"The Script"

June 2004

The official newsletter of the New Zealand Shareholders' Association Incorporated

OUR AGM

The Association's third AGM will be held at the Ellerslie Convention Centre on Tuesday 13 July, starting at 2.00pm. The Guest Speaker this year is Teresa Gattung, CEO of Telecom. Notice for the AGM, together with the Annual Report, will be posted to all members later this month.

REVIEW OF THE FINANCIAL REPORTING ACT 1993

Your Association presented its submission on this review by the Ministry of Economic Development. This was Part 1 of the review of this Act and was restricted to a consideration of the financial reporting structure and accounting standards. The reason for the two parts is because there are trans-Tasman discussions proceeding on the form of enhanced co-operation. Much of the content of the paper was not relevant to listed company presentations but we did take the opportunity to make the point that we were not entirely happy that International Accounting Standards that are certain to be introduced into New Zealand would be wholly successful in every respect. We also brought to the attention of the Ministry other unsatisfactory elements of the present disclosure system. **The Association's submission may be found on our website under the Advocacy section.**

Oliver Saint

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INTERNAL AUDITORS

The subject of corporate governance and the perception of integrity have become a major topic of the period and I would like to explain to you why your Association is treating with a degree of concern a matter that has so far escaped the attention of auditors and the professional body that supervises these individuals, the Institute of Chartered Accountants.

Towards the close of the annual report season last year, I became aware that there were a number of audit firms whose practices were also engaged in undertaking internal audit work for their audit clients. It seemed to me on the face of things this work could introduce a significant conflict of interest. Certainly there is a perception that an accounting practice accepting internal audit work for a client that it also audits may not be best practice. You may ask how this has suddenly become so important. The answer is that until recently the heading 'audit fee' and other professional fees did not get the disclosure that is now required; a merit point for new disclosure requirements.

Now I would like to briefly explain why this matter is so important. As members will be aware, the day to day operation of a business is run by managers (the management) and they are able to supervise their staff and arrange smooth operations by ensuring that all cash and credit transactions as well as risk inducing operations are performed by the operator and checked and confirmed by another member of the staff. The system is generally known as internal control and is a valuable element in the conduct of any business. The system ensures that there is a minimum opportunity for fraud or theft unless it is carried out by collusion and even more importantly that temptation for stealing is not placed in front of employees. This system is vitally important to the external auditor as it will determine how much checking is required before the auditor can be satisfied that the accounts presented are fair and reasonable. The importance of internal controls are such that at the conclusion of each annual audit, it has been generally accepted practice for some decades for what is now known as a management letter to be sent to the client outlining any weaknesses in internal control discovered during the audit. The length of the management letter can be indicative of the standard of the controls.

I have attended many AGMs in my career as a funds manager and investment adviser and I have never yet heard a question put to the chairman about whether and to what extent the auditor considers the internal control of the company could be improved. This is not because I am at all reluctant about mentioning the topic but there always seem to be more pressing matters to be considered. However it is time a question was introduced on the subject, particularly with corporate governance being in the spotlight.

The above is a brief snapshot of the significance of internal control. In summary, it is a series of measures put in place by management that ensure all cash, credit and risk transactions are monitored by more than one person in the organisation.

Having dwelt on the importance of internal controls you will now appreciate that all large companies will wish to ensure that there is an on-going evaluation of internal control. The mechanics of this assurance process is normally carried out by an internal audit department of the company. This department, because of the special importance to the company, will usually be separated from the normal management structure of the company with the reporting regime being to the audit committee of the Board so that absolute independence is maintained and top management are isolated from day to day interference. In these situations it often occurs to Boards that forming an in-house internal auditing division is time consuming and expensive, and therefore the Board considers the possibility of outsourcing this service. Outsourcing of the internal audit service is of course acceptable, as it is a relatively standard business practice. When considering with whom the outsourcing should be conducted the natural inclination is to use the company's external auditors as the external auditor advises on and knows so much about the business of the company. This may be a natural reaction but it places the external auditor in the invidious position of having to review the work of his own staff.

This provides a conflict of interest of serious proportions to the auditor and disadvantage to the company because that company will be without the benefit of the internal control management letter that is such a critical cog in the control process. What firm of auditors would write to clients suggesting improvements in the internal control that they themselves had been responsible for installing and running?

The above is why I am convinced that under no circumstances should the external auditor be involved in internal audit work.
Oliver Saint

GREAT START TO SHAREHOLDER EDUCATION DAYS!

The first NZSA Auckland Education Day was a great success.
16 members registered for the May 22 morning course and 20 for the afternoon course. Most came to both courses. Some were experienced investors who said that with no formal investment education they expected to learn something in the morning course too! With easy parking, pleasant location and refreshments, this positive attitude provided for a great learning situation, and very enjoyable day. As usual there was plenty members could learn from each other as well as from the courses. Comments from those attending included “lots of useful info, not a sales pitch” “learnt lots - great courses – thanks” “have better understanding of company financials” “learnt to understand jargon eg PE and its significance” “offered diverse opinion” “liked interaction with the tutor” ”liked learning in a small group” “simple exercises reinforce”
The next Shareholder Education Days are at Tauranga on Saturday 28 August and Auckland on Saturday 4 September – details elsewhere in the Newsletter.
Graham Wilson

SHAREHOLDER EDUCATION DAYS

Tauranga Saturday 28 August 2004
Auckland Saturday 4 September 2004
Mills Reef Function Centre Boardroom
ICANZ 27-33 Ohinerau St Remuera
Bethlehem Tauranga
(Ohinerau runs off Greenlane Rd opp. the Novotel)

Tutor: Graham Wilson Grad Dip Fin An and Inv (Sec.Instit.Aus.) ASIA Dip Tchg
NZSA Director of Shareholder Education

Course A: 9 – 12 Starting in the Sharemarket
This introductory course covers topics such as how the sharemarket works, benefits of share investment, risk and returns, buying and selling, key financial ratios and some simple strategies. Limited to 16 registrations at Tauranga; 22 registrations at Auckland.

Course B: 1 – 4.30 Investing in Shares
For shareholders, or to follow on from “Starting in the Sharemarket”. Why invest in shares? Understanding a business; Information Sources; Key Financial Ratios; using a NZ company’s annual report, and Investment Strategies.
Limited to 16 registrations at Tauranga; 22 registrations at Auckland

Registration
Each course fee includes a course book and refreshments
NZSA members $55 for one course or $95 for both
Non members $65 one course or $115 for both
Lunch (optional) 12 – 1pm $25.00
Enquiries and/or to Register: Ph Auckland 09 3767368 or Tauranga 07 552 5320
or register online on the NZSA web site www.nzshareholders.co.nz - click on “Shareholder Education” or write NZSA Education PO Box 90821 Auckland 1030
Payment is by Cheque made out to “IENZ”
Email nzsaeducation@invested.co.nz
Register now, as places are limited.

AGMs

CDL Group of Companies

The group held the AGMs of the three listed companies in succession on 26 May, in the newly named Kingsgate Hotel, Greenlane. Mr Wong Hong Ren had been appointed the new chairman of the group during May in place of Mr John Wilson who retired in February 2004.

Kingsgate International Corporation

The meeting was held in the shadow of the takeover offer and before appraisal and other professional advice in the form of independent reports on the offer were available. There was therefore considerable interest from shareholders and the questioning on this subject took up much of the time allotted for this meeting. However with appraisal reports looming there was little information of value that the chairman was prepared to divulge. The difference of around 9 cents between the net asset value and recent share price occupied the minds of shareholders, some wondering whether a dividend of this amount would not be appropriate. The meeting was advised that 21 shareholders with around 100,000 shares had already accepted the offer.

CDL Investments

The performance of the Company had shown a slight improvement compared with the previous year and there were no queries of note from shareholders.

CDL Hotels

Previous meetings of this Company have been noteworthy for some very forthright comment from shareholders and this meeting was no exception. The presence of a new chairman will have encouraged shareholders to expect that perhaps this year a change may occur. It did but it is solely thanks to the perceptive information of an institution that made the difference. Mr Chow of the ACC pointed out that Millennium Copthorne Hotels plc had already announced its first quarter results, as it was required to do under its International Exchange listing rules, and these were around 13% better than the previous year. The Chairman was forced to acknowledge that an increase of around 10% was a reasonable expectation from this group. The futility of presenting nebulously worded platitudes to shareholders in efforts to evade responding to legitimate questions was finally exposed. The fact that it was done by an institutional holder should be exciting news for shareholders. We welcome this new change in attitude as being recognition of a responsibility that institutions must shoulder rather than the old approach of endeavouring to obtain information from one on one discussions with insider connotations. This is the second instance in this newsletter of institutional involvement in AGMs and both were salutary events.

Our own Chairman, Bruce Sheppard made some telling comments and during a lengthy dialogue dealt with the performance of the hotel, the dividend policy, particularly the lack of an interim dividend given the relatively even performance of the group over the year, the lack of an independent chairman and the fees paid to the auditors for other work which in the last two years had exceeded the audit fee for those years. The Zenith apartments and the management of the Millennium Sydney project were also discussed and queried in greater detail when the chairman responded that unforeseen circumstances had occurred. Many shareholders wondered whether there had been poor planning by the Board. Another Association member wondered whether the legal fees paid to Bell Gully, a partner of whom is Mr G A McKenzie, a director of CDL Hotels, was appropriate and whether the Company should not appoint a different legal firm to undertake its work.

It is true to summarise that no satisfactory response was received from the chairman to any of the questions raised

at the meeting.
Oliver Saint

NZ Refining Company – 29 April
The Elliot Rooms of the Crown Plaza Hotel are not the most comfortable of places to have an AGM but a full house packed in to hear what the Chairman Ian Farrant had to say. There was also a full agenda covering changes to the constitution; removal of retirement fees; payments to directors in lieu of retirement allowances; and increases in directors' fees. A major reason for the attendance of your representative was to enquire about the external auditor undertaking internal audit work. However as matters transpired, I was able to ascertain from management that this matter had already been dealt with and, as of the beginning of this year, they would be undertaking their own internal audit assessment. Furthermore any assistance that might be required in the future would not be sought from the external auditors. The chairman referred to this matter in his address. It is pleasing that so many listed companies are getting this message. A query was dealt with about the dividend policy and the chairman confirmed that at the present time it was only possible to state that from 70% to 100% would be paid out. The three resolutions covering directors' fees included approval of the payments to Ian Farrant and Colin Maiden of $129,000 and $78,750 respectively for compensation for removal of the Company's ability to make payments on cessation of office; the removal of entitlement to Retirement Allowances and the first increase in directors' fees since 1998 - from $230,000 to $450,000. This latter item reflected a desire to pay the chairman up to $70,000 per annum and directors $40,000 per annum. The resolutions were passed with the Association supporting all resolutions.

One interesting matter that seems to have crept back into AGM proceedings is the ability, if all shareholders present agree, of taking the reappointment of directors as one resolution. In view of the peculiar circumstances of this company it was tempting to agree to this move but Sir Colin Maiden, an independent director of the company for the last 13 years, was up for reappointment and your representative was obliged to veto the move to vote on block. As a bonus, shareholders were treated to an address by Sir Colin on his plans for the next three years during which he determinedly opposed the recent corporate governance view that ten years is the maximum period for a director to be in office for one company.
Oliver Saint

Property for Industry Ellerslie Convention Centre – 21 May
The Chairman, Peter Masfen, took the opportunity in his address to advise shareholders that the policy of the company was in future to ensure that no retirement fees were paid to new directors. In making the statement he remarked that this new policy would result in the revision of fees to directors and no doubt this matter will be on the agenda next year.

A member, David Lawson as a result of the address and presentation by the General Manager Mr Ross Blackmore, when new developments were emphasized, commented that on passing a section of land owned by PFI in Wiri he had seen a for sale notice where this site would have appeared to have been prime development potential. Mr Blackmore indicated that this land was indeed not for sale. Another member Mr John Wilson asked the chairman whether the Board had ever considered self-managing the portfolio of properties in view of the excellent profitability of the group over the years. The chairman responded that a buy back of the management contract would be required The writer also enquired when the next opportunity arose to review the constitution whether the clauses covering the re-appointment of directors might receive attention. Disappointingly, a convincing

response was not forthcoming from either of the last two enquiries.
Oliver Saint

Trans Tasman
It is hardly surprising that this meeting was a challenge for shareholders and the Board alike. What a dog this company truly is. The major shareholder who is driving strategy has not in living memory turned up to a meeting of shareholders. His strategy, now the company is cashed up, is to invest the proceeds offshore. If you don't like his strategy take his offer of 40c, being 7c less per share than the cash in the bank.
Will the strategy work? - who knows, but the track record of foreign shareholders controlling NZ companies that then invest offshore is not good. Look no further than BIL.
My bet is that in a year or two his compliant Board (of turkeys) will recommend to shareholders that the company migrate to Bermuda with say a Hong Kong or Singapore listing, for what appear to be compelling tax reasons. Don't forget that on migration you lose all your past tax losses, so tax is really a nonsense reason for Trans Tasman, but that will be the reason. Then you will never have another shareholders meeting in NZ and you will have limited ability to influence the Board, if any. Sound familiar?
Bruce Sheppard

Waste Management NZ - 20 April
The meeting attracted a full house and the Chairman advised that owners of over 34 million out of a total issued capital of close to 100 million shares had completed proxies. A slide was shown summarising the proxy position. The CEO, Kim Ellis, gave an interesting presentation titled 'a tale of two cities' and described the company operations in Adelaide and Christchurch.

At question time, the chairman advised that the present dividend policy would be in force for at least the next year. On being pressed to be more specific on the inferred qualification for the future, Mr Syme explained that the Board wanted to remain cautious about future commitments. Questioning by a representative of Fisher Funds elicited the comment that the expected further growth for the current year of 23% did indeed include the write back of the $1.2 million provision covering due diligence etc costs previously made for the Adelaide ventures, costs for which had already been expensed when incurred. A shareholder sought an explanation of the operations in China. It was confirmed that no sustainable business was yet in place. Management were targeting operational contacts and not investing any capital or market development at this time.
The two new appointees to the Board, Messrs Fricker and Frow, addressed the meeting in turn and were each applauded after they had given shareholders a resume of their background and having explained their commitment and how they considered they could contribute to board deliberations.
Before closing, and responding to a shareholder question about this being the 69th AGM of Waste Management , the chairman reminded those present that the company name used to be Carbonic Ice Limited, and this was the reason for the apparent longevity.
Oliver Saint

COMPANY RESEARCH

Property for Industry
I called to see the General Manager Ross Blackmore and Andrew Young, the Finance and operations manager of AMP Capital Investors to talk about the profitability of the Group following my analysis of the results for the 2003 calendar year. Members may be interested to learn that the exchange of correspondence is now on our website under Advocacy.

BRANCHES

Auckland Branch

Approximately 80 members and visitors attended the meeting on 24 March. The meeting started with an evaluation by Bob Boas of the recent site visit to Genesis Research and Development.

The Guest Speaker at the meeting was Carmel Fisher of Fisher Funds Management. (The visit coincidently occurred as the IPO of the Kingfish Fund Limited on the NZX was taking place. However this was not the reason Carmel was invited by the Auckland Committee and she emphasised that she was not there to promote this new listing.)

The company manages two unit trusts and a number of other funds for individual and private investors. An interesting fund within this group is the Fledging Fund, which provides an investment programme with an education component for parents and their children so they can get a good financial start in life. Once she has received Fisher's portion of the Cullen superannuation fund to manage, Carmel estimates that her organization will have about $250million in management.

Her philosophy is that the organization is a stock picker. At present there are 15 stocks in her various portfolios and these are chosen because of their growth potential. The investments are made in smaller New Zealand companies, outside of the top 10. Once a stock is chosen, they regard themselves as business owners. Regular contact is made with management. The focus is on earnings growth. The philosophy is to 'buy and hold'. The companies are invested in as quality proven businesses. When contemplating a purchase, a history of 3 years earning growth would be required. Information about the smaller companies is not easily obtained. The breadth of coverage is limited and has diminished over the last 10 years. This means there are more likely to be undervalued small NZ companies. Carmel believes that you cannot time the market. Rather that timing, it is better to buy on merit. She does not take a view on sectors or on the economy of the country.

Selling is rarely done but would be considered if a key reason for buying a share of the company changed, such as the CEO or a fundamental change in policy. The companies making up her portfolio include Briscoe's, Freightways, Infratil, Metlifecare, POT, Sky City, The Warehouse, F and P Appliances, GPG and Turners Auctions. Carmel described her approach as straightforward, including thinking and acting like owners, bottom up stock picking and a full time focus on one asset class, small NZ companies.

On 27 April, members of the Branch made a bus journey to Taupo to visit the Site of Tenon Ltd's sawmill and moulding plants. The bus, generously subsidized by Tenon, left from Auckland at 8.30am and picked up members from the Waikato and Tauranga branches on the way. A member of the Wellington Branch joined the group at the site. There was great interest in the visit and the numbers had to be restricted at 45 (our largest company visit yet), as Tenon could not manage a larger group for safety and operational reasons. The visit became of added interest in view of the partial takeover offer made by Rubicon Ltd after the visit was organised.

After arrival just before 1pm lunch was supplied by Tenon, and then CEO John Dell addressed us. He described the changes that had occurred as the company had reinvented the previous solid wood business model. As Fletcher Forests Ltd, the dominant investment and interest was in forests. Tenon however has a focus on manufacturing, marketing and distribution of solid wood products. Forests, which were not earning the cost of their capital, have been sold. This capital is being returned to shareholders in two tranches. $362milllion was paid out in March 2004 and up to $321million will be paid out later this year. Also the following points were made:

1 A projected EBITDA growth for FY04 compared with FY03 of 35% to $58-60m.
2 USA distribution through majority ownership by Tenon in AWM and Empire who in turn are suppliers to The Home Depot and Lowe's. Similar model in Europe through 20% shareholding in Danish furniture maker Zenia House. Progress in China and elsewhere.
3 Strong balance sheet with projected debt to capital of 34%
4 Valuation of $2.06 to $$2.32 based on multiple of 6x to 7x Forecast 04 EBITDA.
5 Commencement of dividend expected in 05. Tenon will also explore tax efficient ways of making shareholder distributions, as there are no imputation credits after years of Fletcher Forest losses.

Following an extensive question and answer session and introduction to other senior employees, the group was shown through the Taupo sites. The trip through the sawmill and moulding plants was another highlight of the visit. The efficiency of the processes was remarkable. It was an enlightening experience to observe the logs enter the plant and then be able to see the flawless satin finish of the wood mouldings as a final product.

This was a most interesting visit as it gave an important insight into Tenon, the enthusiasm and competence of management and staff, and their very efficient mill and mouldings operation.

The Branch is most grateful to John Dell and his team for responding to our request to visit the Taupo mill and giving us this opportunity. Their generous hospitality and assistance given with costs of the visit were greatly appreciated

Over 100 members and visitors attended the Branch Meeting on 5 May, which was addressed by Peter Masfen, a prominent New Zealand investor. Peter's topic was "Why we should have Confidence in Investing in New Zealand."

It was noted that the gross return on New Zealand securities has been in excess of 34%. New Zealanders should have more confidence in investing in the country. The capital should be predominantly invested here and certainly before investors considered overseas investments. There is a need for capital in the country. This concept was contrasted with the actions on the politicians as illustrated particularly by the investments made by the 'Cullen' fund where at present $1.6 to 2 billion of our money is being invested overseas. The policy was contrasted with Australia where their compulsory superannuation is largely invested within the country. Peter believes that this is reflected in the consistently 1% greater growth in favour of Australia when comparing the economies of the two countries. In Canada there is the requirement that 70% of private superannuation funds should be invested in the country. A similar situation exists in Holland.

The failure of the government to invest in the country is seen as small time thinking. Without investment in the country then increasingly sectors within the country will be controlled from overseas. Head offices will move overseas and the result of overseas control will be erosion of the country's tax base. As an example, there is the banking industry where decisions are being made in Sydney or Melbourne. Investments by the banks are being made primarily into housing and not being directed into business. It is therefore fortunate that we escaped the takeover of NZX by ASX.

Peter went on to discuss the advantages that New Zealand had. They could be summed up in our being "Clean and Green", having a sparse population and with a consistent rainfall pattern. Therefore industries that would prosper would be considered under the broad headings of FARM, HOTEL AND FOREST.

There are also advantageous features of New Zealand companies.

1 Dividends 6-7%average. This is twice the off shore payment average.
2 Monopolies or near monopolies. - Many companies in New Zealand are monopolies and/or have high barriers to entry eg Sky City and Fletcher Building.
3 Mild tax regime. There is no capital gains tax or stamp duty. There is also no estate tax.
4 The securities are well priced
5 There is no foreign exchange risk
6 Transparency-The companies can be visited and the product is there to be seen.
7 Codes of governance etc. This had improved over the years through legislation and rules from NZX

This was contrasted with the overseas companies. There are many tax and management issues. The major world economy, the USA, has huge internal and external deficits. There have been corporate governance and other problems in companies as prominent as Shell Oil and HIH. In many economies there are major structural problems. Germany was quoted where there is a 75% unfunded liability on the government pension scheme.

At the conclusion of his address Peter answered questions on a wide range of topics. Earlier Graham Wilson outlined the course he is giving on investing in the share market.

The next meeting of the Branch is on Wednesday14 July, at the Alexandra Park Functions Centre, when the speaker is Bruce Davidson from the Institute of Directors, and the next company visit is to DB Breweries in August.
Bryan Trenwith

Tauranga Branch

Branch activities continue at a good clip, maintaining momentum and a good spirit amongst branch members.

We held our regular monthly committee meeting on Thursday 27 May, and earlier on Friday 21 May, the discussion group attracted a total of 19 (of whom 2 were prospective members) to a consideration of portfolio management, and a nomination of favourite stocks, enlivened by the prospect of winning a bottle of choice wine.

6 of our members joined with others from Hamilton and Auckland (plus I understand one from Wellington making this the first organised visit involving representatives from all branches) to participate in the Auckland arranged visit to Tenon's factory at Taupo, travelling by bus and enjoying a lunch followed by an interesting and detailed presentation from Tenon's senior management, all kindly provided courtesy of the company, a much appreciated and generous gesture.

Our branch was privileged to enjoy on 14 April a visit to Zespri at Mount Maunganui with the company poised to celebrate 100 years of Kiwifruit growth in New Zealand. 20 of our members were treated to a detailed presentation by group chairman, Craig Greenlees, supported by other senior management, detailing principal markets and policies to achieve maximum penetration and results. Following refreshments we were taken by bus to Te Puke to observe a pack house in high season frenetic activity, reflecting a very prolific season for growers. Again we are very grateful to Zespri for the time and effort expended for our enlightenment and benefit.

Other events planned but with dates yet to be assigned are a visit to broker ABN Amro Craigs at Tauranga and to Westpac Bank to learn something of their operations. It appears that most (and perhaps all) of our members have renewed their membership which is encouraging and should lead us to be more adventurous in our future programme.
Malcolm Dunphy

Waikato Branch

The Branch has a number of new members, and the Committee is busy planning its programme for the year. A number of members went on the very successful Association visit to the Tenon Plant in Taupo.

Wellington Branch

During the month of May the Wellington Branch, which now has some 30 members, held a meeting at First New Zealand Securities. The meeting featured presentations on investment markets by Ray Jack, technical analysis by Peter Nalder and shareholder advocacy by Phil Kelliher. This was followed up with a general discussion of issues relating to the New Zealand equity market. Finally the evening was capped off with wine and cheese. A big thanks to all attending members and we look forward to seeing you all at the next Branch meeting.

Ray Jack