significant, it is arguable that Hugh Green Investments and The Bakery Associates already have a significant level of control over the affairs of the Company in that they collectively:

- control 53.74% of the voting rights in the Company
- hold 3 out of the 6 Board appointments, including the role of chairman.

2.7 Impact on Financial Position

Dorchester's total equity as at 31 March 2011 was $25.8 million.

The issue of the CNs will raise between $10 million and $12 million, less associated costs. In general terms, the issue of the CNs will have little immediate impact on the Company's level of equity as the bond component of the CNs will be treated as debt (rather than equity) for accounting purposes. The capital raised will however be able to be utilised to provide further capital to DFL and DLL, finance the growth of DFL's receivables book and meet financial obligations as they fall due.

A positive impact on the Company's level of equity will arise if the CNs are converted into ordinary shares. Such conversion may occur at the election of the CN holders on the Maturity Date (31 March 2015).

The variation of the terms of the options may have a positive impact on the Company's financial position. The reduction of the exercise price may increase the level of options exercised and the change in the exercise date will result in the Company receiving additional capital of up to $15.5 million almost one year earlier if all of the options are exercised.

2.8 Shareholding Levels

Share Capital and Shareholders

Dorchester currently has 175,483,122 ordinary fully paid shares on issue held by 6,596 shareholders.

The names, number of shares and percentage holding of the Company's 10 largest shareholders as at 2 September 2011 are set out in section 4.5.

The Company also has 154,807,557 options on issue, held by 5,550 optionholders.

The names, number of options and percentage holding of the Company's 10 largest optionholders as at 2 September 2011 are set out in section 4.5.

Shareholder Control

Hugh Green Investments and The Business Bakery are the Company's 2 largest shareholders, holding 26.88% and 26.85% of the Company's shares respectively. The Bakery Associates collectively hold 26.85% of the Company's shares.

Hugh Green Investments and The Bakery Associates collectively hold 53.74% of the Company's shares.

The number of shares that Hugh Green Investments and The Bakery Associates may hold if the CN Resolution and the Options Resolution are approved will depend upon the number of CNs that are converted into shares and the number of options that are exercised.

Impact on Shareholder Control				
	Hugh Green Investments	**The Bakery Associates**	**Non-associated Shareholders**[1]	**Total**
Current				
Shares	47,173,401 *26.88%*	47,123,298 *26.85%*	81,186,423 *46.26%*	175,483,122
Options	40,000,000 *25.84%*	40,000,000 *25.84%*	74,807,557 *48.32%*	154,807,557
Proposed				
CNs [2]	40,000,000 *33.33%*	40,000,000 *33.33%*	40,000,000 *33.33%*	120,000,000
Convert all CNs and exercise no options	87,173,401 *29.50%*	87,123,298 *29.49%*	121,186,423 *41.01%*	295,483,122
Convert no CNs and exercise all options	87,173,401 *26.39%*	87,123,298 *26.38%*	155,993,980 *47.23%*	330,290,679
Convert all CNs and exercise all options	127,173,401 *28.24%*	127,123,298 *28.23%*	195,993,980 *43.53%*	450,290,679
Only Hugh Green Investments and The Bakery Associates convert CNs and exercise options	127,173,401 *37.91%*	127,123,298 *37.89%*	81,186,423 *24.20%*	335,483,122
Only Hugh Green Investments converts CNs and exercises options	127,173,401 *49.78%*	47,123,298 *18.44%*	81,186,423 *31.78%*	255,483,122
Only The Bakery Associates convert CNs and exercise options	47,173,401 *18.46%*	127,123,298 *49.76%*	81,186,423 *31.78%*	255,483,122

1 Including Mr Byrnes
2 Assumes 120,000,000 CNs are issued

The analysis shows that depending on the number of CNs that are converted into shares and the number of options that are exercised:

- Hugh Green Investments' current shareholding of 26.88% may change to between 18.46% and 49.78%
- The Bakery Associates' current shareholding of 26.85% may change to between 18.44% and 49.76%
- the collective current shareholdings of Hugh Green Investments and The Bakery Associates of 53.74% may change to between 52.77% and 75.80%.

In our view, it is likely that most optionholders will act the same way – they will either exercise all of their options if the options are at the money or in the money at the exercise date or not exercise any of their options. Therefore we consider the likelihood of the scenario where only Hugh Green Investments and / or The Business Bakery exercise their options to be remote.

Similarly, we would expect that most of the CNs holders would act in a uniform manner at the Maturity Date – particularly if the Dorchester shares were below $0.10 (in which case we would expect the holders to redeem the CNs for cash) or if the Dorchester shares were well above $0.10 (in which case we would expect the holders to convert their CNs to shares).

Accordingly, we consider it highly unlikely that the maximum theoretical shareholding levels of 49.78% for Hugh Green Investments, 49.76% for The Bakery Associates or 75.80% for the combined shareholding would be reached.

Instead, we consider a more likely outcome to be similar to the scenario where all the CNs are converted and / or all the options are exercised. This would result in, at most:

- Hugh Green Investments' current shareholding of 26.88% increasing to 29.50%
- The Bakery Associates' current shareholding of 26.85% increasing to 29.49%
- the collective current shareholdings of Hugh Green Investments and The Bakery Associates of 53.74% increasing to 58.99%.

Under this likely scenario, the level of influence that Hugh Green Investments and The Bakery Associates can exert over shareholding voting will not change significantly. Either shareholder currently has the ability to block a special resolution and collectively the 2 shareholders can pass or block an ordinary resolution. This will not change under the likely scenario.

We note however that in the unlikely scenarios of only Hugh Green Investments and / or The Bakery Associates converting their CNs and / or exercising their options, then either shareholder will most likely be able to singlehandedly pass or block an ordinary resolution and collectively the 2 shareholders will most likely be able to pass a special resolution.

Dilutionary Impact

The issue and subsequent conversion of the CNs will have a significant dilutionary impact on Non-associated Shareholders who are either not CN holders or who are CN holders who do not convert their CNs into shares. Such shareholders face the possibility of their proportionate shareholding in the Company being diluted by up to 41%.

The exercise of the options will also have a significant dilutionary impact on Non-associated Shareholders who are either not optionholders or who are optionholders who do not exercise their options. Such shareholders face the possibility of their proportionate shareholding in the Company being diluted by up to 47%.

The cumulative dilutionary impact of the conversion of the CNs and the exercise of the options is up to 61%.

Dilutionary Impact on Non-associated Shareholders		
	No. of Shares	**Dilutionary Impact**
Current	175,483,122	
Conversion of CNs	120,000,000	41%
Exercise of maximum number of options	154,807,557	47%
Maximum number of shares	450,290,679	61%

By way of example, a Non-associated Shareholder who is not a CN holder or an optionholder holding 100,000 shares currently holds a 0.06% interest in the Company. This interest will be diluted by 61% down to 0.02% following the conversion of the CNs and the exercise of the options.

We consider the dilutionary impact of the issue of the CNs to be a negative aspect for Non-associated Shareholders.

2.9 Impact on Share Price and Liquidity

Share Price

A summary of the Company's share price movements since 5 January 2009 is set out in section 4.9.

Details of the CNs were announced on 22 August 2011. There has been negligible movement in the Company's share price since the announcement. Its closing share price on 19 August 2011 was $0.095. Since then, its shares have traded between $0.085 and $0.095 at a VWAP of $0.093.

We consider the existence of the CNs is unlikely to have a material effect (either positive or negative) on the Company's share price in the near term as the conversion price of the CNs is set at $0.10 per share which is close to the current share price.

However, the conversion of the CNs will result in a significant increase in the number of shares on issue in the longer term and any large scale selling of the new shares may place downward pressure on the Company's share price. The exercise of the options will have a similar effect.

Liquidity

A summary of the Company's share trading over the past year is set out in section 4.9.

The average volume of shares traded over the past year has been approximately 1.9% of the shares on issue.

The size of the pool of shares held by the Non-associated Shareholders who are not CN holders will not change as a result of the conversion of the CNs.

In our view, the issue of the CNs in itself is unlikely to have a positive or negative effect on the liquidity of Dorchester's shares.

2.10 Benefits to Hugh Green Investments and The Bakery Associates

The key benefit of the issue of CNs is that it provides Hugh Green Investments and The Bakery Associates with the opportunity to increase their shareholdings (and levels of control) in Dorchester if they choose to convert their CNs to ordinary shares.

The shareholding levels that Hugh Green Investments and The Bakery Associates will hold will however be dependent on the total number of CNs that are converted into shares and the number of options that are exercised. Neither Hugh Green Investments nor The Bakery Associates will be able to control how many CNs are converted by other CN holders or how many options are exercised by non-associated optionholders.

2.11 Disadvantages to Hugh Green Investments and The Bakery Associates

Increased Exposure to the Risks of Dorchester

The key issues and risks that are likely to impact upon the business operations of Dorchester are set out in section 4.3.

As Hugh Green Investments' and The Bakery Associates' ownership in Dorchester increase, so do their exposure to these risks.

Significant Financial Commitment

Hugh Green Investments and The Bakery Associates have both made significant financial commitments to the Company. They each underwrote $3.5 million of the 2010 Capital Raising.

The issue of the CNs will see further significant financial contributions from the 2 shareholders. They will each subscribe for $4 million of CNs.

In the event that they each exercise their options, they will each invest a further $4 million into Dorchester.

2.12 Benefits to Non-associated Shareholders

Strengthens the Company's Financial Position

The key benefit to the Non-associated Shareholders of the issue of the CNs is that it provides the Company with up to $12.0 million of capital in a short timeframe. This will be used to provide further capital for DFL and DLL, finance the growth of DFL's receivables book and meet the Company's financial obligations.

Variation of the Terms of the Options

In conjunction with the issue of the CNs, Dorchester proposes to vary the terms of the options, including reducing the exercise price from $0.125 to $0.10. These variations may be viewed as value-enhancing by Non-associated Shareholders who are also optionholders.

Benefits to Dorchester of Hugh Green Investments and The Bakery Associates as Cornerstone Shareholders

The issue of CNs will enhance Hugh Green Investments' and The Bakery Associates' positions as important cornerstone investors in the Company. Both shareholders have played an active role in the governance of the Company as well as supporting it financially.

The subscription for CNs also signals Hugh Green Investments' and The Bakery Associates' confidence in the future prospects of Dorchester.

2.13 Disadvantages to Non-associated Shareholders

Main Disadvantage

The main disadvantage is that the conversion of the CNs to ordinary shares will see the interests of Non-associated Shareholders being substantially diluted by potentially up to 41%.

May Reduce the Likelihood of a Takeover Offer from Hugh Green Investments and The Bakery Associates

An increase in Hugh Green Investments' and The Bakery Associates' shareholding levels may reduce the likelihood of a takeover offer for the Company from either Hugh Green Investments or The Bakery Associates as they may consider that they have sufficient control over the Company.

It is possible that if Hugh Green Investments or The Bakery 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 have significant control of the Company and hence do not need to pay a control premium of any significance.

Following the allotment of shares upon the conversion of CNs and / or the exercise of options, Hugh Green Investments and The Bakery Associates will not be able to increase the level of their shareholdings in Dorchester unless they comply with the provisions of the Code. They will only be able to acquire more shares in the Company if:

- they make 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.

Neither shareholder will hold a shareholding of 50% or more and therefore neither shareholder would be able to use the *creep* provisions of Rule 7(e) of the Code to buy up to a further 5% of the Company's shares per annum.

Hugh Green Investments and The Bakery Associates could also increase their levels of shareholding in the Company if Dorchester undertook a share buyback that was approved by the Company's shareholders and Hugh Green Investments and / or The Bakery Associates did not accept the offer of the buyback.

Likelihood of Other Takeover Offers Unlikely to Change

Any bidder looking to fully take over the Company at present would need to ensure that both Hugh Green Investments and The Bakery Associates 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 need to ensure that both Hugh Green Investments and The Bakery Associates would accept its offer to ensure the success of its offer.

In our view, the increase in Hugh Green Investments' and The Bakery Associates' shareholdings following the allotment of shares upon the conversion of CNs and / or the exercise of options is unlikely to change the attraction of Dorchester as a takeover target to other parties.

2.14 Implications of the Resolutions not Being Approved

In the event that the CN Resolution and the Options Resolution are not approved, then the Company will need to seek alternate sources of capital. The Company has been unsuccessful to-date in its negotiations to raise bank debt. Raising capital from alternate sources is unlikely to be easy in the current economic environment. If the Company is able to raise capital from alternate sources, it may not be able to do so within the required timeframe nor may it be able to raise capital at the same cost as under the CNs.

We are advised by the Independent Directors that a delay in obtaining additional capital would have no implications regarding Dorchester's ability to meet its short to medium term financial obligations. However, the Company would likely trade at a lower level of activity and would unlikely be able to secure further bank funding in the future. Growth of the DFL receivables book would be dependent upon Dorchester realising non-core assets and raising funds through the refinancing and / or the sale of unencumbered reverse annuity mortgages.

2.15 Voting For or Against the Resolutions

Voting for or against the CN Resolution and the Options Resolution is 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.

3. Evaluation of the Fairness of the Convertible Notes

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 following the conversion of the CNs must consider the fairness of the likely increase in effective control by Hugh Green Investments and The Bakery Associates in Dorchester as well as the fairness of the terms and conditions of the CNs.

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 CNs 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 CNs are fair to the Non-associated Shareholders.

The basis for our opinion is set out in detail in sections 2.4 to 2.14. In summary, the key factors leading to our opinion are:

- the rationale for the issue of the CNs is sound
- this issue price of $0.10 per CN is reasonable as it is within our valuation range of $0.10 to $0.11 per CN
- the initial coupon of 8.95% per annum on the CNs is in line with market yields
- the conversion price of $0.10 per share is above the Company's current share price, thereby avoiding any transfer of value from the Non-associated Shareholders to the holders of the CNs through the conversion process at present
- the CNs will have negligible immediate impact on the Company's financial position but will have a positive impact if the CNs are converted into ordinary shares on the Maturity Date
- the issue and conversion of the CNs will most likely not significantly increase Hugh Green Investments' and The Bakery Associates' respective levels of shareholding control, although in theory they could significantly increase their level of shareholding control if no other CNs holders converted their CNs and no other optionholders exercised their options
- the dilutionary impact of the issue and conversion of the CNs on Non-associated Shareholders will be significant and could result in their proportionate shareholding in the Company reducing by up to 41%

- the issue of the CNs is unlikely to have any material impact on Dorchester's share price or the liquidity of its shares in the near term. However, the conversion of the CNs will result in a significant increase in the number of shares on issue in the longer term and any large scale selling of the new shares may place downward pressure on the Company's share price
- the implications of the CN Resolution not being approved by the Non-associated Shareholders are significant. Dorchester has not been able to secure bank funding at present and requires additional capital in DFL and DLL to grow DFL's receivables book and meet the Company's financial obligations. If the CNs are not issued, the Company will need to seek alternate sources of capital and these may not be available within the same timeframe or at the same cost as the CNs.

3.3 Voting For or Against the Resolution

Voting for or against the CN Resolution is 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.

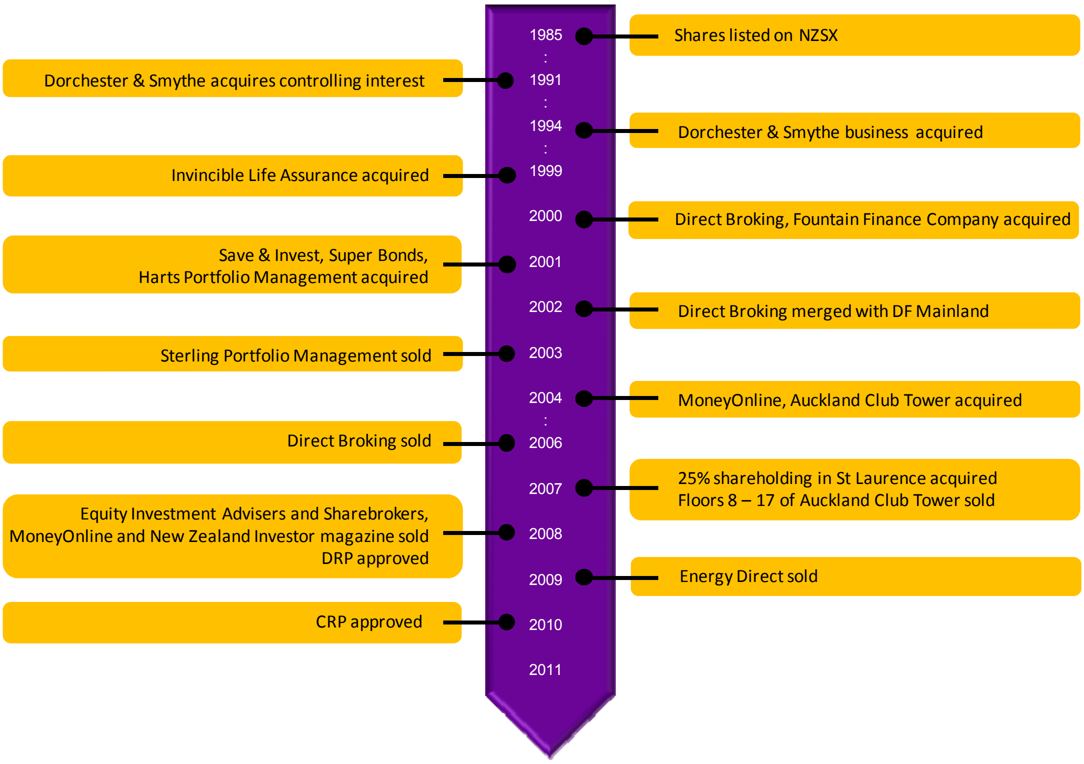
4. Profile of Dorchester

4.1 Background

Dorchester was incorporated on 27 September 1984 as Venture Pacific Limited. It changed its name to Dorchester Pacific Limited on 22 May 1992.

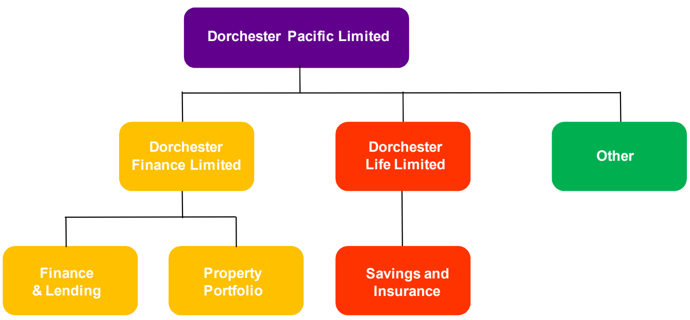
Dorchester listed its shares on the NZSX in 1985. It developed its financial services base through the acquisition of a number of finance companies throughout New Zealand. The Company later expanded into complementary activities including personnel / recruitment, investment advice and publications, life assurance, sharebroking and portfolio management. However, in recent years the Company has tightened its business focus and divested a range of non core assets:

Key events in the Company's history are set out below.



4.2 Nature of Operations

Dorchester's corporate structure is set out below.



Finance Division

DFL represents a significant part of the Group and provides a range of lending products including business loans and personal loans. The loans require regular principal and interest repayments.

Insurance and Savings Division

DLL offers a portfolio of insurance and savings products:

- SimpleLife Insurance
- EasyLife Insurance
- Funeral Plan
- Accidental Death Insurance
- StopGap Insurance
- CornerStone Insurance
- Dorchester SuperLife savings
- AON KiwiSaver scheme.

Property

Dorchester has managed to sell down a substantial portion of its property portfolio which included the outright ownership of several hotel and commercial properties. Most of these properties had been purchased to secure and protect Dorchester's previous position as a debt provider where DFL typically held a second or third mortgage. The remaining property portfolio now consists of 4 properties – a 26 hectare subdivision in Christchurch, 10 apartment units in a complex in Taupo, an apartment in Paihia and a one hectare block of land in west Auckland. These 4 properties are being actively marketed for sale.

4.3 Key Issues Affecting Dorchester

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

- credit risk on the loans its provides to borrowers
- liquidity risk in that it may not have sufficient cash and deposits to meet its obligations as they fall due as a result of borrowers failing to make payments on due date
- a downturn in economic conditions may adversely impact commercial and consumer financing, insurance and savings activities
- interest margins may reduce, thereby reducing the Company's profitability
- insurance risks such as mortality, lapses, market earnings on assets backing the insurance liabilities, variations in claim levels and unforeseen claim events
- changes in the consumer credit and insurance regulatory regimes
- the inability to adequately finance the Company's operations.

4.4 Directors and Senior Management

The directors of Dorchester are:

- Grant Baker, chairman, associated with The Bakery
- Paul Byrnes, executive director
- Michael Fisher, non-executive director, associated with Hugh Green Investments
- John Gosney, independent director
- Gregory Peebles, independent director
- Stephen Sinclair, non-executive director, associated with The Bakery.

The Company's executive management team comprises:

- Paul Byrnes, executive director
- Greg Main, general manager, insurance and lending
- Barbara Badish, group financial controller and company secretary.

4.5 Capital Structure and Shareholders

Ordinary Shares

Dorchester currently has 175,483,122 ordinary shares on issue held by 6,596 shareholders.

The names, number of shares and percentage holding of the 10 largest shareholders as at 2 September 2011 are set out below.

Dorchester's 10 Largest Shareholders

Shareholder	No. of Shares Held	%
Hugh Green Investments	47,173,401	26.88%
The Bakery	47,117,226	26.85%
Paul Byrnes	6,748,937	3.85%
Jae Choi	5,223,000	2.98%
Garrett Smythe Limited	1,476,716	0.84%
Hee Lee and Young Yoon	1,142,716	0.65%
Tribal New Zealand Traders Limited	1,042,293	0.59%
Moon Choi and Keum Choi	817,425	0.47%
Leveraged Equities Finance Limited	755,644	0.43%
Aratas Investment Trust	750,000	0.43%
Subtotal	112,247,358	63.96%
Others (6,586 shareholders)	63,235,764	36.04%
Total	175,483,122	100.00%

Source: NZX Data

Options

The Company currently has 154,807,557 options on issue held by 5,550 optionholders. The options currently have an exercise price of $0.125 and an exercise date of 15 June 2013. Optionholders are required to give notice of exercise between 1 April 2013 and 31 May 2013.

The Company is seeking shareholder and optionholder approval to amend the terms of the options to an exercise price of $0.10 and an exercise date of 20 July 2012. Optionholders will be required to give notice of exercise between 1 June 2012 and 29 June 2012.

The names, number of options and percentage holding of the 10 largest optionholders as at 2 September 2011 are set out below.

Dorchester's 10 Largest Optionholders

Optionholder	No. of Options Held	%
Hugh Green Investments	40,000,000	25.84%
The Bakery	40,000,000	25.84%
Jae Choi	5,345,000	3.45%
Paul Byrnes	5,000,000	3.23%
Eoin Johnson	813,021	0.53%
FNZ Custodians Limited	595,328	0.38%
Moon Choi and Keum Choi	538,241	0.35%
Chun Im and Joung Lee	478,151	0.31%
Byung Chung and Kee Chung	364,219	0.24%
Christopher Studt	350,000	0.23%
Subtotal	93,483,960	60.39%
Others (5,540 optionholders)	61,323,597	39.61%
Total	154,807,557	100.00%

Source: NZX Data

4.6 Financial Performance

A summary of Dorchester's recent financial performance is set out below.

Summary of Dorchester Financial Performance

	As at 31 Mar 09 (Audited) $000	As at 31 Mar 10 (Audited) $000	As at 31 Mar 11 (Audited) $000
Continuing operations			
Operating revenue	24,627	13,058	10,014
Operating expenses	(42,898)	(30,726)	(17,244)
Profit / (loss) before fair value adjustments and taxation	(18,271)	(17,668)	(7,230)
Fair value adjustments	-	-	22,407
Profit / (loss) before taxation	(18,271)	(17,668)	15,177
Taxation (expense) / benefit	(7,598)	-	-
Profit / (loss) from continuing operations	(25,869)	(17,668)	15,177
Profit / (loss) from discontinued operations	437	(1,407)	(1,080)
Total comprehensive income	(25,432)	(19,075)	14,097
EPS ($ per share)	($0.71)	($0.53)	$0.12

EPS: Earnings per share

Source: Dorchester audited financial statements

The Company's operating revenue consists mainly of interest income and life insurance and life investment contract income. The decrease in operating income has been mainly due to reduced interest income, which was $20.6 million in the 2009 financial year and $4.6 million in the 2011 financial year.

The net loss of $25.4 million in the 2009 financial year included bad debt write offs of $28.2 million, an impairment loss on the investment in St Laurence of $21.3 million, impairment losses on finance receivables of $4.5 million and a fair value adjustment gain of $35.2 million arising from the DRP.

The net loss of $19.1 million in the 2010 financial year included bad debt write offs of $11.9 million, a reversal of previous impairment losses on finance receivables of $8.6 million and a fair value adjustment loss in DFL of $16.0 million.

The net profit of $14.1 million in the 2011 financial year included a fair value adjustment gain of $22.4 million arising from the CRP.

4.7 Financial Position

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

Summary of Dorchester Financial Position

	As at 31 Mar 09 (Audited) $000	As at 31 Mar 10 (Audited) $000	As at 31 Mar 11 (Audited) $000
Cash and cash equivalents	13,912	2,374	4,439
Financial assets at fair value	18,641	19,921	19,954
Finance receivables	63,261	19,535	18,203
Receivables and deferred expenses	5,932	2,156	1,528
Reverse annuity mortgages	25,565	23,608	23,998
Other assets	5,556	3,339	3,259
Assets classified as held for sale	16,386	37,956	3,020
Total assets	149,253	108,889	74,401
Other payables	(2,247)	(1,339)	(1,113)
Deferred revenue	(2,349)	(1,160)	(775)
Life investment contract liabilities	(15,810)	(19,041)	(18,835)
Life insurance contract liabilities	(3,614)	(3,094)	(3,048)
Borrowings	(9,833)	(12,882)	(9,197)
Secured debenture stock	(95,492)	(69,438)	-
Subordinated unsecured notes	(3,671)	(4,773)	-
Secured capital notes	-	-	(15,666)
Total liabilities	(133,016)	(111,727)	(48,634)
Total equity	16,237	(2,838)	25,767

Source: Dorchester audited financial statements

Dorchester's total assets have decreased from $149.3 million as at 31 March 2009 to $74.4 million as at 31 March 2011. The reduction in the Company's asset base was largely as a result of:

- the decrease in the carrying value of finance receivables from $63.3 million as at 31 March 2009 to $18.2 million as at 31 March 2011
- cash and cash equivalents reduced from $13.9 million to $4.4 million
- property assets for sale reduced from $16.4 million to $3.0 million.

Total liabilities as at 31 March 2011 were $48.6 million, down from $133.0 million as at 31 March 2009. This largely reflected repayment of debenture stock under the terms of the DRP and the exchange of debenture stock and subordinated notes for other securities under the CRP.

The net impact of the above changes resulted in total equity increasing from $16.2 million as at 31 March 2009 to $25.8 million as at 31 March 2011. During this period, share capital has increased from $46.9 million to $60.9 million as a result of the CRP and the 2010 Capital Raising.

4.8 Cash Flows

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

Summary of Dorchester Cash Flows

	Year to 31 Mar 09 (Audited) $000	Year to 31 Mar 10 (Audited) $000	Year to 31 Mar 11 (Audited) $000
Net cash flow from / (used in) operating activities	(15,030)	(17,721)	(3,392)
Net cash from / (used in) investing activities	(5,433)	3,134	932
Net cash from / (used in) financing activities	503	3,049	4,525
Net increase / (decrease) in cash held	(19,960)	(11,538)	2,065
Opening cash balance	33,872	13,912	2,374
Closing cash balance	13,912	2,374	4,439

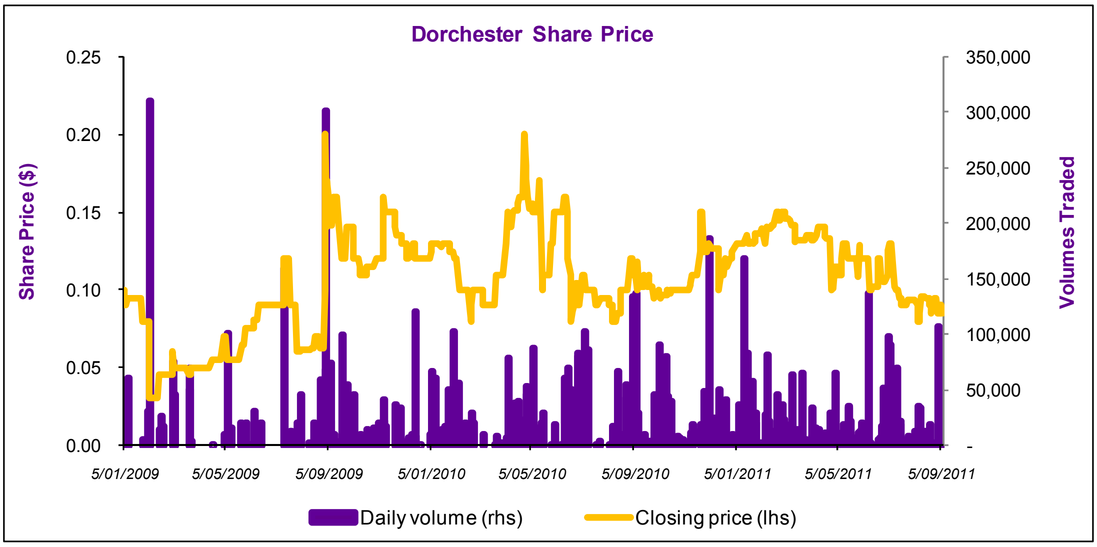
Source: Dorchester audited financial statements

Proceeds from the sale of properties held for resale generated cash of $3.3 million in the 2010 financial year and $1.2 million in the 2011 financial year.

A mortgage loan of $3.5 million raised in the 2010 financial year was repaid in the 2011 financial year. Proceeds from the 2010 Capital Raising amounted to $9.6 million and costs associated with the CRP and the 2010 Capital Raising totalled $1.4 million in the 2011 financial year.

4.9 Share Price History

Set out below is a summary of Dorchester's daily closing share price and daily volumes of shares traded from 5 January 2009 to 7 September 2011.



During the period, Dorchester's shares have traded between $0.03 and $0.20 at a VWAP of $0.114.

Trading in the Company's shares is relatively thin. An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of shares outstanding) is set out below.

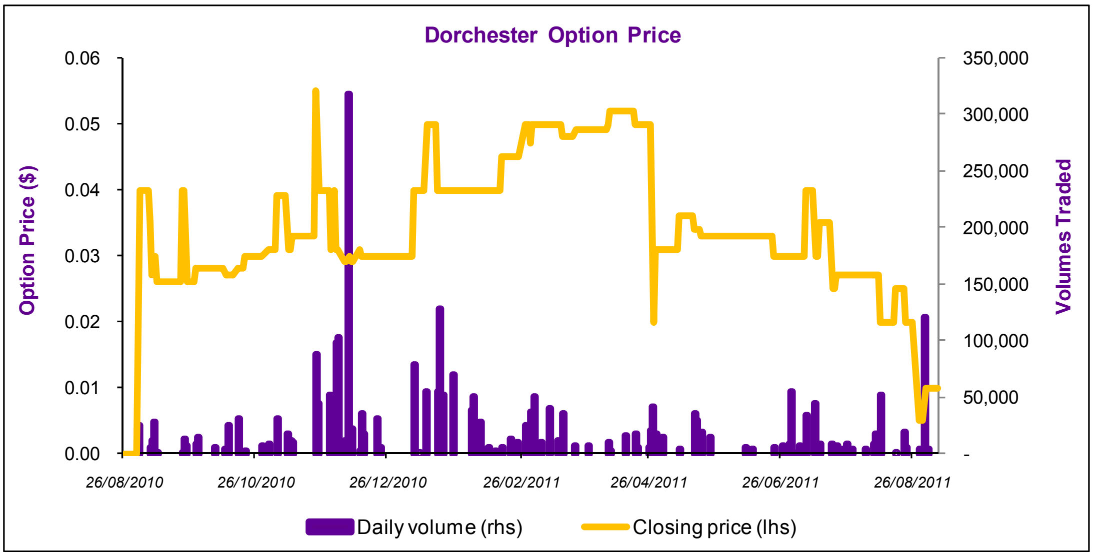
Share Trading					
Period	**Low [1] ($)**	**High [1] ($)**	**VWAP [1] ($)**	**Volume Traded [1] (000)**	**Liquidity**
1 month	0.080	0.105	0.091	245	0.1%
3 months	0.080	0.130	0.108	923	0.5%
6 months	0.080	0.146	0.115	1,492	0.9%
12 months	0.080	0.150	0.119	3,411	1.9%

1 To 7 September 2011

The Company's shares have traded on 156 days in the past year at a VWAP of $0.119.

4.10 Option Price History

Set out below is a summary of Dorchester's daily closing option price and daily volumes of options traded from 26 August 2010 to 7 September 2011.



During the period, Dorchester's options have traded between $0.005 and $0.055 at a VWAP of $0.035.

Trading in the Company's options is very thin. An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of options outstanding) is set out below.

Option Trading					
Period	**Low [1] ($)**	**High [1] ($)**	**VWAP [1] ($)**	**Volume Traded [1] (000)**	**Liquidity**
1 month	0.005	0.027	0.017	229	0.1%
3 months	0.005	0.040	0.024	441	0.3%
6 months	0.005	0.052	0.031	790	0.5%
12 months	0.005	0.055	0.035	2,590	1.7%

1 To 7 September 2011

The Company's options traded on 103 days in the past year at a VWAP of $0.035.

5. Valuation of the Convertible Notes

5.1 Methodology and Valuation Approach

The CNs represent a Dorchester security which is a combination of a bond and an embedded option:

- the bond component promises the CN holders the payment of an initial coupon of 8.95% per annum payable monthly in arrears
- the embedded option component provides the CN holders with the ability to benefit if the share price of Dorchester is above $0.10 at the Maturity Date.

To assess the value of the CNs, it is necessary to assess the value of the bond component and the embedded option component.

Valuation of Bonds

The value of the bond is a function of the interest rate on the bond and the value of the principal returned.

The CNs offer an initial coupon of 8.95% per annum and repayment of $0.10 of principal on the Maturity Date.

A required rate of return higher than the coupon will result in a bond value lower than the principal and vice versa.

In our view, the required rate of return on a "plain vanilla" first ranking secured bond offered by Dorchester at this point in time would be in line with the 8.95% coupon.

Valuation of Options

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 (which can be exercised at anytime during their life, as opposed to European options which can only be exercised on one particular day) 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 a European 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 embedded options in the CNs are in effect warrants and hence Dorchester will issue new shares when the CNs are converted. 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 CNs.

5.2 Valuation Assessment of Bond Component

Valuation Parameters

The key variables applied in our assessment of the value of the bond component of the CNs are:

- valuation date – 1 October 2011, being the expected issue date of the first tranche of the CNs
- coupon – 8.95% per annum, paid monthly in arrears
- repayment date – 31 March 2015, being the Maturity Date
- principal repayment - $0.10
- required yield – 8.0% to 10.0% per annum.

Conclusion

Based on the above, we assess the fair value of the bond component of the CNs to be in the range of $0.0969 to $0.1029 per CN.

5.3 Valuation Assessment of Option Component

Valuation Parameters

The key variables applied in our assessment of the value of the embedded option component of the CNs are:

- valuation date – 1 October 2011, being the expected issue date of the first tranche of the CNs
- exercise price - $0.10 per share, being the conversion price
- the risk free rate – 3.5% based on the current yield on New Zealand Government 15 April 2015 bonds
- the current market value of Dorchester shares - $0.091, being the one month VWAP up to 7 September 2011
- volatility - 25% to 35% (based on the observed volatility levels of movements in Dorchester's share price and for comparable companies)
- the time to expiry – 31 March 2015, being the day that the CNs may be converted into ordinary shares
- expected distributions – assumed to be nil.

Dilutionary Effect

The Binomial Model and Black-Scholes Formula assume that the options are over existing shares. However, the option components of the CNs are akin to warrants. Dorchester will need to issue 120,000,000 new shares if the 120,000,000 CNs are converted 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 conversion of the CNs is 175,483,122, being the ordinary shares currently on issue.

Conclusion

Based on the above, we assess the fair value of each embedded option in the CNs to be in the range of $0.0029 to $0.0073.

5.4 Valuation Conclusion

Based on the above, we assess the fair value of each CN to be in the range of $0.10 to $0.11.

Valuation of CNs

Security Component	Value of CN Low ($)	Value of CN High ($)
Bond	0.0969	0.1029
Embedded option	0.0029	0.0073
	0.0998	0.1102

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

6.1 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 draft notice of special meeting of optionholders
- the draft CN Subscription Agreement
- the draft CN Deed Poll
- the draft Group Security Agreement
- the Dorchester annual reports for the years ended 31 March, 2009 to 2011
- the 2010 Offer Document
- correspondence between Dorchester and BNZ in respect of a proposed $10 million senior debt facility
- share price data and shareholder data in respect of Dorchester from NZX Data and Capital IQ.

During the course of preparing this report, we have had discussions with and/or received information from the Independent Directors and executive management of Dorchester and Dorchester'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 issue of the CNs and the variation of the terms of the options 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 necessary for the purpose of preparing this Independent Adviser's Report and Appraisal Report.

In our opinion, the information set out in this Independent Adviser's Report and Appraisal Report is sufficient to enable the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the issue of the CNs and the variation of the terms of the options.

6.2 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 Dorchester 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 Dorchester. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

6.3 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 Dorchester 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 Dorchester 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 its attention after the date of this report or to review, revise or update its report.

We have had no involvement in the preparation of the notice of annual meeting issued by Dorchester 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.

6.4 Indemnity

Dorchester 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. Dorchester 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.

7. Qualifications and Expertise, Independence, Declarations and Consents

7.1 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.

7.2 Independence

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with Dorchester, Hugh Green Investments and The Bakery Associates that could affect our ability to provide an unbiased opinion in relation to this transaction.

Simmons Corporate Finance has not had any part in the formulation of the issue of the CNs or the variation of the terms of the options 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 issue of the CNs or the variation of the terms of the options. We will receive no other benefit from the preparation of this report.

7.3 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.

7.4 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 Dorchester'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
8 September 2011