"The Scrip"

The official newsletter of the New Zealand Shareholders' Association Incorporated

VECTOR

It should come as no surprise to the board of Vector that the Commerce Commission has an interest in its pricing matrix. It is after all a monopoly and regulating monopoly rents is a statutory brief of the Commission.

The pricing matrix of Vector should not have been surprising to the Commerce Commission either. Gouging businesses and non Auckland residential customers make perfect sense to the combined Auckland Energy Consumer Trust (AECT) and Vector Board. The reason for this is transparent, only Auckland residents get to vote on the election of trustees and the trustees appoint the board. So the combined Vector AECT structure is a washing machine that redistributes wealth from those who can't vote to those who might to garner support for the trustees to continue in existence milking fees.

If this structure had no private ownership whatsoever only the "milked" would care. But unfortunately the AECT allowed private investors to invest in their political gravy train without providing for proper governance within Vector.

Some shareholders may feel that what has happened to Vector is similar to the asset theft from Telecom. It is not. Telecom is a wholly privately owned company. The Crown is taking back part of an asset that they previously sold to the private sector, and they are doing it by statute. Telecom has no remedies from Crown theft. Vector on the other hand may have breached the Commerce Act and it has remedies, it can go to court and appeal decisions etc.

Investors knew when investing that they would be minority partners with the AECT, and also knew that Vector was in a position to extract monopoly rents at least from some of its customers if that suited the major shareholders political views. They therefore should have anticipated the Commerce Commission's involvement.

All of this said, the current ownership structure of Vector does not serve private minority investors well, and there are three possible solutions:

1. The AECT should remove itself form the appointment of Vector directors and the company should operate as a commercial enterprise without politically motivated interference.

2. Or, The AECT should buy out the minority shareholders and operate the company as it sees fit.

3. Or the AECT should be wound up and the shares distributed to the income and capital beneficiaries on an equitable basis. Then the share register would be opened up, and the councils would inherit a substantial asset that they could sell down to provide long suffering Aucklanders with some rates relief.

I vote for the third solution. Bruce Sheppard

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FELTEX CARPETS

The saga continues with the company now sold to Godfrey Hirst. Our deep sympathy goes to all shareholders who have invested in this group since re-listing in 2004. There is more water to flow under the bridge and your Association is far from finished in bringing to account those responsible for this hugely embarrassing corporate failure. To recap we have on 11 May 2005, 18 July 2006 and again on 20 September 2006 written to the Securities Commission on this company alone. Our correspondence and the Commission's reply, such as it was, are shown for all to see on our website in the section on the left hand side of the screen under 'correspondence'. In addition to writing to the Securities Commission we have also written to the Institute of Chartered Accountants of New Zealand seeking a peer review of the 4 major accounting firms. No peer review has ever been undertaken on the Big 4. When we receive acknowledgement and comments on our letters we will then consider whether we can usefully take further action. One matter that is open to us is to lodge a complaint to the Ministry of Economic Development's National Enforcement Unit seeking the banning of directors and management where applicable. You should be aware that members of the public can refer a complaint to the NEU regarding breaches of any legislation it administers and enforces.

UNREALISED CAPITAL GAINS TAX ON OVERSEAS SHARES

Select Committee hearings were held on Auckland for two days at the end of September. The whole process was frustrated by the fact that two Ministers of the Crown had issued a press release that effectively nullified and changed the whole format of taxation of overseas income. The select committee process was as a result punctured. Perhaps corrupted would be a more appropriate word. We would again like to thank all those who attended the select committee hearings to put their point of view. We are also aware that Allen Smith and Lloyd Christie of our Bay of Plenty Branch have spent much time in researching this topic so that they could put their views to their member of parliament. Again we appreciate and applaud this initiative by our branch members.

I attended the select committee hearings on the two days that they were held in Auckland. Bruce Sheppard our chairman set the ball rolling by giving a very lucid explanation of how the existing tax was deficient. I gave my address on the following day along with a big contingent of members from the Bay Of Plenty branch and other members of the Association during that day. It was great to see such support and member interest.

I heard at least 20 submissions and from the questions that were asked by the select committee it was impossible for them to hide the drift of their questioning. The first thing is that the unrealised capital gains tax is, as we all know, dead in the water. The second is that there will be nothing more certain than that a deemed rate of return tax is now a certainty. We have to thank Mr Shewan of PricewaterhouseCoopers for that. In the final part of my address in order to introduce an alternative to what in effect is a wealth tax of sorts I suggested the introduction of a more honest Capital Gains Tax along the lines of the Australian CGT. From the questions from the select committee that I received after my address, and there were many, I soon realised that no form of Capital Gains Tax is on the agenda. All parties seemed determined to keep their promise that a CGT will not be introduced. They did not promise anything about bringing in a diluted form of wealth tax - to my mind worse than CGT - and this is what they will do. There was much comment on the rate. One submitter suggested that as the investment was overseas for diversification then surely the simplest and most reasonable yield to choose was the World Index yield on dividends, the latest figure being 2.6%. From the concentrated questioning of this taxpayer after his address, the committee found merit in this submission. My mention of inflation did not even raise an eyebrow so clearly this was not of concern to them. As an aside, the only time the whole committee became excited and protested was when one submitter had the audacity to comment that the retirement funds of members of parliament were inflation proofed. I had been advised previously that it is not a good move to be critical of the Committee and clearly this was a subject that seemed to hit a nerve. There was also much talk on the quantum of the de minimus. Every single submitter pointed out the stupidity of such a sum of $50,000 and this was taken on board. The minimum level gradually increased with submissions until the final submitter suggested around $250,000. This would let most off the hook – temporarily – until another government reviewed the position. There were a number of brilliant submissions, one from Paula of Whangarei who collected a speeding ticket on the way to the hearing and much sympathy from the committee. This submission, from a young 20 year old determined to save and who took a day off work, was probably the more impressive of the second day of the Auckland hearing.

We will have to wait and see how successful we have been but don't hold your breath. What Cullen wants, Cullen gets.
Oliver Saint

REPORTS OF MEETINGS

Fisher & Paykel Appliances – AGM 21 August 2006
The Annual report contained an impressive and sound looking long term strategy for the growth of the Appliance side of the business. Hopefully the European purchase can be competently digested.
The highpoints of the AGM were:
- Growth in USA sales were slowing from the initial very high figures, partly due to F&P now coming onto the defensive radar screens of established USA competitors.
- Raw material costs have remained very high and have been unexpectedly climbing further since writing the Annual Report. Full recovery by raising prices has not been possible due to competition, even though all competitors must be equally hurting unless protected by Government subsidies etc.
-The decrease in the NZ dollar is only of great value versus the Australian $. There is a natural hedge with the USA $ due to material pricing being in that currency. Due to hedging in place, the full value of the fall against the Australian dollar will only become apparent in some 6 months time.
-Competition in the Financing side of the business has stiffened since the interest rate rises.
- Profit for the next year is now expected to be at the lower end of the guidance range given in the Annual report. The Annual report was written very shortly after the fall in the NZ $. This means that non currency aspects (such as raw material costs) have toughened up since then.
-Only two questions were asked at the meeting.
Martyn Geary

Fisher & Paykel Healthcare - AGM 24 Aug 2006.
This was a well attended, well run meeting with a maximum of good news and absence of any controversy. It was all over in 35 minutes.
The 2006 NPAT was $70M (up 14% on 2005).
Revenue for the same period was $324M (up 20% on 2005).
The gains were across all product categories.
98% of income was earned outside New Zealand with USA being the biggest market , ahead of Europe.
With the $NZ being at record highs ,currency hedging played a large part in the result.
$60M has been spent on a new manufacturing , administration & R & D facility.
The company is investing $27M in a share buyback programme.
Mike Daniels (CEO & MD) emphasised the drive for new innovative products which would open up new patient groups to the company.
Currently 6% of revenue is spent on R &D resulting in 206 new patents being granted in 2006 & 11 new products were released..
The forecast for the first half of 2007 year has been increased from $42M-$43M to $44M-$45M. The full year forecast will be given when the half year results are announced.
The $NZ reduction has cushioned the effect of currency hedges running out.
A shareholder queried the drop in the share price. The Chairman replied that it was a mystery to him also.
I asked for comment on the very low gearing & future plans to manage an increase.
At the time of the separation of Healthcare for F & P Ltd ,there was a float on the US market & the brokers advised that they should aim at low gearing in line with similar US companies.
The steps to manage an increase in gearing are-
Continuation of 90% dividend payout, share buybacks, investment for growth funded by debt (egg the $60M new facility).
Two Directors-Colin Maiden & Lindsay Gillanders were re-elected after addressing the meeting.
The meeting approved the issue of up to 180,000 options to Mike Daniels (CEO & MD)
Tony Sullivan.

Infratil - AGM 7 July 2006 Wellington
The Infratil AGM started on time at 3pm – let us hope this is a sign of things to come with the buses.

It was a quiet affair attended by about 120 shareholders and half a dozen journalists and photographers. The Chairman David Newman started by giving us a brief summary of his experience and what attributes he brings to the board, then passed over to the board members who each did the same. A nice touch and something that more listed companies should be doing as a matter of course.

From then on it was a Lloyd Morrison show. He gave a comprehensive rundown of Infratil's current position and performance and the activities of its energy companies, airports and Stagecoach. A recurring theme was that Infratil is a long-term investor and in the last year in particular has invested heavily for the future. This investment won't be reflected in the P&L for a while but it is adding significant unseen capital value that will eventually be reflected in Infratil's share price. He attributed Infratil's success to having good people and being in the right place at the right time – swimming with the current, not against it.
Martin Dowse

Lombard Group - AGM 28 July 2006 Wellington
I'd never heard of the Lombard Group prior to Oliver asking me if I could attend the AGM on behalf of NZSA. Armed with this lack of knowledge I duly trotted down to the Hotel InterContinental to find out more.

Lombard Group is an interesting company for several reasons:

- They recently listed via a reverse takeover of Pure NZ.
- Of the board of five, four are independent directors – Sir Douglas Graham is the Chairman.
- Their only major asset is Lombard Finance and Investments Limited – making Lombard Group a listed finance company.
- Lombard Finance is a property lender, 98% of lending is to the property sector.
- 96% of the funds invested with Lombard come directly from its existing client base and do not come via brokers or agents.
- Lombard is profitable – although with approximately 2.3 billion shares (last trade 2 cents) on issue the EPS is miniscule.

The small room at Hotel IC was packed with over 50 shareholders attending and Sir Douglas Graham ran the meeting well, afterwards answering a number of questions from shareholders with ease – he knows the business well.

Sir Douglas and CEO Michael Reeves both stressed that Lombard does not lend on motor vehicles or consumer items, only property. While fund inflows have slowed somewhat lately this isn't causing Lombard any problems.
The year(s) ahead:

- Consolidation and growth after a busy year becoming a listed company.
- Possible restructuring of capital to reduce the number of shares on issue.
- Dividend payments to start if not this year then the following.
- Looking for opportunities for diversifying income streams.

Martin Dowse

Rakon Limited
It is not often that shareholders have to go through the security of three check points before arriving at the venue for an AGM but such was the strength of the apparent protest by three different groups that police and private security guards were used to ensure the safe conduct of meeting proceedings at the Ellerslie Convention Centre on 2 September. I say apparent as there were few signs of protest at the meeting and it was not interrupted. The organisers had catered for twice as many people than actually attended so despite a good attendance it must have seemed rather sparse to the Board at their elevated table. The chairman started by advising shareholders that as this was the first public meeting he invited each director to go to the microphone and introduce themselves. This was an unusual act that was appreciated by shareholders.

The important news for those attending was that the five months trading had been strong. The forecast at the time of the IPO would be exceeded by $3 million; any increase in this figure would depend on continued strong trading in the next seven months. Capital expenditure planned includes $4 million for a clean room expansion programme which is a 'critical phase in the manufacture of crystals'. Significant investment will be spent on expanding the range of oscillators, develop further GPS Receiver modules and temperature testing equipment.

Finally, an interesting Law was expounded that may be unfamiliar to members. This is Moore's Law. This law, loosely stated, suggests that technology will double in quality and halve in price every 18 months. Those of you who have used computers for any length of time will no doubt be able to bear witness to this amazing fact.
Oliver Saint

Ryman Healthcare
Some companies struggle to get a quorum at their A.G.M.'S but not Ryman Healthcare Ltd. Their AGM's are full to overflowing with delighted shareholders. What is the secret? Serve them up a delightful lunch washed down with good wine and a 48% increase in dividends from a 49% increase in profit. Managing Director Kevin Hickman informed his enraptured audience that since the I.P.O. in 1999 that the company had returned some 30% per annum compound. And from the details of projects commenced or planned the good news is expected to continue.
Company joint founder Kevin Hickman had hinted at last year's AGM that it was nearing time for him to slow down and stop to smell the roses and this year he announced that the time had now come for him after 24 years with the Company to hand over the reins to the next generation. It was announced that his replacement as Managing Director would be Simon Challies, presently General Manager and C.F.O. and Company Secretary. Kevin stressed that his main consideration was to ensure that the company remained in good hands and he was sure that Simon was the right person to succeed him as MD. Chairman David Kerr asked those present to show their appreciation of Kevin's contribution to the company by acclamation.
The only grizzle that this writer has is that he is still waiting for Simon Challies to reply to his request to hand out NZSA membership brochures at the meeting. Ah, but then, if all companies were like Ryman Healthcare, would there be any need for the NZSA? Silly me, we still have Tim Saunders and the Feltex directors!!!!!!
Ritchie Mein

Skellerup Holdings AGM – 28 September 2006
445 proxies were received representing 18% of voting capital. The chairman's address covered the results to date, progress and the prospects for the future. The chairman also mentioned the continued development in China for its low cost manufacturing operations and was questioned about the results of this division since there were no financial details. A number of shareholders were keen to know more about these operations. The chairman advised that the operations at present represented a cost centre, profits being mostly generated outside China. I pointed out that the lack of information on IFRS was glaring and sought information for shareholders at an early opportunity. Our Tauranga member Howard Zingel queried the level of debt following recent acquisitions and although the chairman advised that he was comfortable with the level of debt, I requested that the Board consider the question of debt policy and advise shareholders on this matter and a dividend policy so that we could all better understand the financial implications of these key indicators – debt and dividend policy.

During his address the chairman advised that it was the Board intention to engage two further non-executive independent directors in the area of international marketing and specialised manufacturing expertise. Keith Smith was up for re-election and Howard Zingel raised the number of directorships he held. The chairman confirmed that he was comfortable with his present portfolio and could handle them. In covering the process of new Board appointments he advised that he consulted with senior management to see that they were happy with the composition of the Board and he had been assured that they were. This is a most important question – the Feltex debacle comes to mind – and undertakings should be sought of all directors where it is believed that the workload may be oppressive. This is particularly so of chairmen where there is more than one chair appointment in the portfolio of directorships.
Oliver Saint

Smiths City - AGM Christchurch 8 September 2006
The presence of a representative from the Shareholders Association was acknowledged by Chairman Craig Boyce. Approval had been granted beforehand for our brochures to be distributed to attending

shareholders. However it was disappointing to find that no proxies had been assigned to the Association. If members want to have their democratic say in the running of their investment companies then it behoves them to do their little bit in completing and sending off their proxy form nominating NZSA as their proxy. You can still vote however you like on any matters or simply leave it to the discretion of the proxy holder. It costs you nothing to do it but could be all important on any contentious issues. It also shows to companies that the NZSA is a powerful force in the investment arena.

Chairman, Craig Boyce, graphically displayed the progress of the company over the last 10 years which revealed that Sales & Profits had doubled, Shareholders Funds had increased fourfold and Dividends & Yields had greatly increased (the current gross yield being just slightly under 10% on the current share price).

As the Company is primarily in the “big ticket” market it is materially affected by any downturn in the economy and historically predicts any trends some 12 months beforehand. In addition to the slowing down of the economy, strong competition is appearing in the market from other big players. Bigger players appear to be getting stronger at the expense of smaller players. The Board believes that to survive Smiths City Group must expand. Hence the recent foray in to the North Island with the purchase of L.V. Martin & Son in Wellington which has itself expanded with the take over of Star Appliances in Rotorua. Smiths City recently took over Meikles Ltd of Tauranga which also has its own Finance Company. Smiths City has also successfully completed two property development projects.

The outlook for the next 12 months is going to be challenging with higher interest rates and reducing price points and having to match competitor’s promotional offers. In their favour the Company believes it has the right strategy of delivering a full service, having its own Finance Company and the ability to develop their own locations. The Board sees the Company benfitting from any improvement in the economy in the 2007/2008 financial years.

Directors Boyce and Holdsworth were duly re-elected and the Financial Report approved. There being no matters raised from the floor the meeting was closed in record time and refreshments served.

Ritchie Mein

Tower

I attended the Tower Bondholders extraordinary meeting to vote some NZSA proxies. I had little background on the issues going into the meeting at the Wellesley Club in central Wellington. The right questions were asked and the answers unfolded the story for me and the possibly 25 interested parties.

As you may recall, Tower are looking to split their operations between NZ and Australia. Currently the group is one New Zealand controlled entity and the Bonds are secured against the New Zealand entity. Tower currently has two tranches of funding, with some capital notes in addition to the bonds. The capital notes have a callable facility, perhaps in contemplation of some restructuring, or perhaps just as a means to minimise funding costs. They will be redeemed at 102% as contemplated in the Capital Notes Trust Deed.

The difficulty for Tower is that the bonds will end up representing around twice the amount of debt they believe the NZ operations should carry, at around $120m verses a desired 65m. This obviously presents issues in terms of profit and variability of profit to their NZ operations.

The difficulty for bondholders is the quite different level of security the bonds offer after the restructuring. The meeting was called to consider early repayment of the bonds, with interest and 102% of principal being returned on their repurchase or redemption.

Group Managing Director Jim Minto deferred to his legal advisors for an explanation of the 102% price. This seems to be a happy coincidence – being the same terms as the Capital notes - and slightly above where the Bonds are trading on the secondary market.

Tower and Guardian dodged giving an opinion on the tax treatment of the 2% premium – fair enough – with the answer depending on the choice of method and the individual’s circumstance.

The votes were called, and when tallied by the auditors, showed 98% acceptance for the redemption / repurchase proposal.

The Tower Bonds will be missed. It is getting hard to find well-rated long-term fixed interest bonds that will pay a fixed coupon through to maturity. Nearly every bond issue seems to have some imbedded option in favour of the issuer. Corporates need to issue these bonds to manage their liquidity, and the use of options is valid in managing their overall interest cost. My pick is that most, if not all, investors at the Tower meeting were looking to the Bonds to provide some ballast in their absolute income.

Currently call rates are quite high relative to longer term rates (an inverted yield curve) and bank competition for these call funds may be heating up. Locking yourself into a long term credit exposure for only a margin over floating, or with the possibility of the bond being called early, won’t add much certainty of absolute income for the investor!

Look out when reinvesting any funds from the Tower Bonds that you understand the callable features of any proposed investment.
Sitting on call starts to look attractive! Matthew Underwood

TAKEOVER DOCUMENTATION

It is the lot of the investor to read many pieces of paper, be they glossy reports, takeover documents or even the mammoth prospectus for a new issue or an issue of fixed interest securities.

On the whole, the quality of the pictures and text is good but once in a while there appears a document that suffers from being too hastily put together with no attention paid to what recipients will think about the standards of the adviser who has been selected to provide the expertise. I came across one of these the other day and I want to seek your help by bringing these unsatisfactory situations either to your attention or to the attention of the particular government organisation involved in supervising governance. Our Association cannot hope to become involved in every minor misdemeanour that may occur but we can and do give our members priority time in listening to their queries and trying to satisfy their complaints.

Gullivers Travel Group has had a short but relatively profitable listing on the New Zealand Exchange (NZX). It was offered on 16 November 2004 at a price of $1.60 a share and is, by the time this article appears in the newsletter, unlikely be a listed company having been swallowed up for $2.35 per share by an Australian Group with the unlikely name of S 8 Limited, itself a listed company in Australia. During the time as a listed company, the standard of documentation of Gullivers has been impeccable and this short piece is not intended in any way to reflect on that company. I do however suggest that the Australian company S 8 allows a rather looser attitude to documentation and shareholders may well wish to remember this if there are further corporate offers from this company in New Zealand.

The takeover document sent to Gulliver shareholders by S 8 Limited and offered through a subsidiary of S 8 - S 8 NZ Pty Limited - was a relatively satisfactory document until one arrived at page 27 (out of a total of 38 pages). The remainder of the document covered the Independent Adviser's Report. It is here that things got a bit messy. Rule 22 of the Takeovers Code requires an independent adviser to report to shareholders where there are differing equity holders of the target company so that the fairness between them may be assessed. In the case of Gulliver there were ordinary shareholders and option shareholders. The organisation entrusted with providing the advice was called Deloitte Corporate Finance (or maybe just Deloitte). There is information about who Deloitte is at the end of the report but this goes no further than a marketing description of activities. The report is lacking any headed paper, contains no address or logo, is undated, unaddressed and unsigned. It is also un-indexed so that the reader will have no idea whether it is complete as its conclusion is abrupt. It does however advise who wrote the report as this is a requirement under the Takeovers Code – one of the few, it seems.

I had a short exchange of emails with a representative of the Takeovers Panel who, whilst explaining in law what is required, did not consider it worth commenting on the fact that some of the vital information is only available to the Panel. It would seem therefore that a hall of shame may be a useful tool for us to introduce. This therefore is the first entry:

The following people or businesses listed as responsible for the affairs of S 8 Limited and listed on page 1 of the offer document:

HALL OF SHAME

The offer document from S 8 Limited for Gullivers Travel Group
The directors, company secretary and registered office of S 8 Limited
The Corporate Advisers: Wellington Capital Limited, Brisbane
The Legal Adviser: Harmos Horton Lusk, Auckland
The Independent Adviser: Deloitte Corporate Finance

Finally, this is where you come into the picture. We cannot hope to cover all documents sent to shareholders. Please, if you take exception to something lacking or incorrect in a document, get in touch with us and we will continue our policy of shaming companies and hopefully government bodies into insisting on a greater degree of accuracy and clarity of information. These documents are, by and large, addressed to and for the attention of the shareholder or investor and not to a government body.
Oliver Saint

Dissertation on Investment By Oliver Saint

Introduction

This is the start of a serial. As with any piece of original thought there must come inspiration. This came to me the other night as I was reading *Angels and Demons* by Dan Brown, not for its literary merit but as a great yarn and for the meticulous research and analytical skills that have gone into the book. For some of us who have now become inured to short time spans of concentration due to the attractions of television, an author tends to cater for this by making the chapters smaller and smaller. This is so in the case of the above book; indeed a chapter may start and end in half a page; this allows the reader to put the book down without trying to skip the odd page to get to the end of a chapter. This serial is intended to be short and sharp and contain recent facts about which our members may be unaware.

Chapter 1 – It's all a game!

A week or so ago, *Harrison J* handed down his judgement on the case brought by BNZ against Access Brokerage, Deloitte Touche Tohmatsu and New Zealand Exchange. To those of us who do not have a legal turn of mind the decision was difficult to follow, to say the least. Suffice to say the case was based in two parts; the first, against Access Brokerage and the previous accountants, was dismissed by the judge who was certain it had no merit at all. The second part of the case against NZX was also dismissed with similar although slightly longer reasoning. It is not for me to discuss the merits of the judgement here but I did take exception to a paragraph in the final stage of the judgement (as opposed to the long introduction) that I found odd. I will quote it in full:

[152] In essence the stock market is a game. NZX the forum and its rules and regulations are the rules of the game. In its regulatory capacity NZX is not an active market participant but is the market itself. To attribute responsibility to the forum provider for all breaches of rules and resulting losses is unduly onerous and, in my judgement, misconstrues NZX's functions.

It is the first sentence of this paragraph that I find hard to digest. Ask some of the shareholders of Feltex Carpets if they consider that their investment is a game and I am certain they will have some very unsavoury response. That a large part of their retirement savings could go up in smoke a mere two years since it was first placed on the market is deplorable and there must be some other retribution than a Neville Chamberlain piece of paper from the Securities Commission saying - Peace in our time!

But then after a day or so of thought, I had to concede that this Association was also effectively treating the investment of retirement funds as a game. What else is a competition between branches to see which shows the best result after five years? There is of course a difference. In order that the 'game' could be as close as possible to the real world, the initial capital introduction was limited to $1,000 per month and the maximum was $50,000 over the five-year period. These rules, among others, satisfied Michael Cullen's exhortation that we save for our retirement. However with judges prepared to say that Share Market (Investment) is a game, the demise of wealth for *Feltex* Shareholders, the slackness of *NZX* in not recognising Contingent liabilities, the disappearance of *Waste Management N.Z.* and *Gullivers Travel Group* and now *The Warehouse Group* being privatised, the outlook for our market is anything but bright at present. All this action will add character to our Branch Committees in their bid to come first.

For your information the rules of the competition will be posted on our website very shortly.
The serial continues in our next newsletter.

A Case Study on Governance Failure

At the last Restaurant Brands AGM, the parting Chairman Bill Falconer ushered in a new director, Suzanne Suckling, with comments that she had over 20 years experience in the governance industry. I commented that governance isn't an industry and the board already had considerable "experience" in governance.

Restaurant Brands (RB) is a case study of continuing governance failure. Governance is about performance and communication. Performance is about good strategic decisions, effective execution and risk management, which results in superior shareholder returns. Communication is about the provision of relevant information in a timely manner. RB is a failure on every point of good governance despite the wealth of experience in the "industry".

Background

RB was listed in 1996, following the purchase from the franchisor of the KFC and Pizza Hut businesses in New Zealand. Its maiden profit for 1997 was $7.6m on sales of $164m; this was in line with forecast. In the directors report for that year they indicated that the prospectus projection of $13.8m would not be meet. The profit for 1998 was $8.1m. The shares crashed to 80c from a list price of $2.20, but unlike Feltex the company survived.

The current CEO (Vicki Salmon) has served on the board since inception and has participated in all major decisions.

Strategy

Of all the decisions made only one may have been a success depending on your view.

The first was the decision to roll Starbucks out in NZ. The first store opened in October 1998, with 10 stores operating by November 1999. The initial contribution in 1999 was negligible. A further 6 opened in 2000, and started contributing. The return on investment in Starbucks has been a long time emerging, and only now, 8 years later, can it be said that Starbucks is paying its way. Doing a Net present value on that decision with the benefit of hindsight and to count it as a success would be a tall order.

In the 2000 year the company bought Eagle Boys ($28.3m), shut them down and rebrand the stores, a very significant investment in the Pizza Hut franchise. Based on Pizza huts current performance and the predictable emergence of competition, also a mistake.

The third was the decision that the company was a retail brand management company, not a real estate company. They sold the company-owned outlets and leased them back. This resulted in significant profits in the 2002 year. Maybe shareholders would have been better off holding the real-estate when you compare it with the returns on the cash invested in Starbucks and Pizza Hut. Perhaps the decision to sell the real estate was more to do with the rising debts of the company based on the rollout of Starbucks and the purchase of Eagle Boys. By the end of 2000, total debt was $105m up from $80m in 1997.

The fourth and most nutty decision was to go into Victoria. A decision jointly led by Collier and Die in a ditch Diab. Collier left shortly afterwards, Diab remains. The Victoria franchise was an underperforming dog and the NZ team thought they could do it better. All that has happened in NZ consumers and shareholders have subsidized cheap Pizza for Australians.

Now we have the decision to exit. Losses continue. At the last AGM I asked if the losses had been fully provisioned. It was confirmed that they were. Now we will have more and significant losses in the current half year.

Execution

In terms of the execution of strategy, a year on from the decision to sell-out of Victoria not one has been settled.

It has taken 8 years to turn Starbucks into something resembling a business that has a value greater than its cost.

Risk Management

The reason we can't get out of Victoria clean is because we need the franchisors' consent. If we try to get out without it, they can close down all the NZ franchises. So we bet the whole business on a foreign expansion strategy. Now, that is risk management failure.

Reporting

Most shareholders in RB have bought for the yield, i.e. the dividend. It has always been a high yield stock as it has little else to recommend it. The board know or should know that. The board announced a significant decline in profitability in some detail last month. The detail did not include the likely impact on the interim dividend of 4.5c per share. I pointed out to the board that their disclosure was inadequate. Despite this warning the follow up announcement is silent on the dividend prospect which is of fundamental importance to shareholders.

At every level this Board, some of whom have been there since the beginning, is a case study on governance failure.

Bruce Sheppard

Shareholder Associations Overseas – An update

From time to we will update you on the overseas activities and news that is available on website that may be of interest.

Members will I hope be aware that we do have reciprocal membership or the ability to view restricted data that is available only to members on the websites of the following organisations.

Australian Shareholders' Association (ASA)
United Kingdom Shareholders' Association (UKSA)
Securities Investors Association (Singapore) (SIAS)

Please contact either Russell Hodge or Oliver Saint if you need further information.

Hong Kong

Members who may have shares in Hong Kong should be aware that it is possible to obtain a free regular email update of events in the Hong Kong market by visiting the website created by David M. Webb. The site is on our links page and is at www.webb-site.com. (Note the double 'b').

David is a well known resident of the Special Administrative Region and before his retirement in 1998 had spent 12 years in the investment banking field, the first five being in London. He is presently a non-executive director of the Hong Kong Exchange, a member of the Hong Kong's Takeovers and Mergers Panel and a member of the SFC Shareholders Group

Hong Kong does not have a Shareholders' Association as such but when you have seen the articles and comments on his website I think you will agree that there is hardly a need for one as he offers an exceptional substitute. For those members with Hong Kong investments this free newsletter is an essential tool.

BRANCHES

Auckland

Our next meeting is on Wednesday 18 October at 7.00pm at Alexandra Park Raceway. We are looking for a good turn out. Please invite your friends along.

Our speaker is Rodney Deacon, an Equity Analyst at Goldman Sachs JB Were.

Rodney worked for seven years from 1998 to 2004 in London for Deutsche Bank then UBS, most recently as an analyst covering the European Media sector. He joined Goldman Sachs JB Were in November 2004.

Currently Rodney covers ten stocks in the New Zealand market ranging across a number of industries and including Sky Television, CanWest MediaWorks, Tower, PGG Wrightson and Nuplex

This is a great opportunity for members to come along to here how share brokers go about researching a company. Especially after the Feltex disaster where someone got things terribly wrong. It also gives us an opportunity to ask many questions on the subject.

Des Hunt, Chairman, Auckland Branch

Bay of Plenty

Lloyd Christie has been elected chairman of the Branch; Kerry Drumm continues as Secretary/ Treasurer. New members of the committee are Lois Robertson ph 07 5524 950 and Dave Higson ph 07 5421 965.

The Branch AGM went off exceptionally well thanks to our high profile guest speaker, Brian Gaynor. Opening the meeting to the general public exposed us to fifty potential new members and our member liaison person Allen Smith will be working the phone for a while. We are proud that three of our members have made personal submissions on the proposed foreign investment capital gains tax – if we end up with a reasonable wealth tax it will be thanks to people such as these three.

Brian Gaynor spoke to us about the kiwi love of property as an investment. Bricks and mortar have done

exceptionally well but the trouble is we have the highest proportion of our wealth in property of any OECD country and this is screwing resources into unproductive enterprise and exposes us to the risk of being very over weight in one asset class. Brian was reasonably optimistic about the outlook for property, we are after all one of the few safe and nice places in the world but how we digest the bubble prices of the immediate past is no doubt something we will all we watching with keen interest. His address ended with well received observations about several quoted companies.
Howard Zingel, Correspondent, BOP Branch

Canterbury

Canterbury Members had a hint of what it must be like in Lebanon on Tuesday 12th September with flashes and bangs from the sky. It is a sign of our troubled times that immediately most people thought of a terrorist attack and were quite relieved to hear later on the news that it was just a plain old meteorite disintegrating in the atmosphere causing no damage except to our nerves.
It is now the season of Company AGM's and we hope to represent our Members at as many Christchurch meetings as we can. So remember to send these proxies in so we can speak on your behalf.
The Branch Committee is endeavouring to arrange some interesting Guest Speakers over the next few months but with Christmas fast approaching we may have to defer some of them to the New Year. We had hoped to have Alan Robb, Senior Lecturer in Accounting at Canterbury University but due to venue problems we will have to defer this to another time. We do have however, Oliver Saint, Director of Research, coming down to address us on 17th October. With all the issues that Oliver is involved in at present we are looking forward with interest to what he will have to say. We are also very appreciative of Oliver giving up his valuable time to visit us in the "deep south". Our two academics on the Committee are in course of organising a workshop/seminar on computer software for tracking and managing share portfolios. Sounds like interesting stuff. Peter Montgomery of Mooring Systems has agreed to give us an address sometime when we can pin him down to a time and place. We might have to borrow one of his mooring systems to keep him in one place for a couple of hours. Scott Technology after a lengthy delay in responding to our letters has agreed to have us on a Company visit early in 2007.

In the last issue of the Headliner we placed a recruiting advertisement to cover the whole of the country. We were offered a 33.3% reduction in the normal price and considered it was too good an offer to decline and would only require a few new members to recover the cost. It is early days to ascertain the effectiveness of the ad but we feel it is essential to keep getting the Associations name in the media to continue to build our credibility with the public. We are requesting other Branches to pay a fifth share of the cost of the ad which comes to only about $112.50 for each branch. Only 4 new members and you are in profit but National will gain even more from each new recruit.
For those of you who may not be familiar with the Headliner it is a fortnightly investment newsletter published in Christchurch by MG Marketing and has a circulation of about 4000 throughout the country. As these readers obviously have an interest in investments they are a high priority target for membership of NZSA.
Ritchie Mein, Chairman, Canterbury Branch

Waikato

The education courses organised and run by Graham Wilson for the New Zealand Shareholders' Association have proved to be a valuable source of new members for the branch. The branch was slow to take the initiative to get courses available in the Waikato region but the series run this year by Graham was well supported; and the courses appreciated by those that attended. Investors who were not familiar with the Shareholders' Association became aware of its existence, and through Graham, saw the advantage to them of joining the Association. The Waikato membership numbers are now eighty; eighteen of whom are joint memberships.

Through the generosity of the Bay of Plenty and Auckland branches, our members were able to visit companies outside our domain - Port of Tauranga and The Warehouse. The visits confirmed the advantages to investors of being 'on site' and meeting the management of the company. At the Port of Tauranga visit we learnt of the 'contest' between the ports of Tauranga and Auckland with POT hoping and expecting that Maersk would favour them if and when Maersk decide to visit only one North Island port. The tour of the port was impressive showing the size of the estate, with spare land for further development, a definite plus for the company. The visit to The Warehouse involved a tour of the Distribution Centre at Wiri and then a tour of The Warehouse Extra at Sylvia Park. In both places we were made very welcome and saw that the organisation at Wiri was very complex and yet the goods flowed. Supplying the customer was the essential of the business. At Sylvia Park the layout of the store was different and better than the traditional Warehouse format. Early days, but the management are pleased with the customer's response so far.

The inter-branch Portfolio competition is attracting increasing interest from members. It is another opportunity for members to gather and hear the deliberations of the chosen few – and also to be invited to express ones own opinion about what is 'hot' and what is 'not'.
The branch committee, for some time, have debated the opportunities we have of inviting academics to address our members. In early September the committee invited Dr Grant Samkin, from the Waikato University to address the membership on ***International Financial Reporting Standards***.
A process to be introduced by companies in the next few years to replace the GAAP. Grant was very amenable and accommodating to the need to keep the delivery within the capabilities of the audience.
Those members that attended the meeting were impressed with the manner of Grant's delivery. He acknowledged that it was a difficult subject but we understood the basis of the approach and the contrast between this approach and that of accounting principles. The complexity of modern processes in many fields emphasises to 'ordinary folk' the need to keep in touch with experts.

This Spring, the branch has set up an opportunity for its members to attend company AGMs, most of which are in Auckland. A valuable activity for any investor, and for those who have the time and opportunity to travel to Auckland or Tauranga, a worthwhile experience, with the additional bonus of congenial company and time for discussion during the journey.
Alex Eames, Chairman Waikato Branch

Wellington

Welcome to all the new members who have joined recently. It has been a busy few months since the last newsletter.

We were very pleased to have Geoff Brown, Head of Market Products for NZX, speak to our last meeting. Geoff was a great speaker and entertained us with his longer term perspective on the market, and the energy being put into the opportunities within the NZX business. Geoff's focus is on growing the listings, and finding and encouraging exciting new companies to the market, and he ran us through some of the activities he undertakes to make that happen. Last year was a good year for new listings with the Rakon and Delegats floats. The executive was pleased we were able to host a listed company manager, and run a positive informative meeting irrespective of relationships between our National Office and their company.

We have attended a number of company meetings in the last two months, often voting proxies for NZSA. See the separate report on the Tower Bond Holder EGM. We also decided to take up Carmel Fisher's public invitation to hear about Fisher Funds as a "company visit" for the Wellington branch. A number of us had attended these roadshows before and once again we found it enlightening. Do take the opportunity to attend if you can for her team's views on portfolio management, diversification, and stock picking. Those of you who say me collecting two extra sets of goodie bags, pens, and paperwork will be pleased to know they were for two colleagues who couldn't attend, and they have been passed on.

I presented a course to the Institute of Chartered Accountants on "an introduction to the sharemarket" as part of our membership drive. I took the opportunity to push membership of the Shareholders Association as the best advocacy an investor could get for $100 per year!
We look forward to seeing you all at the next meeting.
Matthew Underwood, Chairman Wellington Branch

DISCLAIMER

The comments contained within this Newsletter, or appearing on the Association's website, should not be construed as providing investment advice or recommendations, under the provisions of the Investment Advisors (Disclosure) Act 1996, or otherwise.