Mercer Group Limited

Independent Adviser's Report and Appraisal Report

In Respect of the:

- **Acquisition of Fully Paid Ordinary Shares by Asset Management Limited and National Mortgage Underwriters Limited**
- **Underwriting Arrangements and Allotment of Fully Paid Ordinary Shares to Asset Management Limited**

September 2016

Statement of Independence

Simmons Corporate Finance Limited confirms that it:

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

Simmons Corporate Finance Limited has satisfied the Takeovers Panel, on the basis of the material provided to the Takeovers Panel, that it is independent under the Takeovers Code for the purposes of preparing this Independent Adviser's Report.

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1. Introduction

1.1 Background

Mercer Group Limited (**Mercer** or the **Company**) designs and supplies innovative food processing and packaging technologies. It has also developed a medical steam sterilisation technology known as S-Clave.

Mercer is listed on the main equities security market (**NZX Main Board**) operated by NZX Limited (**NZX**). The Company had a market capitalisation of $7.5 million as at 21 September 2016 and its audited total equity as at 30 June 2016 amounted to $8.3 million.

A profile of the Company is set out in section 5.

1.2 Humphry Rolleston and the Rolleston Associates

Humphry Rolleston is a major shareholder in Mercer. Mr Rolleston was a director of the Company until 12 July 2016.

Mr Rolleston is associated with a number of companies that are currently (or potentially soon will be) shareholders in Mercer. We refer to Mr Rolleston and these various shareholders as the **Rolleston Associates**.

The Rolleston Associates currently hold 81,086,515 ordinary shares in the Company, representing 25.99% of the shares on issue. The various Rolleston Associates and their respective shareholdings in the Company are set out below.

Rolleston Associates Shareholding in Mercer

Rolleston Associate	No. of Shares Held	%
Asset Management Limited (**AML**)	44,737,879	14.34%
Humphry Rolleston and Graham Riley	35,687,988	11.44%
Asset Trading Limited (**ATL**)	612,567	0.20%
Humphry Rolleston	26,482	0.01%
Victoria Mansions Limited (**VML**)	21,599	0.01%
National Mortgage Underwriters Limited (**NMUL**)	-	-
	81,086,515	25.99%

Source: NZX Company Research

1.3 Rakaia Fund Distribution

Up until 2 September 2016, Murray Capital Rakaia Fund Limited Partnership (**Rakaia Fund**) was Mercer's largest shareholder, holding 100,000,000 ordinary shares, which represented 32.05% of the Company's total shares on issue.

The Rakaia Fund is a private equity fund structured as a limited partnership. Its general partner is Murray Capital General Partner Limited (**MCGPL**). Mr Rolleston is a director of MCGPL. Accordingly, we have treated the Rakaia Fund as being part of the Rolleston Associates.

On 2 September 2016, the Rakaia Fund made an *in specie* distribution of 93,366,507 ordinary shares in Mercer (29.93%) to 38 of its limited partners for nil consideration.

Subject to shareholder approval, the Rakaia Fund intends to make an *in specie* distribution of the remaining 6,633,499 ordinary shares (2.13%) for no consideration to 2 of the Rolleston Associates who are limited partners of the Rakaia Fund (the **Rakaia Fund Distribution**):

- 4,975,124 ordinary shares (1.59%) to AML
- 1,658,375 ordinary shares (0.53%) to NMUL.

Following the Rakaia Fund Distribution, the Rakaia Fund will hold no shares in Mercer. The Rolleston Associates will hold 28.12% of the Company's shares.

1.4 Rights Issue and Underwriting Arrangements

Mercer announced on 29 August 2016 that it plans to undertake a renounceable pro rata rights issue to raise $7,019,335 of additional capital (the **Rights Issue**).

The proceeds from the Rights Issue will be used to reduce borrowings and to provide working capital.

Asset Management Limited (**AML**) has agreed to underwrite any shortfall of subscriptions under the Rights Issue up to $7,019,335, subject to shareholder approval (the **Underwriting Arrangements**). AML is one of the Rolleston Associates.

Overview of the Rights Issue

The principal terms of the Rights Issue were:

- only shareholders who are residents of New Zealand will likely be eligible to participate in the Rights Issue
- the rights to subscribe for 2.25 new ordinary shares for every one ordinary share held as at 31 October 2016 (the **Record Date**), resulting in the issue of up to 701,933,504 new ordinary shares (subject to rounding)
- shareholders on the Record Date are entitled to the rights at no cost
- the rights are renounceable (meaning shareholders can sell or transfer some or all of their rights)
- there is an oversubscription facility for shareholders to apply for ordinary shares in excess of their pro rata entitlement
- the rights will be quoted and tradable on the NZX Main Board from 28 October 2016 to 15 November 2016
- the closing date for applying for the new ordinary shares will be 21 November 2016 and the new ordinary shares will be allotted on 23 November 2016
- the new ordinary shares will be issued at $0.01 each, payable in full in cash
- subject to shareholder approval, the Rights Issue will be fully underwritten by AML.

The full terms of the Rights Issue will be set out in the Rights Offer Document to be dated on or about 28 October 2016 (the **Rights Offer Document**).

Overview of the Underwriting Arrangements

The principal terms of the Underwriting Arrangements, as documented in the draft Underwriting Agreement between Mercer and AML (the **Underwriting Agreement**), are:

- AML will take up its entitlements under the Rights Issue so as to maintain its current shareholding level
- AML will fully underwrite the Rights Issue
- AML will be paid an underwriting fee of $280,773, representing 4.0% of the $7.0 million of capital to be underwritten
- AML may appoint sub-underwriters (with the prior written consent of Mercer)
- the Underwriting Arrangements are conditional on shareholder approval.

1.5 Impact on Shareholding Levels

Rakaia Fund Distribution

The Company's shareholders not associated with the Rolleston Associates (the **Non-associated Shareholders**) currently collectively hold 71.88% of the Company's ordinary shares on issue.

The Rakaia Fund Distribution will result in the Rolleston Associates' shareholding in the Company remaining at 28.12%:

- the Rakaia Fund's shareholding will decrease from 2.13% to nil
- the shareholding of the Rolleston Associates other than the Rakaia Fund will increase from 25.99% to 28.12%.

The Rakaia Fund Distribution will have no impact on the Non-associated Shareholders' collective shareholding level in the Company.

Shareholding Levels After the Rakaia Fund Distribution

	Current		Rakaia Fund Distribution	Post the Rakaia Fund Distribution	
	No. of Shares	%	No. of Shares	No. of Shares	%
Rakaia Fund	6,633,499	2.13%	(6,633,499)	-	-%
Other Rolleston Associates	81,086,515	25.99%	6,633,499	87,720,014	28.12%
Rolleston Associates	87,720,014	28.12%	-	87,720,014	28.12%
Non-associated Shareholders	224,250,432	71.88%	-	244,250,432	71.88%
Total	311,970,446	100.00%	-	311,970,416	100.00%

Rights Issue and Underwriting Arrangements

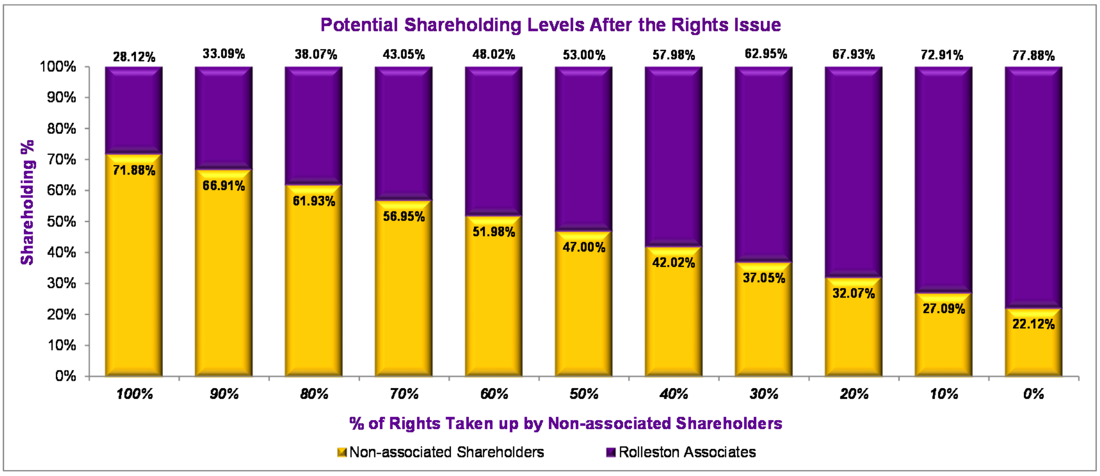
The table on the next page sets out the minimum and maximum shareholding levels for the Rolleston Associates and the Non-associated Shareholders after the Rights Issue, depending on the number of shares taken up by the Non-associated Shareholders under the Rights Issue:

- the Rolleston Associates' shareholding will remain at 28.12% if all shareholders take up their full entitlements under the Rights Issue (the **Minimum Scenario**)
- the theoretical maximum shareholding that the Rolleston Associates will hold is 77.88%, based on the Non-associated Shareholders taking up none of their entitlements under the Rights Issue (the **Maximum Scenario**).

Range of Potential Shareholding Levels

	Rolleston Associates		Non-associated Shareholders		Total
	No. of Shares	%	No. of Shares	%	No. of Shares
Minimum Scenario					
Current	87,720,014	28.12%	224,250,432	71.88%	311,970,446
Rights Issue	197,370,032	28.12%	504,563,472	71.88%	701,933,504
Post the Rights Issue	285,090,046	28.12%	728,813,904	71.88%	1,013,903,950
Maximum Scenario					
Current	87,720,014	28.12%	224,250,432	71.88%	311,970,446
Rights Issue	701,933,504	100.00%	-	-%	701,933,504
Post the Rights Issue	789,653,518	77.88%	224,250,432	22.12%	1,013,903,950

The graph below shows the potential shareholding levels for the Rolleston Associates and the Non-associated Shareholders, depending on the entitlements taken up by the Non-associated Shareholders under the Rights Issue.



1.6 Annual Meeting

The Non-associated Shareholders will vote on ordinary resolutions at the Company's annual meeting of shareholders on 18 October 2016 in respect of:

- the Rakaia Fund Distribution (resolution 2c) (the **Distribution Resolution**)
- the Rights Issue (resolution 2d) (the **Rights Issue Resolution**)
- the Underwriting Arrangements (resolution 2e) (the **Underwriting Arrangements Resolution**)
- the Underwriting Fee (resolution 2f) (the **Underwriting Fee Resolution**).

We refer to the Rights Issue Resolution, the Underwriting Arrangement Resolution and the Underwriting Fee Resolution collectively as the **Capital Raise Resolutions**.

The Capital Raise Resolutions are interdependent. All 3 resolutions must be approved in order for any single resolution to be approved.

The Rolleston Associates are not permitted to vote on the Distribution Resolution or the Capital Raise Resolutions.

Shareholders will also vote on resolutions in respect of:

- the re-election of Paul Smart as a director (resolution 2a)
- authorising the directors to fix the remuneration of the Company's auditor (resolution 2b).

1.7 Regulatory Requirements

Takeovers Code

Rule 6 of the Takeovers Code (the **Code**) prohibits:

- a person who holds or controls less than 20% of the voting rights in a code company from increasing its holding or control of voting rights beyond 20%
- a person holding or controlling 20% or more of the voting rights in a code company from increasing its 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(c) of the Code, enables a person and its associates to increase their holding or control of voting rights by an acquisition of shares if the acquisition is approved by an ordinary resolution of the code company.

Because the Rolleston Associates control 28.12% of the voting rights in the Company and the Rakaia Fund Distribution will result in AML and NMUL increasing their control of the voting rights in Mercer through the acquisition of 6,633,499 ordinary shares from the Rakaia Fund by way of an *in specie* distribution, the Non-associated Shareholders will vote at the Company's annual meeting on an ordinary resolution in respect of the Rakaia Fund Distribution in accordance with the Code.

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

This Independent Adviser's Report is to be included in, or accompany, the notice of meeting pursuant to Rule 15(h).

Another exception, 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 Underwriting Arrangements may result in the Rolleston Associates increasing their control of the voting rights in Mercer from 28.12% to up to 77.88%.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on an ordinary resolution in respect of the Underwriting Arrangements and the allotment of ordinary shares to the Rolleston Associates in accordance with the Code.

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

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

NZX Main Board Listing Rules

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

Listing Rule 7.5 states that no issue of Securities shall be made by an Issuer if:

- there is a significant likelihood that the issue will result in any person or group of Associated Persons materially increasing their ability to exercise, or direct the exercise of effective control of that Issuer and
- that person or group of Associated Persons is entitled before the issue to exercise not less than 1% of the total votes attaching to the Securities of the Issuer

unless the precise terms and conditions of the issue have been approved by an ordinary resolution of the Issuer.

The Underwriting Arrangements involve the issue of equity securities which may materially increase the Rolleston Associates' ability to exercise, or direct the exercise of effective control of the Company.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on an ordinary resolution in respect of the Underwriting Arrangements and the allotment of ordinary shares to the Rolleston Associates 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.

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 ordinary shares to AML and the underwriting fee payable to AML under the Underwriting Arrangements may be Material Transactions and AML is a Related Party of the Company. 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.

1.8 Purpose of the Report

The Company's board of directors (the **Board**) has engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the Rakaia Fund Distribution and the Underwriting Arrangements in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 15 August 2016 to prepare the Independent Adviser's Report.

The Board has engaged Simmons Corporate Finance to prepare an Appraisal Report on the fairness of the Underwriting Arrangements and the allotment of ordinary shares to the Rolleston Associates in accordance with Listing Rules 6.2.2 (a) and 9.2.5.

Simmons Corporate Finance was approved by NZX Regulation on 19 August 2016 to prepare the Appraisal Report.

Simmons Corporate Finance issues this Independent Adviser's Report and Appraisal Report to the Board for the benefit of the Non-associated Shareholders to assist them in forming their own opinion on whether to vote for or against the Distribution Resolution and the Capital Raise Resolutions.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits of the Rakaia Fund Distribution and the merits and fairness of the Underwriting Arrangements in relation to each shareholder. This report on the merits of the Rakaia Fund Distribution and the merits and fairness of the Underwriting Arrangements 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 Rakaia Fund Distribution

2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the acquisition of ordinary shares by AML and NMUL under the Rakaia Fund Distribution having regard to the interests of the Non-associated Shareholders.

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 Independent Advisers and the Takeovers Code* dated 7 September 2015
- 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 Rakaia Fund Distribution should focus on:

- the rationale for the Rakaia Fund Distribution
- the terms and conditions of the Rakaia Fund Distribution
- the impact of the Rakaia Fund Distribution on the control of the Company
- the impact of the Rakaia Fund Distribution on Mercer's share price
- other issues associated with the Rakaia Fund Distribution
- the implications if the Distribution Resolution is 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 Rakaia Fund Distribution

The Rakaia Fund Distribution represents a transaction between various Rolleston Associates whereby the Rakaia Fund will make an *in specie* distribution of 6,633,499 ordinary shares to AML and NMUL. In our opinion, if the Rakaia Fund Distribution is approved, it will have no significant negative impacts from the perspective of the Non-associated Shareholders.

Our evaluation of the merits of the Rakaia Fund Distribution is set out in detail in sections 2.3 to 2.7. In summary, the key factors leading to our opinion are:

- the rationale for the Rakaia Fund Distribution is reasonable. The Rakaia Fund Distribution represents the *in specie* distribution by the Rakaia Fund of the remaining 6,633,499 ordinary shares to its 2 remaining limited parties (AML and NMUL) on the same terms and conditions as the *in specie* distribution of 93,366,507 ordinary shares that it undertook on 2 September 2016 to 38 of its other limited partners

- the Rakaia Fund Distribution will have no impact on the Rolleston Associates' ability to influence the outcome of shareholder voting as their current 28.12% shareholding level will not change
- the Rakaia Fund Distribution will not impact on the Rolleston Associates' influence over the Board or the Company's operations
- the Rakaia Fund Distribution will have no impact on Mercer's share price or the liquidity of the Company's shares
- the Rakaia Fund Distribution will have no dilutionary impact on the Non-associated Shareholders' shareholding levels
- the Rakaia Fund Distribution will not change Mercer's business risk profile
- the Rakaia Fund Distribution will not impact the attraction of Mercer as a takeover target
- the implications of the Distribution Resolution not being approved by the Non-associated Shareholders are that the Rakaia Fund Distribution cannot proceed. The Rakaia Fund will retain ownership of the shares.

2.3 The Rationale for the Rakaia Fund Distribution

Up until 2 September 2016, the Rakaia Fund was Mercer's largest shareholder, holding 100,000,000 ordinary shares in the Company (32.05%).

On 2 September 2016, the Rakaia Fund made an *in specie* distribution of 93,366,507 ordinary shares in Mercer (29.93%) to 38 of its limited partners for nil consideration. It can only distribute the remaining 6,633,499 ordinary shares (2.13%) to AML and NMUL on the same terms as the other distributions if Mercer obtains shareholder approval of the distribution in accordance with the provisions of the Code. This is why the Non-associated Shareholders are voting on the Distribution Resolution.

2.4 Impact on Control

Share Capital and Shareholders

Mercer currently has 311,970,446 fully paid ordinary shares on issue held by 563 shareholders. The names, number of shares and percentage holding of the Company's 10 largest shareholders as at 9 September 2016 are set out in section 5.4.

Mercer currently has 3 substantial security holders:

- AML – 14.34%
- New Zealand Control Securities Depository Limited (**NZCSD**) – 11.46%
- Mr Rolleston and Mr Riley – 11.44%.

The 3 shareholders collectively hold 37.24% of the fully paid ordinary shares in the Company at present.

Rolleston Associates' Shareholding Level

The acquisition of 6,633,499 ordinary shares by AML and NMUL under the Rakaia Fund Distribution will not result in any change in the Rolleston Associates' collective shareholding in Mercer of 28.12%.

Shareholding Voting

The Rolleston Associates' current 28.12% shareholding level enables them to collectively block special resolutions (which require the approval of 75% of the votes cast by shareholders) but not to collectively pass or block ordinary resolutions (which require the approval of more than 50% of the votes cast by shareholders) or to collectively pass special resolutions.

The Rakaia Fund Distribution will not change the Rolleston Associates' ability to influence the outcome of shareholder voting.

Board Control

As set out in section 5.3, the Company currently has 3 directors, none of whom are deemed to be associates of the Rolleston Associates.

We are advised by the Company that the composition of the Board is likely to change following the Rights Issue (rather than the Rakaia Fund Distribution). While no agreements have currently been entered into with Mr Rolleston, we would expect that the Rolleston Associates would have representation on the Board if they held a significant shareholding (of say greater than 50%) after the Rights Issue.

Operations

We are advised by the Company that the Rolleston Associates currently do not have any influence over the operations of Mercer. This may change following the Rights Issue (rather than the Rakaia Fund Distribution) if the Rolleston Associates hold an increased shareholding in Mercer and have Board representation.

2.5 Impact on Share Price and Liquidity

Share Price

The Rakaia Fund Distribution represents an *in specie* distribution of 6,633,499 ordinary shares at nil consideration rather than an acquisition of the shares at a specified purchase price.

Given this, we are of the view that the Rakaia Fund Distribution will have no impact on the Company's share price.

Liquidity

The size of the pool of shares held by the Non-associated Shareholders will not change as a result of the Rakaia Fund Distribution. In our view, the Rakaia Fund Distribution will have no impact on the liquidity of Mercer's shares.

2.6 Other Issues

No Dilutionary Impact

As the Rakaia Fund Distribution is an *in specie* distribution of shares by the Rakaia Fund to AML and NMUL, it will have no dilutionary impact on the Non-associated Shareholders' shareholding levels. No new shares will be issued by the Company under the Rakaia Fund Distribution.

No Change in Business Risk

As the Rakaia Fund Distribution does not involve the acquisition of one or more new businesses or the disposal of part or all of Mercer's existing business, it will not change Mercer's business risk profile.

No Change to the Attraction of Mercer as a Takeover Target

The Rakaia Fund Distribution will not change the Rolleston Associates' level of control over the Company nor (presumably) change their desire (if any) to increase their level of control.

Non-associated Shareholder Approval is Required

Pursuant to Rule 7(c) of the Code, the Non-associated Shareholders must approve by ordinary resolution the Rakaia Fund Distribution.

The Rakaia Fund Distribution will not proceed unless the Non-associated Shareholders approve the Distribution Resolution.

2.7 Implications of the Distribution Resolution not Being Approved

If the Distribution Resolution is not approved, then the Rakaia Fund Distribution cannot proceed. The Rakaia Fund will retain ownership of the 6,633,499 ordinary shares.

2.8 Voting For or Against the Distribution Resolution

Voting for or against the Distribution 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 Merits of the Underwriting Arrangements and the Allotment of Ordinary Shares to AML

3.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the allotment of ordinary shares to AML under the Underwriting Arrangements having regard to the interests of the Non-associated Shareholders.

We are of the view that an assessment of the merits of the Underwriting Arrangements should focus on:

- the requirement for the Rights Issue
- the prospects for Mercer without the Rights Issue
- the structure of the Rights Issue
- the terms and conditions of the Underwriting Arrangements
- the alternatives to the Underwriting Arrangements
- the impact of the Underwriting Arrangements on Mercer's financial position
- the impact of the Underwriting Arrangements on the control of the Company
- the impact of the Underwriting Arrangements on Mercer's share price
- other benefits and disadvantages for Mr Rolleston of the Underwriting Arrangements
- the benefits and disadvantages for the Non-associated Shareholders of the Underwriting Arrangements
- the implications if the Underwriting Resolution is 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.

3.2 Summary of the Evaluation of the Merits of the Underwriting Arrangements and the Allotment of Ordinary Shares to AML

Our evaluation of the merits of the Underwriting Arrangements and the allotment of ordinary shares to AML is set out in detail in sections 3.3 to 3.15.

In summary, the positive aspects of the Underwriting Arrangements are:

- the rationale for the Rights Issue and the Underwriting Arrangements is sound. The Company requires the $7.0 million of capital to repay debt and to fund its working capital needs
- the structure of the Rights Issue is reasonable:
  - the size is sufficient to fund the Company's near term capital requirements
  - all New Zealand resident shareholders are able to participate on a pro rata basis and, if they chose, apply for additional shares
  - the issue price of $0.01 is at a deep discount to the current market price of $0.03

   – the rights are renounceable, meaning that they can be transferred or sold. The Company will apply to have the rights quoted on the NZX Main Board

- the terms of the Underwriting Arrangements are not unreasonable. The underwriting fee of 4.0% of the underwritten amount of $7.0 million is slightly above the average level of fees paid for similar underwriting arrangements in New Zealand. However, Mercer has limited underwriting options available to it and therefore is not in a position of strength to negotiate a lower underwriting fee
- the Underwriting Arrangements provide Mercer with the certainty that the Rights Issue will raise $7.0 million (before costs)
- the Underwriting Arrangements will have a positive impact on the Company's financial position
- the Underwriting Arrangements are unlikely to have any material impact on the liquidity of Mercer's ordinary shares
- the implications of the Capital Raise Resolutions not being approved by the Non-associated Shareholders are that the Rights Issue and the Underwriting Arrangements cannot proceed. Unless alternative sources of capital are accessed in a relatively short period of time, the Company will not be able to meet its debt repayment obligations or adequately fund its working capital requirements. Accordingly, its ability to continue to operate as a going concern will be questionable.

In summary, the negative aspects of the Underwriting Arrangements and the allotment of ordinary shares to AML are:

- the Rolleston Associates' level of voting rights will range from 28.12% to up to 77.88%
- the Underwriting Arrangements will potentially result in the Rolleston Associates significantly increasing their ability to influence the outcome of shareholder voting and exert shareholder control over the Board and the Company's operations
- the dilutionary impact of the Underwriting Arrangements on the Non-associated Shareholders will result in their current collective interests in the Company reducing by up to 69% following the Rights Issue (depending on the number of shares that they subscribe for)
- the Rights Issue is priced at a deep discount to the current share price. This will likely result in the Company's share price reducing after the Rights Issue. Non-associated Shareholders who do not take up their entitlements and do not sell their rights will potentially see a dilution in the value of their investment in the Company
- depending on the level of the Rolleston Associates' shareholding following the Rights Issue:
   - the attraction of Mercer as a takeover target may reduce
   - Mercer may forfeit some or all of its tax losses.

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

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

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

Conversely, if a number of Non-associated Shareholders are unlikely to take up their entitlements under the Rights Issue, they need to consider whether the negative aspects of the Underwriting Arrangements, including the potential dilution, justify voting against the Capital Raise Resolutions with the likelihood that the Company will not be able to meet its debt repayment obligations or adequately fund its working capital requirements.

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

3.3 The Requirement for the Rights Issue

The purpose of the Rights Issue is to raise funds to enable Mercer to strengthen its financial position.

The Rights Issue will raise $7.0 million of capital for Mercer. The capital will be used to:

- fund the costs of the Rights Issue, which are estimated to be in the vicinity of $0.3 million
- repay $1.0 million of existing debt owing to Bank of New Zealand (**BNZ**) that is due for repayment on 31 October 2016
- repay $3.5 million of existing debt owing to Gresham Finance Limited (**Gresham**) that is due for repayment on 31 March 2017. Gresham is owned by AML
- fund general working capital requirements, including the payment of overdue creditors and building repair costs.

3.4 The Prospects for Mercer Without the Rights Issue and the Underwriting Arrangements

The carrying value of Mercer's equity was $8.3 million as at 30 June 2016 and its net tangible assets at that date was negative $1.0 million (treating the deferred tax asset of $4.8 million as an intangible asset).

The Company had negligible cash and cash equivalents as at 30 June 2016 and $10.5 million of borrowings at that date (which we are advised totalled $10.95 million as at 12 August 2016).

At the close of the Rights Issue on 21 November 2016, 701,933,504 new ordinary shares will be issued, raising $7.0 million (before costs).

Without the $7.0 million of funding from the Rights Issue that is guaranteed by the Underwriting Arrangements, the Company will not be able to make the BNZ $1.0 million debt repayment (thus breaching a banking covenant) nor repay the $3.5 million Gresham loan or settle the overdue creditors. This is likely to raise concerns over Mercer's ability to continue to operate as a going concern.

3.5 Alternatives to the Rights Issue and the Underwriting Arrangements

Mercer could pursue alternative forms of raising capital including:

- making a series of share placements
- sale of assets
- seeking additional debt funding.

We are advised by the Company that the Board did not seek to make any share placements as it did not wish to dilute existing shareholders' interests in the Company. The $7.0 million of capital sought would result in significant dilution if it was raised from share placements. The Board considered a pro rata rights issue to be the fairest form of capital raising for the Company's shareholders.

We are of the view that the alternative funding sources are not realistic alternatives at this point in time. Having sold its Medical division in 2015 and its Interiors division in 2016, the Company has negligible uncharged assets available for sale. Furthermore, given the Company's current financial leverage levels, we do not consider that Mercer could access sufficient additional debt funding on commercially viable terms.

3.6 Structure of the Rights Issue

Overview

The Rights Issue is structured as an issue of up to 701,933,504 new ordinary shares to eligible shareholders on a 2.25 for one basis at $0.01 per new share and fully underwritten by AML.

We are advised by the Company that the terms of the Rights Issue were agreed by the Board on 19 August 2016, with the Company's chair and chief executive officer (**CEO**) tasked with negotiating the Underwriting Arrangements with AML.

We have been provided with a draft of the Rights Offer Document. The Company advises that because the Rights Offer Document is not due to be released until after the annual meeting, it will finalise the Rights Offer Document after this report is sent to shareholders. Accordingly, our comments in respect of the terms and conditions of the Rights Issue are on the assumption that the key terms and conditions of the issue will not change.

Size of the Rights Issue

We are advised by the Board that the $7.0 million of capital to be raised under the Rights Issue is based on the Board's estimate of the level of capital required to meet near term borrowings repayments and to provide sufficient working capital for the Company.

Pricing

The Rights Issue is priced at a deep discount to the prevailing share price. The Board set the subscription price at $0.01 on the basis that it was a 67% discount to the closing share price of $0.03 as at 19 August 2016.

The subscription price of $0.01 per share represents:

- a 67% discount to the Company's volume weighted average share price (**VWAP**) for the one month up to 19 August 2016 of $0.03
- a 64% discount to the Company's VWAP for the one month up to 21 September 2016 of $0.028.

These levels of discount are towards the upper end of the range of discounts observed for rights issues in New Zealand.

When rights issues are priced at a discount to the prevailing share price, this results in a transfer of value from shareholders who do not participate in the rights issue to shareholders who take up their entitlements.

Based on Mercer's one month VWAP up to 21 September 2016 of $0.028 and a 2.25 for one rights issue at a subscription price of $0.01 per share, the theoretical price of Mercer's shares after the Rights Issue (the **Theoretical Ex-rights Share Price**) is $0.016 ([$0.028 x 1 + $0.01 x 2.25] ÷ 3.25).

Renounceable

The rights are renounceable, meaning that they can be transferred or sold.

The Company will apply to NZX to have the rights quoted on the NZX Main Board between 28 October 2016 and 15 November 2016. Depending upon the demand for the rights, Non-associated Shareholders not wishing to take up their entitlements may be able to sell their rights.

Based on Mercer's one month VWAP up to 21 September 2016 of $0.028 and a subscription price of $0.01 per share, the theoretical rights price is $0.006 ([$0.028 - $0.01] / [2.25 / 1 + 1]).

Oversubscription Facility

Under the terms of the Rights Issue, oversubscriptions will be allowed. Accordingly, shareholders wanting to increase their shareholding via the Rights Issue will be able to do so in one of 2 ways:

- through the oversubscriptions facility and / or
- by buying rights on the NZX Main Board.

Eligible Shareholders

Existing shareholders who are resident overseas will not be able to take up their rights entitlement unless Mercer is satisfied that it would not be unduly onerous to make the Rights Issue offer to the overseas shareholders under all applicable laws.

The rights attributable to shares held by ineligible shareholders will be issued to a nominee who will endeavour to sell those rights and the net proceeds will be paid to those ineligible shareholders on a pro rata basis.

3.7 Underwriting Options

Mercer has the following options regarding the underwriting of the Rights Issue:

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

Underwriting Arrangements

AML will be paid an underwriting fee of $280,773, representing 4.0% of the $7.0 million underwritten by AML.

The payment of underwriting fees to an underwriter is a normal part of a rights issue. The actual fee percentage varies and generally is a function of the discount of the rights price, the size of the issue and the assessment of the risk that the underwriter is assuming (ie the probability that the underwriter will be called upon to purchase any shortfall in subscriptions). Underwriting fees in New Zealand tend to be in the range of 1.5% to 5.0%. The 4.0% underwriting fee is above the midpoint of the range.

AML has the right to sub-underwrite all or part of its underwriting obligations with Mercer's prior written consent. In such circumstances, AML will be required to meet the costs of any sub-underwrite fees.

We consider the Underwriting Arrangements to be reasonable. While the underwriting fee is above the midpoint of the range of fees generally charged, we note that Mercer is not in a particularly strong position to negotiate a lower fee.

Alternative Underwriter

Given the relatively small size of the Company, the limited number of institutional investors on its shareholder register and the limited liquidity of the Company's shares, we consider it unlikely that the underwriting opportunity would hold appeal to potential underwriters other than a party who was prepared to possibly hold a significant shareholding in Mercer.

We are advised by the Company that the Board held discussions with more than 10 potential underwriters and AML was the only credible party who was prepared to underwrite the Rights Issue.

No Underwriter

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

A discounted subscription price does not necessarily guarantee the full take-up of a rights issue. Other factors that impact on the likely level of subscription under a rights issue include the demand for the shares (i.e. liquidity and spread of shareholders), the quantum of the required investments (in this case the average required investment is approximately $5,000 per Non-associated Shareholder (excluding the 10 largest shareholders)) and the general state of the equity markets.

Given that the demand for Mercer shares is relatively low (based on volumes traded), we are of the view that Mercer would bear considerable risk of not raising the $7.0 million of capital if it did not arrange for the Rights Issue to be fully underwritten.

3.8 Impact on Financial Position

A summary of Mercer's recent financial position is set out in section 5.7.

Mercer's audited total equity as at 30 June 2016 was $8.3 million. This equated to $0.027 per share.

The Underwriting Arrangements ensure that the Rights Issue will raise $7.0 million (before costs in the vicinity of $0.3 million).

For illustrative purposes, if the full proceeds from the Rights Issue were to have been received on 30 June 2016, Mercer's total equity would increase to $15.1 million and equity per share would decrease to $0.015 per share (due to the Rights Issue subscription price of $0.01 per share being considerably lower than the $0.027 equity per share as at 30 June 2016).

Illustrative Effect of the Rights Issue on Mercer's Financial Position

	Equity ($000)	No. of Shares (000)	Equity / Share ($)
30 June 2016	8,337	311,970.4	$0.027
Rights Issue	7,019	701,933.5	$0.010
Costs	(300)		
Post the Rights Issue	15,056	1,013,903.9	$0.015

$4.5 million of the proceeds from the Rights Issue will be used to repay debt owing to BNZ and Gresham, thereby improving Mercer's financial leverage position:

- borrowings : equity would decrease from 121% to 37%
- equity : total assets would increase from 34% to 67%.

3.9 Impact on Control

Rolleston Associates' Potential Shareholding Levels

The allotment of up to 701,933,504 ordinary shares to AML under the Underwriting Arrangements will result in the Rolleston Associates increasing their shareholding in Mercer from 28.12% to up to 77.88%.

The Rolleston Associates will increase their control of voting rights in the Company without having to make a formal offer to all shareholders in accordance with Rules 7(a) or 7(b) of the Code. To do this under the Code requires the Non-associated Shareholders to have the opportunity to vote for or against the Underwriting Resolution.

Shareholding Voting

As discussed in section 2.4, the Rolleston Associates' current shareholding level of 28.12% enables them to collectively block special resolutions but does not enable them to collectively pass special resolutions or to pass or block ordinary resolutions.

Following the allotment of shares under the Underwriting Arrangements, the Rolleston Associates' ability to influence the outcome of shareholder voting will increase, and the degree to which it will increase may be substantial. At the theoretical maximum shareholding level of 77.88%, they will be able to collectively pass or block any special resolution and any ordinary resolution that they were permitted to vote on.

In our view, the probability of the Rolleston Associates reaching the theoretical maximum shareholding level of 77.88% after the Rights Issue is negligible as the Rights Issue is priced at a deep discount to the current market price and therefore we consider it likely that a number of Non-associated Shareholders will take up their entitlements. We note that if the Non-associated Shareholders take up 50% of their entitlements, then the Rolleston Associates will hold a 53.00% shareholding in Mercer. This will enable them to collectively control the outcome of ordinary resolutions and block special resolutions but they will not be able to collectively pass special resolutions.

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

Given the above, we are of the view that the Underwriting Arrangements will significantly increase the Rolleston Associates' ability to exert shareholder control over Mercer. However, the level by which the Rolleston Associates' influence over shareholding voting is in the hands of the Non-associated Shareholders as it is dependent upon the level of their subscriptions under the Rights Issue.

Ability to Creep

The Rakaia Fund Distribution will result in AML holding 15.94% of the Company's shares. Following the Rights Issue, AML will hold between 15.94% and 65.70% of Mercer's shares, depending on the level of entitlements taken up by the Non-associated Shareholders.

If AML controls more than 50% of the voting rights in the Company, then it will be able to utilise the *creep* provisions of Rule 7(e) of the Code. The *creep* provisions enable entities that hold more than 50% and less than 90% of the voting securities in a code company to buy up to a further 5% of the code company's shares per annum without the need for shareholder approval.

When a shareholder holds 90% or more of the voting rights in a Code company, it can compulsorily acquire the remaining shares in the company in accordance with Part 7 of the Code.

Board Control

We are advised by the Company that the composition of the Board is likely to change following the Rights Issue. While no agreements have currently been entered into with Mr Rolleston, we would expect that the Rolleston Associates would have representation on the Board if they held a significant shareholding (of say greater than 50%) after the Rights Issue.

Operations

We are advised by the Company that the Rolleston Associates currently do not have any influence over the operations of the Company. This may change following the Rights Issue if the Rolleston Associates hold an increased shareholding in Mercer and have Board representation.

3.10 Dilutionary Impact

The Underwriting Arrangements will potentially result in the Non-associated Shareholders' current collective shareholdings in the Company being diluted.

The dilutionary impact of the Rights Issue on the Non-associated Shareholders will range from nil to up to 69%, depending on the number of shares that the Non-associated Shareholders subscribe for under the Rights Issue and therefore the number of ordinary shares issued to AML under the Underwriting Arrangements.

3.11 Impact on Share Price and Liquidity

Share Price

A summary of Mercer's daily closing share price and daily volume of shares traded from 3 January 2014 is set out in section 5.9.

During the period, Mercer's shares have traded between \$0.024 and \$0.27 at a VWAP of \$0.124. Over the last year, the Company's shares have traded between \$0.024 and \$0.10 at a VWAP of \$0.033.

Given that the Rights Issue subscription price of \$0.01 is at a 64% discount to the current one month VWAP of \$0.028, the Company's share price could possibly drop immediately after the Rights Issue. As set out in section 3.6, the Theoretical Ex-rights Share Price is \$0.016.

Liquidity

Trading in the Company's shares is relatively thin, reflecting that up until 2 September 2016, the Rakaia Fund and the Rolleston Associates collectively held 58.04% of Mercer's ordinary shares. Only 6.0% of the Company's shares have traded in the past year.

The size of the pool of ordinary shares held by the Non-associated Shareholders will not change under the Underwriting Arrangements.

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

3.12 Key Benefit to the Rolleston Associates

The Underwriting Arrangements provide the Rolleston Associates with the opportunity to increase their shareholding (and level of control) in Mercer, potentially to a very significant level.

3.13 Disadvantages to the Rolleston Associates

Increased Exposure to the Risks of Mercer

The key issues and risks that are likely to impact upon the business operations of Mercer are summarised in section 5.5.

As the Rolleston Associates' ownership in Mercer increases, so does their exposure to these risks. The Rolleston Associates' level of voting rights will range between 28.12% and up to 77.88%. The Rolleston Associates have little control over their ultimate level of shareholding in Mercer as it will be a function of the number of shares subscribed for by the Non-associated Shareholders under the Rights Issue.

Further Financial Commitments

The current market value of the Rolleston Associates' holding of ordinary shares was $1.9 million as at 21 September 2016.

AML may be required to subscribe for up to $7.0 million of shares under the Underwriting Arrangements. This will increase the Rolleston Associates' level of equity investment in Mercer by up to 366%.

In addition to its equity investment, the Rolleston Associates have provided a total of $4.3 million of loans to Mercer (via Gresham). $3.5 million of capital raised from the Rights Issue will be used to repay some of the Gresham loans.

3.14 Other Issues

All Shareholders Have the Opportunity to Participate in the Rights Issue

The Rights Issue is a pro rata issue to all shareholders. All Non-associated Shareholders who are resident in New Zealand have the opportunity to take up their entitlements to acquire new shares. If all Non-associated Shareholders take up their entitlements, then the Rolleston Associates will not increase their level of voting rights in the Company as a result of the Underwriting Arrangements.

Benefits to Mercer of the Rolleston Associates as a Cornerstone Shareholder

The major benefit to Mercer of the Underwriting Arrangements is that the Company is certain to obtain the $7.0 million of funds (before costs) from the Rights Issue.

The Underwriting Arrangements will enhance the Rolleston Associates' position as an important cornerstone investor in the Company and further signals their confidence in the future prospects of Mercer.

Non-associated Shareholder Approval is Required

Pursuant to Rule 7(d) of the Code and Listing Rules 7.5 and 9.2.1, the Non-associated Shareholders must approve by ordinary resolutions the Underwriting Arrangements and the allotment of ordinary shares to the Rolleston Associates.

The Rights Issue and the Underwriting Arrangements will not proceed unless the Non-associated Shareholders approve all 3 of the Capital Raise Resolutions.

May Reduce the Likelihood of a Takeover Offer

Following the Rights Issue, the Rolleston Associates will not be able to increase the level of their shareholding in Mercer unless they comply with the provisions of the Code and the Listing Rules. The Rolleston Associates will only be able to acquire more shares in the Company if:

- they make a full or partial takeover offer
- the acquisition is approved by way of an ordinary resolution of the Non-associated Shareholders
- the Company makes an allotment of shares which is approved by way of an ordinary resolution of the Non-associated Shareholders
- the Company undertakes a share buyback that is approved by the Company's shareholders and the Rolleston Associates do not accept the offer of the buyback
- AML complies with the *creep* provisions of Rule 7(e) of the Code.

An increase in the Rolleston Associates' shareholding from 28.12% to up to 77.88% may reduce the likelihood of a takeover offer for the Company from the Rolleston Associates as they may consider that they have sufficient control over the Company.

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

The increase in the Rolleston Associates' shareholding may reduce the attraction of Mercer as a takeover target to other parties, as any bidder looking to fully or partially take over the Company would need to ensure that the Rolleston Associates would accept its offer.

Tax Losses May Be Forfeited

Mercer had $22.1 million of New Zealand tax losses, of which $15.4 million was recognised by way of a $4.3 million deferred tax asset as at 30 June 2016 and $6.7 million was unrecognised.

The carry forward of tax losses are subject to meeting the shareholder continuity test which requires 49% shareholder continuity over the period during which the relevant losses occurred. Depending on the level of subscriptions by the Non-associated Shareholders, the Rolleston Associates' shareholding level may increase under the Underwriting Arrangements such that the shareholder continuity requirements are breached. This would result in some or all of the tax losses being forfeited.

3.15 Implications of the Capital Raise Resolutions not Being Approved

If any one of the 3 Capital Raise Resolutions is not approved, then the Rights Issue and the Underwriting Arrangements will not proceed as currently intended.

If the Rights Issue and the Underwriting Arrangements do not proceed, this could have serious negative implications for Mercer and all of its shareholders:

- Mercer will be in default of a banking condition to repay $1.0 million of its banking facilities provided by BNZ that is due in October 2016
- Mercer will not be able to repay a $3.5 million loan provided by Gresham that is due for repayment in March 2017
- Mercer will not be able to settle its overdue creditors.

Mercer will need to seek alternative sources of capital in a very short time frame from one or more share placements and / or asset sales and / or alternative sources of borrowings. As discussed in section 3.5, we do not consider these alternative sources of capital to be realistic alternatives at this point in time.

Alternatively, the Board could elect to subsequently proceed with the Rights Issue without it being underwritten by AML. This could be done without the need for shareholder approval on the basis that no related parties were involved in underwriting the capital raising or the Rights Issue not being underwritten. However, if the Rights Issue is not underwritten, there is a high probability that the Company will not receive the $7.0 million of capital it seeks.

In our view, it would be extremely difficult for the Company to raise capital in the vicinity of $7.0 million in the near future from alternative sources or from a rights issue that was not underwritten. Therefore, if the Rights Issue and Underwriting Arrangements do not proceed, Mercer will likely breach its banking covenants and will be unable to adequately fund its working capital requirements. Accordingly, its ability to continue to operate as a going concern will be questionable.

3.16 Voting For or Against the Capital Raise Resolutions

Voting for or against the Capital Raise Resolutions 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. Evaluation of the Fairness of the Underwriting Arrangements and the Allotment of Ordinary Shares to AML

4.1 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 of shares under the Underwriting Arrangements and the underwriting fee 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. Our assessment of the merits of the Rights Issue and the Underwriting Arrangements is set out in section 3.

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.

4.2 Evaluation of the Fairness of the Underwriting Arrangements and the Allotment of Ordinary Shares to AML for the Purposes of Listing Rule 1.7.2

In our opinion, after having regard to all relevant factors, the consideration and the terms and conditions of the Underwriting Arrangements and the allotment of ordinary shares to AML are fair to the Non-associated Shareholders.

The basis for our opinion is set out in detail in sections 3.3 to 3.15. In summary, the key factors leading to our opinion are:

- the rationale for the Rights Issue and the Underwriting Arrangements is sound
- the terms of the Rights Issue and the Underwriting Arrangements are reasonable
- the Underwriting Arrangements provide Mercer with the certainty that the Rights Issue will raise $7.0 million (before costs)
- the Underwriting Arrangements will have a positive impact on the Company's financial position
- the Rolleston Associates' shareholding level will range from 28.12% to up to 77.88%. This may result in the Rolleston Associates significantly increasing their ability to influence the outcome of shareholder voting and exert shareholder control over the Board and the Company's operations
- the dilutionary impact of the Underwriting Arrangements on the Non-associated Shareholders will result in their current collective interests in the Company reducing by up to 69% following the Rights Issue (depending on the number of shares they subscribe for)
- the Rights Issue is priced at a deep discount to the current share price. This will likely result in the Company's share price reducing after the Rights Issue. Non-associated Shareholders who do not take up their entitlements and do not sell their rights will potentially see a dilution in the value of their investment in the Company

- the Underwriting Arrangements are unlikely to have any material impact on the liquidity of Mercer's ordinary shares
- depending on the level of the Rolleston Associates' shareholding following the Rights Issue:
  - the attraction of Mercer as a takeover target may reduce
  - Mercer may forfeit some or all of its tax losses
- the implications of the Capital Raise Resolutions not being approved by the Non-associated Shareholders are that the Rights Issue and the Underwriting Arrangements cannot proceed. Unless alternative sources of capital are accessed in a relatively short period of time, the Company will not be able to meet its debt repayment obligations and fund its working capital requirements. Accordingly, its ability to continue to operate as a going concern will be questionable.

4.3 Voting For or Against the Capital Raise Resolutions

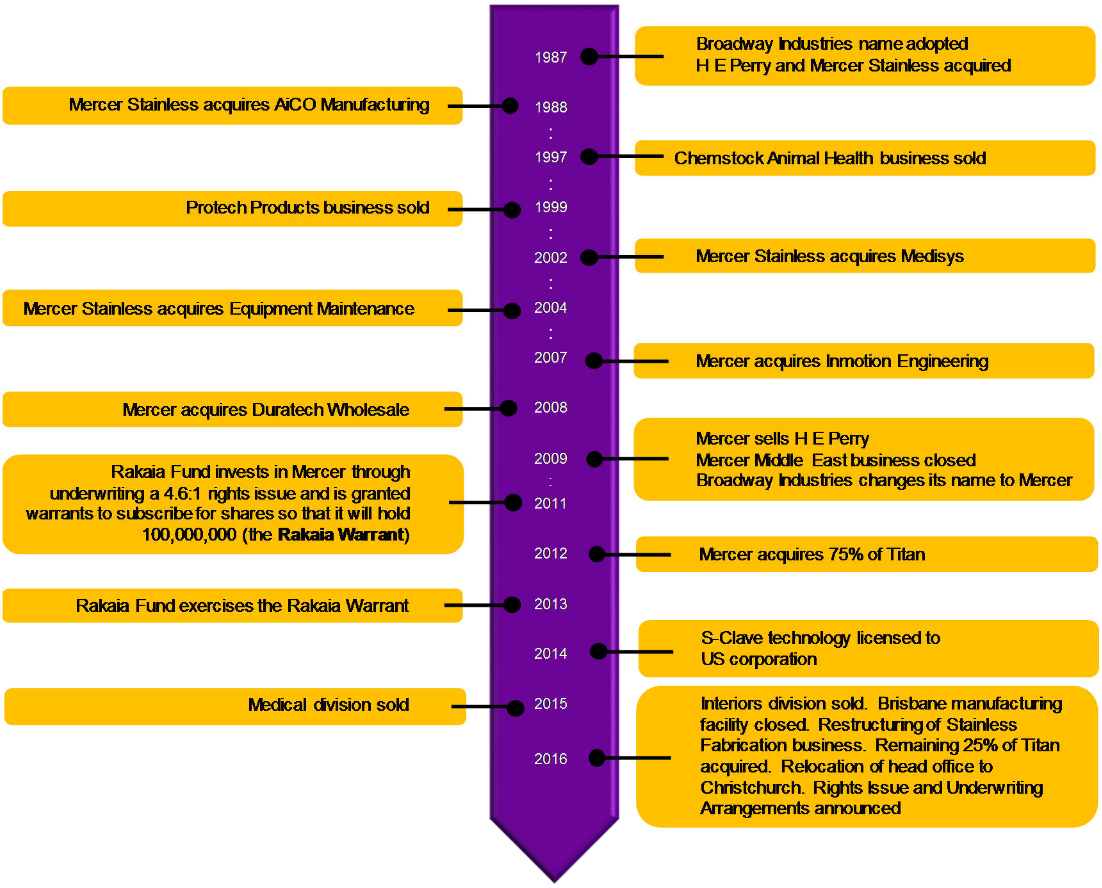
Voting for or against the Capital Raise Resolutions is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

5. Profile of Mercer

5.1 Background

The Company was incorporated on 20 November 1987 as Broadway Industries Limited. It changed its name to Mercer Group Limited on 30 November 2009.

The Company's key events are set out below.



5.2 Nature of Operations

Mercer restructured its operations in July 2015 (the **Restructure**) in a drive to be a leaner, more focused business. The Restructure involved:

- exiting non-core and poorly performing businesses (the Medical and Interiors divisions and the Australia fabrication business based in Brisbane)
- assessing the commercial viability of S-Clave
- focussing on the core fabrication business
- reducing costs by relocating its operations to Christchurch.

Following the Restructure and a change of management in 2015, Mercer now consists of 2 businesses:

Food Processing and Packaging Technologies

S-Clave

The Food Processing and Packaging Technologies business involves the design and supply of innovative food processing and packaging technologies. This is an established business with a range of technology-led machines that assists food companies in automation and efficiency. Its key products are:

- Titan Slicer
- AiCo carton equipment and packaging equipment
- Beta cheese processing equipment
- PV valves
- a cooking and cooling range.

Mercer's industrial fabrication business also sits in this division.

Mercer has developed to and beyond proof of concept stage a medical steam sterilisation technology known as the S-Clave. The key features of the S-Clave are:

- it provides a fail-safe non-porous sterile barrier that eliminates transfer of infection or cross contamination from airborne or waterborne bacteria. The S-Clave system is the first known instance of successfully adopting impenetrable plastic materials in a steam sterilisation environment
- its rapid turnaround fast processing enables a 15-minute compliant processing time versus the current steam processing times of 40 to 50 minutes. S-Clave will be the fastest and most reliable delivery of critical instruments for immediate use without compromising the integrity of the sterilisation process
- its package is robust, transportable, provides proof of sterile integrity on delivery (not currently available in alternative procedures) and will extend shelf life of sterile garments and apparatus.

Mercer holds patents or has patents pending relating to the process and equipment of the S-Clave. The business model is a consumable model where revenues will be driven off the sale of capital equipment and the ongoing sale of the plastic bag or container.

5.3 Directors and Senior Management

The directors of Mercer are:

- John Dennehy, non-executive chair
- Richard Rookes, managing director
- Paul Smart, non-executive director.

Mr Rolleston retired as a director of the Company on 12 July 2016.

Mercer's senior management team consists of:

- Richard Rookes – managing director and CEO
- Ian McGregor – chief financial officer
- Ross Coppard – operations manager
- Ramon Barr – general manager Food Solutions
- Tom Irvine – general manager Meat Solutions and Service
- Bruce Tulloch – branch manager New Plymouth.

5.4 Capital Structure and Shareholders

Ordinary Shares

Mercer currently has 311,970,446 ordinary shares on issue held by 563 shareholders.

The names, number of shares and percentage holding of the 10 largest shareholders as at 9 September 2016 are set out below.

Mercer's 10 Largest Shareholders

Shareholder	No. of Shares Held	%
AML	44,737,879	14.34%
NZCSD	35,746,089	11.46%
Humphry Rolleston and Graham Riley	35,687,988	11.44%
Custodial Services Limited (**Custodial**)	14,726,254	4.72%
Rodger Shepherd	14,410,333	4.62%
Whitford Equity Investments Limited (**Whitford**)	14,285,714	4.58%
Spence Investment Holdings Limited	9,950,249	3.19%
Vienna Investments Limited	6,633,499	2.13%
Rakaia Fund	6,633,493	2.13%
RD & TR Shepherd Limited **(RD&TR)**	6,374,587	2.04%
Subtotal	189,186,085	60.64%
Others (553 shareholders)	122,784,361	39.36%
Total	311,970,446	100.00%

Source: NZX Company Research

Rodger Shepherd is a former director and CEO of Mercer. He is a director and shareholder of Whitford and RD&TR. Interests associated with Mr Shepherd hold 35,070,634 ordinary shares (11.24%).

Options

Mercer currently has 14,428,572 options outstanding held by 2 optionholders as set out below.

Options

Optionholder	Position	No. of Options	Grant Date	Exercise Date	Exercise Price
Richard Rookes	CEO	5,500,000	30 Nov 2015	31 Aug 2017	$0.05
John Dennehy	Chair	3,571,429	30 Nov 2015	31 Aug 2017	$0.07
Richard Rookes	CEO	5,357,143	30 Nov 2015	31 Aug 2018	$0.07
Total		14,428,572			$0.062[1]

1 Weighted average exercise price

Source: Mercer

Mr Dennehy holds 3,571,429 options and Mr Rookes holds 10,857,143 options.

5.5 Key Issues Affecting the Company

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

- a reduction in overall market demand for the Company's products
- the development and commercialisation of new products and technology
- material changes in input costs (especially stainless steel prices) for manufactured products
- material changes in the value of the New Zealand dollar against other currencies
- disruption to manufacturing operations by industrial disputes
- the inability to retain sufficient skilled tradespersons in workshops
- the loss of key staff
- circumvention of the Company's intellectual property protection (via legal or illegal means)
- adverse regulatory or legislative changes
- the inability to adequately finance the Company's operations.

5.6 Financial Performance

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

Summary of Mercer Financial Performance

	Year to 30 Jun 13 (Audited) $000	Year to 30 Jun 14 (Audited) $000	Year to 30 Jun 15[1] (Audited) $000	Year to 30 Jun 16 (Audited) $000
Continued Operations				
Revenue	38,773	40,802	32,436	26,104
Surplus (deficit) before interest and taxation	1,648	70	(1,378)	(3,778)
Surplus (deficit) before taxation	1,193	(424)	(1,961)	(4,579)
Surplus (deficit) after taxation	778	(483)	(1,539)	(5,152)
Discontinued operations deficit after taxation	-	-	(5,486)	(1,576)
Surplus (deficit) after taxation	778	(483)	(7,025)	(6,728)

1 Restated

Source: Mercer audited financial statements

The Restructure in July 2015 limits the usefulness of a comparison of the Company's financial performance for the 2016 financial year with prior years.

Key items to note in Mercer's financial performance for the 2016 financial year are:

- continuing operations revenue from the sale of goods and construction contracts decreased by $8.9 million from $32.2 million to $23.3 million, due in part to the downturn in the dairy sector
- revenue included $2.6 million of insurance proceeds received for the settlement of an insurance claim in relation to earthquake damage to the Company's Christchurch property
- $1.7 million of restructuring costs were incurred
- discontinued operations represented the losses incurred by the Medical division (sold in October 2015) and the Interiors division (sold in February 2016).

5.7 Financial Position

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

Summary of Mercer Financial Position

	As at 30 Jun 13 (Audited) $000	As at 30 Jun 14 (Audited) $000	As at 30 Jun 15 (Audited) $000	As at 30 Jun 16 (Audited) $000
Current assets	11,883	13,763	17,298	7,437
Non current assets	19,203	20,769	18,699	17,310
Total assets	31,086	34,532	35,997	24,747
Current liabilities	(8,291)	(7,625)	(21,297)	(10,563)
Non current liabilities	(5,562)	(6,431)	(90)	(5,847)
Total liabilities	(13,853)	(14,056)	(21,387)	(16,410)
Total equity	17,233	20,476	14,610	8,337

Source: Mercer audited financial statements

Mercer's main current assets are inventories and trade receivables.

Mercer's main non current assets are fixed assets (freehold land and buildings and plant and equipment), intangible assets (mainly in the form of S-Clave intellectual property and purchased goodwill) and a deferred tax asset (mainly arising from tax losses).

Current liabilities consist mainly of trade and other payables and borrowings.

Non current liabilities consist of borrowings.

Mercer had negligible cash on hand as at 30 June 2016 and $10.1 million of interest bearing debt at that date:

- BNZ loans - $5.5 million (including a $1.0 million overdraft facility)
- Gresham loan - $3.5 million
- Gresham financing arrangement - $0.8 million (in respect of the deferred consideration from the sale of the Interiors division)
- other loans - $0.3 million (mainly representing a loan from Monument Finance in respect of a machine).

5.8 Cash Flows

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

Summary of Mercer Cash Flows				
	Year to 30 Jun 13 (Audited) $000	Year to 30 Jun 14 (Audited) $000	Year to 30 Jun 15 (Audited) $000	Year to 30 Jun 16 (Audited) $000
Net cash inflow / (outflow) from operating activities	458	(1,817)	(3,609)	(1,626)
Net cash from / (used) in investing activities	(2,150)	(1,238)	(1,701)	2,094
Net cash from financing activities	1,043	3,435	2,728	1,750
Net increase / (decrease) in cash held	(1,009)	380	(2,582)	2,218
Opening cash balance	648	(337)	46	(2,268)
Effect of exchange rate movements	24	3	(92)	(69)
Closing cash balance	(337)	46	(2,628)	(479)

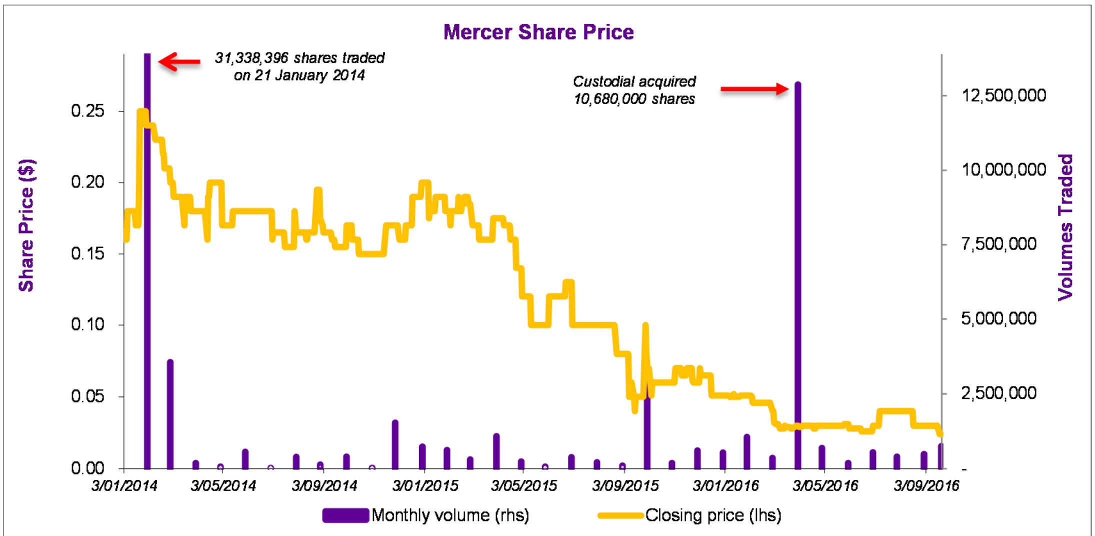
Source: Mercer audited financial statements

Net cash used in investing activities mainly represents expenditure on property, plant and equipment and patents and development activities. $3.2 million was received in the 2016 financial year in respect of the sale of the Medical and Interiors divisions.

Net cash from financing activities represents the draw down of borrowings from BNZ and Gresham and proceeds from the exercise of options ($3.0 million in the 2014 financial year and $1.3 million in the 2015 financial year).

5.9 Share Price History

Set out below is a summary of Mercer's daily closing share price and monthly volumes of shares traded from 3 January 2014 to 21 September 2016.



Source: NZX Company Research

During the period, Mercer's shares have traded between $0.024 and $0.27 at a VWAP of $0.124.

Trading in the Company's shares is extremely thin, reflecting that 58.04% of the shares have historically been held by the Rakaia Fund and the Rolleston Associates (up to 2 September 2016) and the top 10 shareholders collectively held 83.97% of the shares (up to 2 September 2016).

An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of shares outstanding) up to 21 September 2016 is set out below.

Share Trading					
Period	**Low [1] ($)**	**High [1] ($)**	**VWAP [1] ($)**	**Volume Traded [1] (000)**	**Liquidity**
1 month	0.024	0.030	0.028	1,239	0.4%
3 months	0.024	0.040	0.029	1,730	0.6%
6 months	0.024	0.040	0.029	9,679	3.1%
12 months	0.024	0.100	0.033	18,848	6.0%

1 To 21 September 2016

Source: NZX Company Research

6.0% of the Company's shares have traded in the past year on 68 days.

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 Rights Offer Document
- the draft Underwriting Agreement
- the Mercer annual reports for the years ended 30 June, 2013 to 2016
- data in respect of Mercer from NZX Company Research and S&P Capital IQ.

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

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

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

In our opinion, the information to be provided by Mercer to the Non-associated Shareholders is sufficient to enable the Board and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the Rakaia Fund Distribution and the Underwriting Arrangements.

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 Mercer and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of Mercer. 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 Mercer will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of Mercer 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, provided that this shall not absolve Simmons Corporate Finance from liability arising from an opinion expressed recklessly or in bad faith.

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

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

Mercer has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. Mercer 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), INFINZ (Cert).

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 Mercer or the Rolleston Associates or any conflicts of interest that could affect our ability to provide an unbiased opinion in relation to these transactions.

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

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the voting in respect of the Distribution Resolution and the Capital Raise Resolutions. 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 Board for its 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 Mercer'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
22 September 2016