

# "The Scrip"

October 2007

The official newsletter of the New Zealand Shareholders' Association Incorporated

## THE TIPPING POINT

Eighteen months ago I published a thought piece, "Vision Leadership and Governance". To summarise the propositions:

- The number one issue facing New Zealand is its appalling savings rate.
- If households do not save, then progressively those households become dependent upon the savings of others to survive.
- Dependency rather than self sufficiency breeds insecurity, despondency, depression, self abuse and crime; all of these social ills start from a lack of self respect, and these start with a feeling of lack of control and this in turn starts from dependency.
- Without savings there is no pool of investment capital available domestically, our nation becomes dependent collectively on foreign capital, and over time this puts at risk our very sovereignty as a nation.
- Our savings rate is not just a bad habit, we have been taught by successive governments that saving is either a bad habit or fruitless. Our current government continues these messages, and to the extent that they have a vision at all, it is a vision of creating a nation of dependents, rather than striving self-reliant citizens.
- A knowledge wave is surging the planet and New Zealand is a swimmer not a surfer, as we do not know how to make surfboards to ride the waves. There is no problem with innovation, we are successful inventors, but we fail to take these inventions to the world. Why? No capital. Why? No savings. Why no talent? Because the opportunities for talent are greater overseas. Why? Because capital is more freely available overseas. Why? Because their cost of funds is lower. Why? Because New Zealand has higher interest rates. Why? Because we are perceived to have a high risk attached to our economy, and why is that, because we are reaching debt and foreign ownership saturation.

Things can be done. I listed some ideas. I circulated the articles to all of our politicians. I got no reply, I sent it again. Finally a reply from New Zealand First saying they have considered it fully at caucus, but they have no ideas of their own. National silence. Labour's caucus in rapture of their Prime Minister, silence. I then sent it to the cabinet. Four acknowledgements, finally a reply from Dr Cullen who described my thought piece as portraying a despicable little economy.

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What is needed is an accord on what is to be done to redress savings. It must be parliament wide so that changes in the administration of our country do not result in changes in direction or vision. What needs to be done?

- Incentives to save and invest. Kiwi Saver is not enough and does not help those who cannot contribute.
- Welfare reform.
- Education reform.
- And work out how to build a surfboard to ride the knowledge wave.

Unfortunately we do not have much time as a nation to do this; we cannot wait for an election to achieve this accord. Debt saturation at least at the consumer level is more or less upon us, and the tipping point is close. Five or Six finance companies have fallen over since I first wrote this article, all but one in the consumer finance sector, falling over on the back of customer defaults. Wide spread consumer default is now upon us.

If you are concerned, write to your MPs, request meetings with them, ask them what their vision is; ask them why they sought election. If they do care, and I am sure individually they all do, ask them why then collectively they cannot find agreement. If it is because their respective leaderships are overbearing and the caucus processes are frustrating, suggest that this is in their hands to change.

What is certain is this, we all care about our future, but the actions to date are not enough and are not broadly adopted by all those in parliament. Remind our leaders that our future is in their hands individually, they have the power to take action and if they fail their legacy to the people of New Zealand will be remembered, probably on the afternoons of ANZAC Day when we and our Australian friends, under one flag, remember.

***Bruce Sheppard***

## THE FINANCE INDUSTRY IN NEW ZEALAND

The US is not the only Nation to be confronting a household debt crisis. We too have a sub prime lending market and it managed by our collective bag of finance companies. The collective sum of savings at risk in this sector is reported to be \$16b. Put another way nearly a third of the total value of our stock exchange, just over 10% of annual GDP, and \$4000 for every man woman and child in the country. The US situation is nearer US\$500b. On every measure, a significantly less than of our own problem with sub prime debt. NZ's position is 4 times worse that the American situation, which has brought on a global confidence crisis. Work out for yourself what that means for economic outlook domestically.

While this sounds brutal, it is the investors themselves who are to blame. For the last 15 years investors have poured money into this sector without demanding compensation for the risks they are taking, and worse having no desire to understand the risk. Investors lacked the will or the capacity to objectively assess what they were doing. This basic lack of financial literacy within the population allowed this bubble of lending to accelerate. So now for a quick and selective chronology.

During the 1980s, interest rates at the bank for depositors were routinely in excess of 18%. With high inflation and tax at 33% the real return however was negative. It was better to buy assets. However a large portion of the population chose bank deposits over assets and got used to a very high headline rate of interest. They lacked the financial literacy to understand that in fact the Crown was stealing their money insidiously through inflation and taxes.

When interest rates (and inflation) fell in the early 90's, these investors saw interest rates drop. It was therefore very tempting to respond to adverts promising high interest rates. Initially finance companies offered a high rate relative to the banks. They also lent out at a high rate and on prudent terms. In short investors and companies got paid for the risk they were taking. Then of course others followed and finance company liquidity increased faster than they could lend it out. So the interest

rate paid to investors progressively dropped to the point where the margin paid above the bank rate made no sense at all.

Then you have the financial advisors. During the late 80's a bunch of Life Assurance salesman who saw the writing on the wall in selling insurance (whole-of-life assurance was always a dumb product because it confused risk and saving), thought that the next wave would be to organise the public's saving and investing habits. Out of this grew a fund management industry and financial advising "profession" that sold the public modern portfolio theory and efficient market theory, which ensured that all that followed the recommended model would in the words of Warren Buffett "do average less costs". Practically this approach has over the last 10 years produced after tax returns for most investors of less than what they would have enjoyed out of a bank term deposit.

So guess what happened? The salesman (they call themselves a profession) gave you some financial information, sometimes dressed up as education, took your money, you paid nothing, and the people they gave the money to paid them a commission. Now this would not be a problem if every investment paid the same commission rate, but of course they don't, some syndicated property transactions were paying up to 5%, Bridgecorp 3%, and don't fool yourself, investors ultimately are paying the commission. And this model is exactly how the Life Assurance industry did and still works, the more you think things change the more they are the same.

So what did these advisors do? They sold investors the belief that finance company bonds were a fixed interest security and allocated significant lumps of investment capital into the sector. Sure some of them spread it around so as to diversify risk, while others piled into Provincial and Bridgecorp because of the high commissions. In terms of hypocrisy it is interesting to note that the planner who whines about other planners who funded Bridgecorp was a major recommender of Provincial.

Sure these bonds have a fixed return, but the security is a facade. What you have when you buy finance company bond is a quasi equity in terms of risk, and if you are accepting a fixed return for an equity risk you have just sold your upside short.

So as big lumps of money came into the finance companies what did they do? They didn't leave it in the bank; they had to get it out "working". So the credit criteria were loosened. Commissions were paid to finance brokers without recourse, car dealer were provided funding lines without having any responsibility for the loans they wrote, Provincial would for example lend to people with bad credit reports so long as they had no actual defaults at the time of the loan. Why would you lend to someone who has demonstrated an unwillingness to pay? This however is just one example. There are many. Here is a lesson for finance companies, sometimes it is better to do nothing and go on holiday that does dumb stuff just because everyone else is.

So the problem is this; investors and finance companies alike behaved like uninformed irrational Lemmings.

### ***So how do we fix this and what should investors do?***

- We do not need more regulation we need more common sense.
- In the short term to avoid a melt down the Reserve Bank should be empowered to review the lending practises of all finance companies and those that get a tick should be given a liquidity guarantee from the Reserve Bank, if they have to call on the guarantee to meet depositor demands then they should pay a rate appropriate for the risk. (I.e. a high one).
- If the Reserve Bank did in effect provide a guarantee on good finance company notes, it would ensure that the good companies don't go down with the bad when the run on funds really gets momentum.
- Identifying the bad ones early, which this process would help, is a good start to an industry clean up.
- In the short term the trustees for the debenture holders need to do their job, properly. Many have been asleep at the wheel.
- Investors need to wake up and realised that to survive they cannot ignore the basics of financial survival. The NZSA will next year launch a comprehensive financial literacy programme. Our

programme will be funded with charity funding, not bank sponsorship or the like. Our programme will not be an infomercial.

- Finance companies need to simplify their prospectuses. You can judge an investment in a finance company quite easily if you know what their lending criteria is, this should be published and no loans should be written outside of the lending criteria, including to related parties. If investors don't like the way they lend they don't invest. In addition they should disclose the total of all loans outside of lending criteria and update this monthly, so that investors have a feel for the level of risk that is building up in the loan book.
- Long term Reserve Bank scrutiny, clear covenants and reporting obligations to the trustee for the investors, and trustees that act should do the trick.

***Bruce Sheppard***

## CREDIT RATING AGENCIES

Several members have asked about Credit Rating Agencies over the past few months. The Government has placed some emphasis on credit ratings as one method of protecting depositors and investors in finance companies. Iosco (International Organisation of Security Commissions) has recently promulgated a code of conduct for credit rating agencies, which covers the conflicts of interest between the awarding of a credit rating and the offering of other consultancy services, the same issue as faced auditing after the Enron collapse in USA. They have noted that key agencies such as Standard and Poor and Moody often refrain from explaining their methodology when giving a rating, and one submission says clearly that credit rating is an art not a science – ultimately, “an opinion.” We think all rating agencies operating in a market should explain their methodology on their website.

From an international perspective the big three in ratings are Standard and Poor, Moody, and Fitch. It is acknowledged that anything below an A rating from them is “speculative”. Of the 16 New Zealand banks, only one, TSB, falls into that category and it is a high B. These huge agencies are concerned with outside political influences on their work. For example when the USA Government instituted sanctions on Iran, Moody immediately withdrew its sovereign ratings. Big agencies also assign ratings from publicly available information without consultation, and are investigating the need to acknowledge Pd (public data) ratings as distinct from solicited ratings. Ratings are big money and bond issuers in USA pay millions of dollars for licenses to use Moody and S&P ratings. It is a far cry from our little market with its high-risk, small-scale capital raisings.

Corporate credit ratings involve the legal, qualitative, financial and non-financial evaluation of the company. They are formal independent evaluations of the company and its ability to meet obligations of commercial debt or the repayment of capital to shareholders. They are supposed to provide risk signals for investors, lenders, fund managers, banks, insurers, municipal and government authorities, lessors, and international trading partners. So why do they sometimes appear deficient in this?

Firstly, in our rapidly moving markets, a credit rating based on historical audited accounting reports will be out of date almost as soon as it is published. This does not however, deter a company which commissions a rating from using the dated opinion long after it has been assigned. We have also seen the rise of a new generation of software packages providing instant assessments using a company's balance sheet and income statement. Rapid Ratings™ for example attracts business in a variety of markets because its opinions are offered quickly and cheaply by comparison with the bigger names. Finally although the trading environment is part of the evaluation even in these quick-fire assessments, important general conditions are often omitted. For example in the recent sub-prime finance company collapses, the effect of Australian-owned banks awash with overseas cash lending beyond their traditional markets over 100% of a mortgaged property, and inviting the funds to be used for purchasing cars, holidays, and business ventures was not part of most credit assessments.

What can NZ Shareholders conclude from this? Firstly, recognise that Credit Ratings date and keep checking the current liquidity of your borrower. If you don't know how to assess liquidity, ask your adviser, or attend one of our courses. Keep assessing the general market conditions surrounding

your borrower, and try to assess whether the risk is increasing or declining. Consider seriously whether you would be better to invest cash in a portfolio of shares or keep a balance in low risk deposits. It is a sad irony that many of those caught in the collapse of eleven finance companies felt that a deposit secured by debenture (a junk bond,) was a much safer bet than ownership of shares in a company.

**Alan Best**

## ANNUAL REPORTS

Readers will be aware in the case of some of their investments that listed companies have, since late July, been forwarding their Notices of Meeting without also including any annual reports. We thought that it would be helpful if we explained very briefly what is happening in the corporate world.

There is now a world wide push to try to reduce paper work wherever possible and in most developed countries it is now no longer necessary for companies to send shareholders a copy of their annual report. In prior years there was a move to reduce this paperwork by providing shareholders with a copy of a concise or abbreviated annual summary in place of the annual report. In July our Companies Act was revised to bring us into line with most of the rest of the world. This initiative is partly due to the increasing popularity and usage of computers and the ability of individuals to download information quickly in their own home or office. It is also in part due to the more complex information required from companies to the extent that the annual report of say HSBC Holdings is now more than 450 pages in length and weighs in at close to 2Kg. One wonders too whether the fact that shareholders by and large hardly ever read these tomes weighed on the thought that perhaps a more critical view should be taken on their continued distribution.

As a matter of interest readers should also be aware that much of the changed New Zealand legislation arises because we belong to organisations such as the International Organisation of Security Commissions (IOSCO) and their charter obliges all members to follow the dictates of members.

Now back to the annual report. You should know that the annual report is still a requirement but **it is now up to the shareholder to ask for a copy**. The Act now states:

'The board of a company must send to every shareholder of the company, not less than 20 working days before the date fixed for holding the annual meeting of shareholders,-

- a) a copy of the annual report; or
- b) a notice containing the statements specified in subsection (3).

The notice ..... Must contain-

- (a) a statement to the effect that the shareholder has the right to receive from the company, free of charge, a copy of the annual report if the shareholder, within 15 working days of receiving the notice, makes a request to the company to receive a copy of the annual report; and
- (b) a statement to the effect that the shareholder may obtain a copy of the annual report by electronic means; and
- (c) a statement as to how the shareholder may obtain a copy of the annual report by electronic means (for example, from a specified website address); and
- (d) a statement as to whether the board of the company has prepared, in relation to the same accounting period as the annual report, a concise annual report.....'

Similar regulations deal with a concise annual report and have not been repeated here.

We thought that it was worth stating in full the changes made to this portion of the Companies Act so that you are aware of your revised rights.

We will conclude this piece by remarking that on the one hand we are all being urged to take more care in financial matters and read investment statements and prospectuses more carefully and on the other, arguably, the most important document of the year now has to be requested by shareholders.

# REPORT FROM THE CEO

At our AGM in Tauranga we announced a series of strategic initiatives which will take the activities of the NZSA to a new level and focus. We are pleased to announce steady progress on all three fronts and expect to have some solid outcomes by Christmas.

## **Research Scholarships**

In order to strengthen our research capability we have decided to partner with leading universities to establish scholarships. This will provide us with postgraduate students who will work for the NZSA whilst they complete their thesis.

The plan is to have an independent organisation provide funding for the scholar. The university will match this funding and provide the scholarship structure and research supervision. The best part is that a major Funds manager will host the scholar in their offices and provide facilities and research support, in particular the “grey hair and wisdom” necessary for practical research.

The NZSA will have 600 hours of research time from the student at no cost. This will be under the direction of our NZSA Research Director who will set up an annual research programme in conjunction with the University. This will give us resources to support branches in their advocacy roles at AGM’s and other issues and events as they arise.

We currently have agreements in place for two scholarships and are working on a third so watch for announcements in late October as we want to have the whole process in place by Christmas - 2007

## **Financial Literacy Education Programme**

Over the last 5 years the NZSA has run successful investor education programmes for over 300 people under the management of Graham Wilson. With his support we are currently reviewing the programmes with the intention of taking it to a larger audience and to change some of the teaching methods.

This will require substantial investment if we are to achieve our goals of taking it to tens of thousands of people like tertiary students and the public. We are currently working on proposals for funding and expect to hear in December. This mean we could revise and relaunch the programmes by May 2008.

In the meantime, please continue to support delivery of the current programmes, and we expect to have even greater involvement of our membership in the future delivery of programmes in your region.

We hope to have some good news in December and will give you a comprehensive update when we know we have sufficient funding in place.

## **mydirector**

As you are aware we are building a reputational website for people to provide feedback on the performance and reputations of directors in New Zealand. It will be called **mydirector.co.nz**. Currently we are working on the high level design and talking to website and database builders to finalise design and the costs involved.

We have already raised sufficient funding from donors to build the site and have it running in early 2008.

Our primary concern is to build an authoritative site that has the support of the investment community and attracts sufficient ratings to provide valid feedback to the market. We do not want a “blog”, chat room or negative site which invites endless bitching from the disgruntled. We have received a lot of positive support , and funding on the basis of our proposed design and operating model

Watch for progress updates on the NZSA website but you will not hear any public announcements until we are ready to launch.

**Kevin McCaffery**

## AGMs

### **Air NZ AGM 28 September Wellington**

The 68<sup>th</sup> Annual General Meeting of Air New Zealand was held at the Te Whaea National Dance and Drama School in Wellington, formerly known as the Winter Show Buildings.

I knew I had the right place as an Air New Zealand flight crew greeted me, and this theme was maintained right up to the start of the meeting when a flight attendant gave the 120 shareholders in attendance a safety briefing. By this stage I had already stowed my baggage under the seat in front of me – more legroom than in your average cattle class flight.

Air New Chairman John Palmer kept the theatrical tone alive during his address by starting off with a promotional video followed by a video of Air New Zealand ground crew doing a haka for the World Cup bound All Blacks. The point of this was to show that morale in Air New Zealand was recovering well from the restructuring of the last few years.

The record 2007 NPAT of \$268 million was achieved in spite of fuel prices increasing from 14% of revenue in 2003 to 26% of revenue in 2007. Annual savings due to the restructuring were \$324 million vs. the target of \$245 million and the balance sheet is stronger than ever with a billion dollars in cash and gearing at 47.3%. Not a bad result considering the perilous state of Air New Zealand in 2002.

Given the good performance a special dividend of 10c per share was declared, in addition to the 8c a share dividend (interim plus final).

John Palmer explained why Air New Zealand is seeking shareholder approval for a series of purchases and options to purchase Boeing 777-300 ER and 787-9 over the next seven years. The aircraft are needed to allow Air New Zealand to compete effectively – the extended range allows them reach many Asian and American destinations non-stop, and they are more fuel efficient than current aircraft. Shareholder approval is needed as when considered together the purchases and options are a very large transaction – more than half the value of their assets before the transaction.

CEO Rob Fyfe spoke next, explaining that revenue and passenger number growth was driving the increased profitability. Contributing to this was growth in the long haul business and a focus on optimising routes - code sharing or culling those that are under performing and adding capacity and routes where there is demand.

Looking forward more of the same and a make over of Air New Zealand's domestic service including faster check-ins, premium seats, more cheap seats on grabaseat ([www.grabaseat.co.nz](http://www.grabaseat.co.nz)) to make life hard for Pacific Blue and themed flights!

We then had the pleasure of watching a video selling Air New Zealand's commitment to the environment – a bio fuel pilot with Boeing, lots of efficiency and recycling, and helpful tips to passengers such as save fuel by taking less baggage. The one tip notable by its omission was how to save fuel by reducing the number of flights you take.

All resolutions were passed. There were a number of questions from shareholders, the more notable were answered as follows:

- No plan to move to triple bottom-line accounting – Air New Zealand reports on these issues anyway.
- The charter business is not a core business for Air New Zealand – it is used only as a way of keeping aircraft busy that would otherwise be idle.
- International flights from Palmerston North were discontinued because they were unprofitable.
- Expect an announcement within the next six months on plans for carbon credit offsets.
- No comment on what the board will recommend to an incoming government in regard to maintaining or reducing the Government's stake in Air New Zealand, but John Palmer did note John Key (Leader of the National Party) is on record as saying a National government will keep a majority stake in Air New Zealand.

### **Martin Dowse**

### **Barramundi AGM 13 September**

This was conducted with Rob Challinor's usual verve. He told the meeting that the September 2006 IPO was well oversubscribed which may have led to a large premium to NTA for the first 6 months.

Since then the share price has registered up to 10% negative to NTA. The new PIE legislation means that the organisation can operate with a single company rather than three.

Carmel Fisher then outlined the investment strategy, which is identical to Kingfish – eg to seek growth or overlooked companies of medium size which are under the radar of the major broking houses –thus shares are not fully priced.

The average profit growth of the investments for the year to June 2007 was 40%. The forecast growth for the next 3 years is 33% compounded or 135% in the period. Outstanding growth from Arrow Energy 168%pa & Bravura 61% pa.

The report shows the capitalisation & 2006 profits of the investments. This shows some very high PEs but the growth above will reduce them. In future they will consider bringing the results up to date (eg the current year profit & capital value)

They focus on the company opportunities & achievements rather than the “mood of the market”. They carry out regular visits to the 14 companies in the portfolio.

In answer to a question Rob Challinor stated that normally dividends would be about 2% (cash income) but profits on investment sales might be distributed or reinvested.

**Tony Sullivan**

### **Dorchester AGM August 2007**

The meeting held in a swish hotel was not as well attended as usual. The after match function was less well catered than usual, and very few hung around.

With the turmoil surrounding the finance sector the board and CEO were upbeat while also trying to be realistic.

During the presentation the following was announced.

- Projected dividend for 2008, steady on 9c, presumably fully imputed.
- Projected profit for 2008, up by 100% to \$6m.
- Non core businesses will be sold, specifically the consulting and publishing business of the Equity group.
- The Hamilton branch has been closed and others will follow, the company is exiting the car market in Auckland.
- Liquidity is sound and the company has \$28m in the bank.

The theme of Andrew Walker and Barry Graham’s address continued last year’s approach of blaming previous management for the “legacy issues” that pulled back profit in 2007.

A bit of a surprise occurred when the resolution to increase director’s fees was lost. I had a bet (a good bottle of Red) with Barry Graham before the poll result was called that he would not find anyone to join the board in the next twelve months, after all they have been trying to 2 years now so it seemed like a good bet and Barry of course was cockily confident. He accused me after the meeting of cheating as our vote was the vote that defeated the directors’ fees increase and he is now complaining that he doesn’t have the money to pay anyone so he can’t succeed in recruiting and it is my entire fault.

The preoccupation of the Board with Brent King and what he did or didn’t do is sickening. After the meeting I was told that files had been delivered to the SFO regarding King’s conduct, and further the board was considering suing previous management, read King. The venom of Hugh Green to King has inflected the Board and the personality crusades continue. It is costing the company dearly through an apparent lack of focus.

I am of course a bad reporter so my reporting of facts now stops and I am moving to comment and opinion.

Last year the new CEO put a coat of paint over the brand and told shareholders all was good.

This year he is blaming previous management for declining profits when in actual fact it appears to be declining activity, and further the bad things from previous management neutralise with the good.

He is planning to now cash up the group; Senate Finance is for sale, as will be the property trust units, and presumably the management rights. What the group will be left with at the end of this process will be a loan book of equipment finance and property.

The property finance group will be anchored in the activities of St Lawrence. The option to increase the ownership of St Lawrence to 50% will probably be exercised this year using the proceeds of asset sales. It will be interesting to see how the trustee for the debenture holders reacts to its lenders funds being used to pay for goodwill.

Podmore the St Lawrence representative on the board does not sit on the credit committee when property loans are approved due to his company operating in the same space. You will recall that Petricovich was seen off with the board citing his conflict of interest in property lending. Podmore has the same conflict. Hypocrisy. Now Dorchester is expanding its property book and the only board member with experience in writing complex property loans is Podmore who is excluded, go figure that. So my bet is that St Lawrence will conduct the property lending activities of Dorchester and Dorchester will progressively move into a fund raising role for St Lawrence.

While Podmore denied that he has plans to reverse list St Lawrence, the net effect of Dorchester's plans is exactly that, an effective listing of a 25 or 50% shareholding in St Lawrence with a fund raising arm attached to it, so that the Dorchester shareholders assume more than half the risk for half the equity return.

***Bruce Sheppard***

### **Infratil AGM 6 August 2007**

Infratil is a leveraged investor which has multiplied an original investment in 1994 19 times to the last annual report. It is a steady achiever, and longterm investor having recently moved out of ports (Tauranga), probably foreseeing the rationalisations outlined by Mark Cairns at our AGM. It focuses on Airports (Wellington, Auckland and 3 in Europe), Energy (Trust Power plus 4 power stations in Australia), and Public Transport (Auckland and Wellington Buses). Infratil concentrates on strategic positioning of its investments, being in the right place at the right time, and consequently publishes very good information on conservation, energy efficiency, and international travel. These reports are available on Infratil's website. Lloyd Morrison's address is always a highlight, and this year he took an overview of energy developments in Australia, the prospect of huge growth in international air traffic with the orders for new 787s from relatively small airlines, and the emphasis on brand improvement in the bus lines.

The meeting re-elected Lloyd Morrison, David Newman, and Anthony Muh without debate, and voted for a continuance of the bond programme which is a successful form of financing for infrastructure assets with their consistent cash flows. Shareholders also approved an increase of fees as follows: Chairman \$120k to \$140k, but he will also receive \$80k from Wellington Airport; other directors \$60k to \$70k

With increased allowances of \$15k for those who are also directors of Wellington Airport, but no increase for directors of European Airports.

Questions from shareholders ranged over gearing (naturally high with infrastructural cash flows,) revaluations over Trust Power's old generating assets, wind energy and buses, fair value of derivatives and financial instruments, but the strongest questions concerned the management fees paid to Morrison and Company by Infratil. These are a reducing scale of fees over the value of the company, with different fees for non Australasian investments, venture capital funds, and incentive fees for gains in international assets. They have been modified over the years to provide greater incentives for overseas success and are different from the special incentives we objected to in the case of Tourism Holdings. In Infratil they have been part of the declared structure of the company from the outset, although not requiring ratification by shareholders when they are modified. The commissions have been used to build up a powerful body of analysts in all aspects of international business –treasury, marketing, accounting, property, and governance. The absence of these engaged think tanks has hampered New Zealand business in the past, and Infratil has lead the way in developing this type of investment approach.

## **Rakon AGM 10 August 2007**

This is one exciting, thriving company! This was the second AGM since Rakon became a public company in May 2006 and it has been added to the NZX50 Index in that time, having established itself as potentially a core portfolio growth stock. The company has shown its capabilities to add shareholder value.

Much has been achieved during the year; including the acquisition of the Frequency Control Products (FCP) division of European based C-MAC Micro Technology for US\$37 million. The FCP business is complementary to Rakon's existing business and will provide Rakon with leading market positions not only in the supply of crystal oscillators to the GPS industry, but also to the telecommunications network timing and synchronisation and aerospace markets. The purchase of FCP doubles revenue and provides access to new markets and new products.

For this purchase Rakon raised funds through a capital raising – and there was overseas interest which proved that being listed in NZ had not hindered the company's ability to raise global funds because the global investment community is excited about the company's opportunities.

**Revenue and earnings:** Operating revenue grew by 43% to \$106.2 million. Revenue has grown at an average compound rate of 25% since 2002.

EBIT was \$16.5 million, up 85% on last year

Net surplus after tax was \$10.6 million, up 122% on last year.

In addition to top line revenue growth, earnings were boosted by new lower cost product designs, lower material costs and business efficiencies achieved not only by production volume growth but from continued investment and improvement in equipment performance and automation.

High NZ currency may impact reported profit; however the earnings overseas remain strong.

**Products:** Investment in research and development is continuous at Rakon with many new product developments in the pipeline. The GPS market remains a strong focus and Cellular GPS has finally started to show some signs of ramping up into real volumes. New product releases are Pluto and Barracuda TCXOs which are designed to meet requirements in the emerging femtocell market.

### **To quote from the Chairman's speech:**

"To understand the Quartz Crystal business, at its very basic, it is important to recognize that virtually everything electronic requires some sort of timing device in order for it to operate.

This timing device can act like a human heart in an electronic circuit, pumping information around a circuit; it allows microprocessors to work and computers to function; it can be used to encode and decode simple or complex signals, enabling us to communicate with one another; it can even help us to tell the time.

The scope and scale of the need for such timing or frequency control devices is really only limited by the boundaries of mankind's imagination".

By way of background the Chairman read a couple of paragraphs from a comprehensive article in the April 28th issue of the Economist entitled "When everything connects":

The opening paragraphs reads:

"The wireless was once a big wood-panelled machine glowing faintly in the corner of the living room. Today's wireless device is the sleek mobile phone nestling in your pocket. In coming years wireless will vanish from view, as communications chips are embedded in a host of everyday objects. Such chips, and networks that link them together, could yet prove to be the most potent wireless of them all. Just as microprocessors have been built into everything in the past decades, so wireless communications will become part of objects big or small. The possibilities are legion. Gizmos and gadgets will talk to other devices-and be serviced and upgraded from afar. Sensors on buildings and bridges will run them efficiently and ensure that they are safe. Wireless systems on farmland will measure temperature and humidity and control irrigation systems. Tags will certify the origins and distribution of food and medicines. Tiny chips on or in people's bodies will send vital signs to clinics to help keep them healthy".

The closing paragraph reads:

“What is different about new wireless communications is that people will barely notice them. Machines will talk to machines without human intervention. But humans will nevertheless be laying the foundation of a new infrastructure which, like the electrical power grid, will become a platform for subsequent innovation. There is no saying how it will be used other than that it will surprise us.”

This “wirelessness” is what gives Rakon Directors considerable confidence about the opportunities for growth that Rakon technologies and energies can harvest for the future.

**People:** Rakon now has a team of over 800 people worldwide with good knowledge and skills across all the businesses – and it has in place share option plans for long serving staff and senior members. It is finding that a lot of good people want to come and work at Rakon which is pleasing.

**Manufacturing:** Rakon announced that it will undergo manufacturing expansion in China, as it views direct investment in certain important regions as a vital part of being geographically close to its markets. So Rakon will build a factory in China – a new facility which is in the planning stage together with its existing Chinese business partner. It is important to understand this is not a shutting up of its existing NZ manufacturing, but an expansion of Rakon’s global business.

There was a question from the floor on the company’s nil dividend policy: Would this change and could Rakon look at bonus shares in the future? Rakon replied that on listing it did not see dividends as vital, as its strategy was to build a global growth company and profits were needed for this expansion.

**Jacquie Staley**

### **Ryman Healthcare AGM 3 August 2007**

There was a good turnout of shareholders to this mid-afternoon meeting, followed by a welcome afternoon tea.

Chairman David Kerr addressed the meeting and Chief Executive Simon Challies introduced his management team and answered questions. Together the following comments were made:

#### **Financial:**

- \* Solid 15% growth for the 5th successive year and on track to achieve 20% growth this year.
- \* Net surplus up 18%, ie an increase of 6.5 million on the 2006 result.
- \* Increase in the dividend from 3.4 to 4 cents (allowing for share split).
- \* An 18% increase in company equity.
- \* \$1000 invested in 1999 now worth \$9034.
- \* From September 2007 the company will use the new reporting standards called IFRS (International Financial Reporting Standards). During the transition period both IFRS and GAAP (NZ Generally accepted Accounting Practice), results will be given.
- \* Property price increases/decreases not expected to have any affect on sales and statistics give confidence as 495 000 people now 65+, expected to grow to 1 million by 2031.

#### **Villages:**

- \* Target of building 300 village units and 100 care beds per year for the next four years ie about 2 new villages per year.
- \* Well positioned for future building with a good land bank in place. No decision on the Dunedin Highgate property which did not get resource consent. The new Edmund Hilary Retirement Village in Remuera will be home to over 500 residents when completed.
- \* Of total units sold each year Ryman properties account for 10% (up from 6% on previous year).
- \* Significant capital raising and higher interest rates may have lead to recent price decrease.
- \* All design, construction, management of properties done in-house.
- \* 3000 residents, 1500 staff, 17 properties.

#### **Patient Care**

- \* Triple A exercise programme designed for residents.
- \* Retirement Act now in force meant the introduction of a code of practice and lifted the level of protection for patient rights. RHC had no trouble meeting these standards giving everyone security.

This years good result and future sound prospects earned the directors an increase in fees from \$280 000 to \$380 000, with no dissent from the loyal shareholders.

***Pam Hurst***

### **Telecom AGM**

It was the first time that Telecom had held its AGM in Dunedin and most fitting in view of the fact that new CEO Paul Reynolds is a native of Glasgow, Scotland. It gave me a chance to give him a welcome in Gaelic and to make him feel really at home by donning my "See you Jimmy" hat as worn by members of the Tartan Army Supporters when following their team. This had the immediate effect of getting the paparazzi in to a frenzy of flashing cameras. There was then no doubt that the NZSA was present at the meeting. It even made the 6 o'clock News that night. Whilst on my feet I took the opportunity to express the thanks of the NZSA to Telecom in promoting the benefits of membership to shareholders which had resulted in a good gain in new members. Wayne Boyd, Chairman, confessed to me later that he had taken a lot of flack over sending out that letter but that he was still firmly of the belief that a strong shareholders association was necessary.

Wayne Boyd spoke of the changes that Telecom had already implemented and of the changes and challenges facing the company with new technology, competition and regulatory changes. Paul Reynolds drew up all of his nearly 2 metres in height (where was he on Sunday morning against the French) and explained to us how British Telecom had faced a very similar situation in the UK and which he considered BT had weathered and come out the other side in a stronger position in regard to the shareholders. We hope he is proven right in regard to Telecom Shareholders.

The majority of items on the agenda revolved around the re-election of Directors Michael Tyler, Murray Horn and Ron Spithill. Shareholders were also asked to elect Paul Reynolds as a Director but this first required an amendment to the Constitution to allow in excess of 50% of the Board to be non-resident in NZ. I asked the question as to what were the benefits of the CEO also being a Director. The answer was a bit of a fudge about the CEO has traditionally been a Director and that it is usual in Public Companies to have a Managing Director. Another reason given was the ability to sign off various certificates as a director. Max Smith and I were not fully convinced that these reasons were sufficient to require a change to the constitution but we were on a no-winner on this one so let it ride.

Max Smith then sought clarification on the matter of the 10 return trips to the UK for the CEO. It was explained that as there was five in Paul Reynolds family this would only entitle the whole family to a maximum of two trips to the UK. Our initial concern was that the new CEO would be spending a large portion of his time on an aircraft between the UK and NZ and not attending to his duties as CEO. We were assured that this was not the case.

The matter of the CEO's remuneration was brought up and as was to be expected a couple of shareholders spoke against the motion. It was pointed out that this was the going rate to get someone of the calibre of Paul Reynolds and as he had started in his job it was a bit late to attempt to adjust his remuneration.

Paul Reynolds has already gone on record as stating his objective is for Telecom to be "getting things right first time every time". With in excess of 40,000 customers and 6000 employees it can be seen how important this is going to be for the future of the company. Paul expects it will take him until February 2008 to sort out his vision for the company and to report back to the Board and of course the shareholders. The industry worldwide is faced by massive technological changes and pressures. Indications are that profit for 2008 should be in the \$950 to \$975 million bracket. The Audit Fee this year was higher than usual due the need to comply with U.S Listing requirements.

After hearing the various qualifications and experience of the individual directors and speaking to most of them personally at the after match bun fight I arrived at my own personal opinion that the company is lucky to have such a wide cross section of experience on its board and a new CEO who is confident of leading the company forward in to what is very much uncharted waters. I came away from the AGM feeling much more comfortable about my investment than when I went in.

***Ritchie Mein and Max Smith***

# BRANCHES

## Auckland

About 80 members turned out to hear Kevin McCaffrey and Jim Delegat at our meeting on 15 August. Kevin gave us a preview of his presentation for the Association's AGM in Tauranga. He understands that if we are to develop small "hit squads" of members, who can use background research on companies to question the boards on both their performance in the past, their human talents for the present, and their direction for the future, we need well founded research. To have access to graduate researchers, sponsored by various funds and universities in all the main centres is a grand step towards informed shareholder activism. His view of a comprehensive education programme, built on the blocks of Grahams successful modules, but modified for teachers, computer-aided learning, and different levels of schooling, and then implemented by a "Dads' Army" of NZSA members, will keep us busy for some time. Then again the My Director programme which builds on our fundamental aim of monitoring and evaluating the performance of board members could be the start of a serious rethinking of the composition of boards in New Zealand. It is important that Auckland Branch takes ownership of this vision of the future, involving itself particularly in the "hit team" and educational part of the vision. Auckland members' suggestions on the implementation of the projects should be made to Kevin, or Des.

Jim Delegat presented us with his classic story of niche marketing to world markets within our wine industry. Based on consumption figures from various countries: France 120 L/capita, Japan 3 L/capita, USA 6 L/capita, Jim showed that wine purchases could continue to grow around the world provided makers understand they are part of a fashion market concerned with consumers' aspirations, and not simply a another commodity for the supermarket trolley. Delegat's emphasis on the four factors, (a) Oyster Bay brand, (the world's your oyster), (b) in-market distribution, with offices in all major markets working closely with major retailers, (c) measured supply side management, (vineyards), (d) Uncompromising control of product quality, were the key ingredients of success. Now in UK, Delegat's representatives develop an annual business plan with merchandisers, and Oyster Bay has become the number one wine brand, as the largest selling brand in the over 5 GBP price range, Number 1 in Canada, and number 1 bottled wine by value in Australia. Jim fielded questions about the need for strategic planning with the long lead time between planting and payment for bottled wine, about biosecurity, about the high proportion (85%) of exports to total sales, and about the proportion of subcontract growers in the total supplies of grapes.- all in all, a fascinating case study for all students of marketing.

Over 160 members turned out on a wet night to Auckland Branch's October meeting. Des Hunt introduced the new Branch Chairman, Ken Cook; Oliver spoke about proxies, and Chris outlined the plan for Corporate Advocacy Teams (CATs), and need for a research coordinator. However, the crowd was there to hear Brian Gaynor's take on the current NZ market.

Brian began on the anniversary of the 1987 crash with the question, "What has happened since?" While the Australian market cap has grown by 600%, New Zealand's has grown by a paltry 45%, and we still have to find 130 listed companies to make up the number listed in 1987! The 8 largest companies then were capitalised at \$350 billion, while today, the top 8 (very different, largely government spin-offs) total after all the intervening inflation only \$303billion. In Australia financial assets including equities form 39% of household wealth, while in New Zealand they comprise only 21%, the balance 79% being invested in dwellings.

We need far more savings and risk capital, more individual risk takers prepared to grow and stick with businesses, and more directors and managers with the vision to create large international companies. Too many of our business leaders lack the ambition to stay with growth businesses and have been too easily persuaded to sell out to foreign bidders. Perhaps we should be less niggardly, and pay much bigger incentives to import overseas executives with proven expertise. Brian had quizzed his team at Milford and they could identify only 12 companies of our 158 with real ambition to lead internationally in their chosen field. Several others had moderate ambition but were too small. Only 23% of surveyed investors felt that our sharemarket would show small gains in the coming year

(compared with China at 70% of investors) and even Mark Weldon seemed to have doubts recently about our ability to survive as an independent stock market.

It was a depressing picture but one which challenged all members to “ginger up” these New Zealand boards, and support those which are prepared to exercise vision and leadership.

### ***Alan Best***

#### **Bay of Plenty**

On 17 August, the Association's AGM was held in Tauranga. The morning's programme was run by the branch. A well received departure from the usual format were presentations by four local listed companies, Comvita, Port of Tauranga, Seeka Kiwifruit Industries and Trustpower, followed by a quality presentation by Brian Fallow, the NZ Herald's economic reporter.

The National Executive ran the afternoon programme, which featured the election of a new director, Alan Best, the adoption of a new constitution and the appointment of a CEO, Kevin McCaffrey, who presented his comprehensive and wide ranging vision of how he thinks our Association should move forward to a new level of performance.

On 31 August, 30 members of our branch were privileged to be the guests of Seeka Kiwifruit Industries Ltd (SEK) for a company visit. During the visit we were taken around four quite different venues. SEK is New Zealand's biggest kiwifruit post harvest operation, packing 27% of New Zealand's kiwifruit. The operation includes 12 packhouses and 20 coolstores. SEK is also New Zealand's biggest kiwifruit orchardist with over 1250 ha of leased or managed orchards.

The first stop was at 60year old Green orchard that was still producing fruit economically. The second stop was at Oakside, where we saw the state of the art, high speed nine lane grader, where the primary grading is done by digital cameras, taking 28 shots of each fruit. The labour requirement is now half that required a few years ago. The third stop was a young gold orchard one week into budburst. It looked a picture.

Stop number 4 was for a concise visual display and presentation of the company's productive and financial performance by the CEO, Michael Franks, after which we enjoyed the company's hospitality. We were impressed by their resourcefulness and attention to detail in all aspects of their operation. Like all exporters the company is subject to the influence of New Zealand's exchange rate. SEK is a well run operation that has a record of paying good dividends.

A discussion group is scheduled for 28 September, when it is due to discuss Ryman Healthcare and Skellerup, and have a free for all on "the share trading experiences of a new trader".

Our Christmas Dinner is planned to be a buffet meal on 20 November.

The branch couldn't get any enthusiasm for a make believe share club, ie with no money involved, but rising from the ashes of that idea is a fully fledged share club (20 members) using real money. A great learning curve for those who participate. We wish them well.

Some time next year the branch is committed to running a session on the subject, “How does the remaining spouse manage the portfolio if the current portfolio manager becomes incapacitated.”? If anyone has any ideas on how to handle this subject your contribution would be most welcome.

### ***Lloyd Christie, Chairman***

#### **Canterbury**

We have a busy few weeks ahead of us with the Company Reporting Season getting in to full swing. Max Smith and I travelled down to Dunedin for the Telecom AGM. Coming up shortly, we will be having the Contact Energy AGM in Christchurch, and then on 29 October, it is the EBOS AGM at the Addington Raceway. I will be the Proxy Holder at both meetings. By combining members proxies, it gives the NZSA much more clout at these AGMs. I understand that Director of Research Alan Best may be coming down to lend some weight to our resistance to the re-appointment of Tim Saunders to Contact's Board. It will be a good opportunity for members to meet Alan in person.

On 24 October, we will be visiting Ryman Healthcare's new facility of the Anthony Wilding Aged Care Home at Aidenfield. A chance for some of us to see what facilities are available when we reach the stage of needing care and attention.

Next month, probably about the 20<sup>th</sup>, we hope to arrange a visit to SYFT Technology. This will be a unique opportunity to see Canterbury's world leading technology in action. We shall advise members of details once they are finalised. We are working on something different and interesting for December for our wind up for the year.

Last month we had a question and answer session at Fendalton Croquet Club. Despite problems experienced by members in finding the venue and a bitterly cold evening, we had an excellent turnout of members who raised some interesting questions and came up with some innovative answers.

**Ritchie Mein, Chairman**

### **Waikato**

A contingent of about 25 Waikato members attended the National AGM at Tauranga. We enjoyed the good range of speakers from the local companies in the morning, followed by an excellent lunch.

Waikato members Keith Tanner (re-drafting of NZSHA rules) and Trevor Barron and Bryan Phippen (Financial Statements review) were thanked for their efforts.

“The Way Forward” initiative announced at the meeting and the appointment of a CEO looks to be an exciting move.

Our thanks to the Tauranga team for their hospitality and their “boomer” meeting as promised. Having helped Graham Wilson on education courses it was nice to see him receive recognition and know that his excellent material will continue to be used in the new education programs.

We look forward to meeting and getting more details of the new initiatives from Kevin McCaffrey at our October 25 meeting. A pity Waikato couldn't hold on to the Log of Wood - maybe he would then have reclaimed his Waikato roots.

The share investment competition group continues to provide its members with a useful forum for their investment ideas. In the present market turmoil, cash has been kept in the bank waiting for stability and bargains. Fortunately the portfolio has only suffered a small loss off its highs.

A successful meeting was held on Sept 20, where Mark Lister from ABN Amro Craig's discussed PIE's. Mark gave a wide-ranging talk and summary of the investment scene as he sees it. One of the points made was that although the government has given the managed funds (and PIE's) tax advantages, investors need to **be wary these advantages are not swallowed up by fees**. Useful strategies were suggested using PIE's and FDR especially those on higher tax rates. Opportunities as an individual investor may be available under FDR – by investing in high yielding Aussie entities subject to the FDR. (such as those outside the ASX 200, stapled securities and trusts) The new changes are quite complex. The 30 people attending certainly got a better insight into PIE's, even if Mark did not add to the 14 people in NZ who fully understand them.

Some members felt the need to hold a special meeting regarding Finance Company failures. However there was little general interest in following through, the feeling being that the horse had already bolted.

The new committee is now well settled. We welcome feedback and initiatives from our local members to enhance your membership experience.

**Robert Foster**

### **Wellington**

Wellington Branch has been business as usual, with a trip to the AGM in Tauranga and a visit from the Association's CEO as variety.

Our regular monthly meetings hosted Director Tim Brown from Infratil, Chief Counsel Liam Mason from the Securities Commission, and two advisors from OMF Financial.

Liam Mason gave us the background to the changes in the Securities Legislation. I found his longer term perspective on the market regulations fascinating. It is a complete antidote to the current rushed process, odd outcomes and fraught implementation that is the tax side of investments currently. It also provided a background to review the Securities Commission report on Feltex, where it seems the accounting profession may have left the standards for mid year review rather wide open, and the process for fielding referrals from the Securities Commission somewhat short of a formal complaint.

Tim Brown gave a polished presentation on Infratil. The Infratil team seem quite on top of their game and their annualised return on equity of 20% plus since listing is a great benchmark. We reflected afterwards that these guys are a great role model. They epitomise the sort of investment animal the association likes, they act like long term owners and generate good returns

Two of us made the trip to Tauranga for the National AGM. We were most impressed by the day. ThankYou Tauranga Branch. The company speakers were excellent, the national business outlined the next level for the shareholders association, and we were able to give a solid round of applause to our “Mr Education” Graham Wilson. We looked with envy at the existing and planned roads for Tauranga in comparison with the tar sealed cart tracks of SH1 and Wellington generally. The Tauranga locals tell me it is apparently more about leverage than governance, and Winston Peters is involved somewhere. We made two points for the branch. We noted that the NZX continues to frustrate speedy dissemination of company information, preferring to milk the monopoly. We also noted that the current tax lurches combine to be one of the most concentrated attacks on direct share ownership short of outright nationalisation.

OMF presented on what they offer the market and an in-depth look at share ownership and leverage through Contracts for Differences. Their pitch was so good one of our members has since gone to work for them.

We had a visit from Kevin McCaffery at our last meeting and he updated the branch with the exciting developments at a national level. I am sure these will have been covered elsewhere so let me just say how encouraged the Branch was by the initiatives.

A number of things seemed to fall into place with the current national NZSA initiatives. We heard from Kevin about the usual suspects ripping off the usual victims. The NZSA initiatives of Research, Rate My Director, Find a Director, and widespread investor education seem spot on when one considers the failure of finance companies, the role of financial planners, the ongoing revelations about the Feltex situation, and see how the current governments current tax policy is herding even more kiwis into the arms of the intermediaries.

Food for thought / Prediction: In 12 months time there will be a dedicated PIE for every NZ Listed share, much like the American Depositary Receipts (ADRs). What will that do to the drivers of “ownership”?

Next month we are off to the movies, Wall Street looks like the movie of choice!

***Matthew Underwood, Chairman***

## **Research Volunteer**

NZSA needs a volunteer to coordinate our Research activities. While not being a graduate researcher, the person would have an interest in company research.

He or she would act as liaison between the corporate advocacy teams and the voluntary research team, and also between the Board and senior scholarship students working on NZSA projects. Any member interested in this vital job should contact the CEO, Kevin McCaffrey, whose contact details are in the Directory on the front page.

## **OBITUARY**

Peter Kreamer, one of our very active foundation members, sadly passed away recently. Peter was a regular at Auckland Branch meetings, and at many company AGMs. He was a strong advocate for the Association's principles, and a vociferous critic of poor performance. We will miss him.

## **DISCLAIMER**

**Any comments or information contained in this Newsletter or within courses conducted by the Association, including related coursebooks, should not be construed as providing investment advice or recommendations under the provisions of the Investment Advisors (Disclosure) Act 1996, or otherwise**