

Explanatory Notes to Resolutions

Resolution 1 – Purchase of National Finance Receivables from Evolution Finance Limited

Shareholder approval of the purchase by the Company's wholly owned subsidiary, Cynotech Finance Group Limited, is required because the transaction is a major transaction as defined in Rule 9.1 of Appendix 1 of the NZAX Listing Rules– that Rule requires such transactions to be approved by shareholders.

This Resolution is an ordinary resolution. An ordinary resolution is passed if a majority of votes cast on it are in favour of the resolution.

The Receivers of National Finance (2000) Limited (In Receivership) (*National Finance*) have sold the total remaining receivables book of that company to Evolution Finance Limited for \$7,700,000. The price was arrived at in a competitive process following the provision of an expression of interest and lengthy negotiations with the receivers.

The total receivables acquired by Evolution Finance Limited effective 6 October 2006 were:

| | |
|-------------------|---------------------|
| Gross Receivables | \$23,000,000 |
| Deferred Interest | <u>\$ 2,000,000</u> |
| Nett Receivables | <u>\$21,000,000</u> |

The receivables consist of some loan accounts which are being paid on time, some where the repayments have become slow or erratic, and other loans in substantial default and a group of salvage receivables which may not be collectable. The Gross Receivables were categorised as follows in the ledgers of National Finance – these figures must be regarded as indicative only and are subject to reclassification and collection action since acquisition by Evolution Finance Limited:

| | |
|--------------------------------|---------------------|
| Current Loans | \$4,600,000 |
| Up to 90 days overdue | \$3,300,000 |
| Over 90 days overdue | \$12,300,000 |
| Salvage & written off accounts | <u>\$2,800,000</u> |
| | <u>\$23,000,000</u> |

To put the transaction in perspective, the Company's average market capitalisation for the 20 working days before the proposed purchase of the National Finance receivables was announced to the market on 6 October 2006 was \$8,942,409. For a comparison of the statements of financial position of the Group before and after the proposed purchase, please refer to the notes and statements later in this document.

Your Board considers that the Company's subsidiary, Cynotech Finance Group Limited, has the expertise and resources to realise more than the \$7,700,000 purchase price from the receivables book which is proposed to be acquired. Cynotech Finance Group Limited has conducted a thorough due diligence on the receivables book before entering into an agreement to purchase (subject to the shareholder approval which is being sought by this resolution).

Another of the Company's subsidiaries, Budget Loans Limited, currently has receivables in the order of \$4,000,000. The purchase of the National Finance receivables will result in a material increase in the level of the Cynotech Group's resources committed in the Finance Sector.

Your Board wished Cynotech Finance Group Limited to purchase the National Finance receivables direct from National Finance. However, the Receivers' timing requirements for the sale and settlement of the sale were such that there was insufficient time for the Company to obtain shareholder approval for the purchase. To secure the investment for consideration by shareholders of the Company, it was necessary to negotiate the share purchase through a third party, Evolution Finance Limited.

If shareholders approve the purchase, Cynotech Finance Group Limited will have all the rights and benefits of the National Finance receivables accruing to Evolution Finance Limited under its agreement with National Finance which was settled on 6 October 2006 (after deducting the costs of administering the receivables book and the cost of funding the purchase price in the interim period) – in all respects, Cynotech Finance Group Limited will be in the same situation financially as if it had purchased the receivables book direct on 6 October 2006.

Evolution Finance Limited is a single purpose company formed solely for the purpose of purchasing the National Finance receivables pending a decision by shareholders of the Company whether to approve the purchase by Cynotech Finance Group Limited. If shareholders of the Company do not approve the purchase, the Cynotech Group will have no further interest in or involvement with the receivables book, and there will be no break fee or other amounts payable to Evolution Finance Limited or National Finance

Resolution 2 – Borrowing to enable purchase of National Finance receivables

Shareholder approval of the borrowing of \$6,000,000 by the Company's wholly owned subsidiary, Cynotech Finance Group Limited, to assist in funding the purchase of receivables is required because the transaction is a major transaction as defined in Rule 9.1 of Appendix 1 of the NZAX Listing Rules – that Rule requires such transactions to be approved by shareholders.

This Resolution is an ordinary resolution. An ordinary resolution is passed if a majority of votes cast on it are in favour of the resolution.

Cynotech Finance Group Limited proposes to fund the purchase in the following way:

| | |
|-------------------------------|--------------------|
| External Loan | \$6,000,000 |
| Cynotech Group cash resources | <u>\$1,700,000</u> |
| | \$7,700,000 |

The Group has sourced the external loan funds for the purchase at interest rates from 12 to 13 percent per annum for a flexible period up to 3 years. Interests associated with Evolution Finance Limited have agreed to provide these loan funds. Security for the loan will be the issue by Cynotech Finance Group Limited of a general security interest over all its assets and undertaking, and an unsecured guarantee and indemnity issued by the Company.

The cash component will be sourced by the Company from surplus funds held in the consolidated Cynotech Finance Group.

Resolution 3 – Guarantee by Cynotech Holdings Limited

Shareholder approval of the guarantee and indemnity is required because:

- (a) The transaction is a major transaction of the Company as defined in section 129 of the Companies Act 1993; and
- (b) The transaction is a major transaction defined in Rule 9.1 of Appendix 1 of the NZAX Listing Rules.

Because the transaction is a major transaction of the Company, a special resolution is required. A special resolution is passed if 75% or more of the votes cast on it are in favour of the resolution.

The size of the loan referred to in Resolution 2 is large compared to the value of the assets of Cynotech Finance Group Limited and its subsidiaries and the value of the total assets of the Cynotech Group. The lender will require the Company as the parent company in the Group to issue a guarantee and indemnity in relation to Cynotech Finance Group Limited's obligations under the loan. That guarantee and indemnity will be unsecured.

Comparison of statements of financial position before and after purchase of National Finance Receivables

If Resolutions 1-3 are passed and the transactions contemplated by those Resolutions take place, the unaudited statements of financial position of the Cynotech Group would change substantially. Attached are summary unaudited statements of financial position of the Cynotech Group at 30 June 2006 with a comparison of the unaudited statements of financial position of the Cynotech Group following the purchase of the National Finance receivables, based on the 30 June 2006 figures.

BALANCE SHEET

EFFECT OF NATIONAL FINANCE RECEIVABLES ACQUISITION

(Assuming shareholder approval)

GROUP

| | Actual 6 months 30th June 2006 | After Acquisition Proforma Balance Sheet |
|---------------------------------------|--------------------------------------|--|
| Current assets | | |
| Cash and cash equivalents | 1,190,214 | 777,858 |
| Finance receivables | 4,119,405 | 10,031,071 |
| Inventories | 348,344 | 348,344 |
| Trade and other receivables | 373,050 | 373,050 |
| Total current assets | 6,031,013 | 11,530,323 |
| Non current assets | | |
| Goodwill | 1,531,758 | 2,067,448 |
| Fixed assets | 2,215,364 | 2,215,364 |
| Total non current assets | 3,747,122 | 4,282,812 |
| Total assets | 9,778,135 | 15,813,135 |
| | | |
| Current liabilities | | |
| Deposits | 1,497,221 | 1,497,221 |
| Trade and other payables | 398,904 | 433,904 |
| Total current liabilities | 1,896,125 | 1,931,125 |
| Non current liabilities | | |
| Deposits | 221,000 | 6,221,000 |
| Interest bearing loans and borrowings | 1,711,639 | 1,711,639 |
| Total term liabilities | 1,932,639 | 7,932,639 |
| Total liabilities | 3,828,764 | 9,863,764 |
| | | |
| Equity | | |
| Issued capital | 12,963,798 | 12,963,798 |
| Convertible notes | 250,000 | 250,000 |
| Retained earnings | (7,264,427) | (7,264,427) |
| Total equity | 5,949,371 | 5,949,371 |
| Total equity and liabilities | 9,778,135 | 15,813,135 |

Notes to the proforma accounts

- 1 The accounts above are to give an indication of the impact of this transaction on the Group's Financial position. The figures are proforma and unaudited.
- 2 An assessment has been made as to the value at which the National Finance receivables are included in the Group consolidation based on an analysis of the loan categories, the ageing of receivables and the stage of legal or other collection action. This assessment is subject to final Director and Auditor confirmation.
- 3 Additional borrowings of \$6,000,000 have been arranged to assist with the funding of the purchase of loan receivables.
- 4 The Group's equity position changes as a result of the transaction as follows.
Equity percentages compared to total equity and borrowings.

| | |
|--------|-----|
| Before | 61% |
| After | 38% |