"The Scrip"
MANY INVESTORS; ONE VOICE
New Zealand Shareholders Association Inc. NZSA

February 2009

## BRUCE'S PAGE: IS NZX A VIABLE SOURCE OF OFFERINGS TO INVESTORS?

NZ is a nation of small businesses and thus new listings and investment opportunities are likely to come from relatively small offerings.

As a protagonist of shareholder rights, I as a matter of principle always favour a rights issue over placements. The reason for this is that a company is owned by its shareholders and a fundamental right of shareholders is the right to own. Thus if a company needs new capital the existing owners should be given the right to put the money up first, and then if they decline, those who are not currently shareholders who wish to invest can do so. Obviously retaining earnings is always preferable, but the pressure to pay dividends for listed companies is relentless.

From the company's point of view, it needs surety that it will get the cash it needs, and this can be achieved in two ways, both of which involve cost. The first is to have the issue underwritten; the second is to assess the likely uptake rate, and then do a rights issue for more than you actually need.

The first involves the cost of finding and remunerating an underwriter, usually somewhere between 2 and 5% depending on the risk.

The second approach means you run the chance of getting more capital than you need thus forcing a greater dilution on those who do not take the issue up than would otherwise be the case, which is also a cost, but not borne equally by all shareholders.

I sit on a number of private company boards and one small public company board, and can now compare the two. So I can now compare how each circumstance affects the way capital is raised, and can also now assess the dead weight cost of listing. The net outcome is that unless you have a market capitalisation of at least $100m and unless you are raising at least $50m in a rights or other issue, you are way better off not to go anywhere near NZX.

In private companies, when you need more cash you go back to shareholders with a rights issue. You assess what you need, you assess the uptake rate, and you go for more than you need to get what you want. It is not a hard science, and it works. If however you do not have a shareholder base that will support you at any price, then your only choice is to accept that the existing owners are sellers, and you sell the business either outright or by dilution through placement. The process is easy - no brokers, no underwriters, no expert accountants or auditors, no prospectuses, and you target habitual investors and get on with it. Placements are hard but not impossible to do, as usually any interested party is interested in control, and then the reason for the existing owners to stay is complex. So it results in an outright sale, often for less than the business's value, because the reason for the sale is the business's need for cash. So many small and promising NZ companies are sold offshore at a discount simply because our capital base in NZ is too small and too conservative to double down on good businesses. This is accentuated by our historically high interest rate environment. So the hollowing out of NZ is endemic through both public and private companies.

If the company is bigger you might consider trying to find underwriters, but in a private company that is a complete waste of time, unless the amounts are quite large, -like

NZ$10m plus, but then the cost is extreme. Further, the underwriter will normally only get interested if there is some certainty of what it will end up with, and then you end up back at the placement option. So small private companies which run out of cash, and do not have a shareholder base with deep pockets and a strong belief, end up being sold outright and mostly offshore.

Now to the public company experience. Firstly I have to apologise to the board for being such a frustrating and dogmatic bastard on this issue. Finally I had to accept that placement was better than a rights issue, because the costs of my principle relative to the need was so great that I was actually destroying not creating shareholder value, and worse, the delays that the listing requirements created in the process, almost cost the shareholders the company. This story is for any entrepreneur who is misguided enough to even think about listing his small company anywhere.

This company is a small company, market capitalisation sub $10m. It has less than 400 shareholders and rarely trades and never in volume. So listing has created little liquidity. Any volume trades are conducted between the shareholders off market, - no change from what existed before listing. The company oscillates between profit and loss but is building its revenues and business value. Last year it needed an injection of $1.5m. I was insistent that it be done by a rights issue, and to give shareholders confidence, the board should at least partially underwrite it. Seemed like a sensible plan, at least to me, and the rest of the board sort of gave in, or possibly they were humouring me. We structured a very compelling preference share rights issue, with yield and conversion rights, and thought, “Great! This is a compelling pitch.” The board was prepared to underwrite a third of it, and eventually, and it was hard, we found a number of the investors who would part underwrite it; none of the big obvious players were interested as it was too small.
“ Come back to us with a $10m ask and we will think about it” There was not a chance in hell I was going to raise $10m because the company did not need that much and the potential dilution would be enormous to those who did not take up the rights. The reality was that outside the board, the company would have been lucky to have 10 shareholders with deep enough pockets and a belief, and the last rights issue we did was quite poorly supported among our small shareholders. (Less than 50 took up rights).

Now to the cost of this process…. We had to do a prospectus, which includes an auditors report, and under the listing rules we had to get an organising broker. I couldn’t see why myself, as it would have been fully underwritten, and it was only an offer to our existing shareholders, but that is the food chain. Then NZX gets to clip fees for approving it, as do the MED and so the process grinds on. The total cost of this principled approached was likely to be the best part of $200k for a capital raise of $1.5. But here is the worst of it, if we choose to go without an underwrite, because that too was expensive, it was likely that we would only raise $600k, which by the way was actually enough, just, and the cost would still be $200k. Even I managed to see eventually that a principle that cost this much was a principle that had to be abandoned.

Now - the worst part. We desperately needed the cash last year. That was when we started planning this, but by the time we were ready to launch, we were outside the window, and had to delay it until the publishing of our next annual result, a delay of a further 4 months.
So the result was that the board just financed the company with soft loans.
Ironically, the company’s circumstances have now changed so that additional capital is useful but not needed.

Finally, what is the cost of being listed? The listing fees and sundry other compliance crap costs about $15k pa. But that is just the start of it. We have to do IFRS accounts, around $50k of cost, we have to be audited $25k and we spend money with lawyers to make sure we are not doing anything bad, say another $10k pa. Total costs of listing $100k. This was, last year, about half our operating cash flow. Have I missed something or is this nuts?

So the upshot of all of this: the world class capital markets we aspire to have are just completely unsuited to the likely companies that might aspire to list. We need to think seriously about how we form capital efficiently for small enterprises with promise.

***Bruce Sheppard***


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## OUTSTANDING ISSUES FOR THE TASK FORCE AND THE GOVERNMENT

There is a new government and an existing task force which are both keen to improve the operation of our capital markets. NZSA Board will be meeting with the Ministry of Economic Development and members of the Task Force in March, and there are several issues which are already on our agenda from recent advocacy reports and correspondence. Of course we have an overview of the current ails affecting our sharemarket, as is shown in Bruce's editorial above, but there is also a need to make some detailed changes in the way the markets are supervised.

1. Change the definition of Investment Advisers in relation to their business under the Securities Markets Act 1988 and the amendment of 2008.

The Act defines - "investment adviser and adviser—as a person (whether or not the person is also an investment broker) who, in the course of the person's business or employment, gives investment advice;

But then defines "business" as "any profession, trade, or undertaking, whether or not carried on with the intention of making a pecuniary profit"

This is too wide and technically embraces the NZSA as well as such organisations as The Consumers' Institute and educational institutions. The disclosure obligations then become so onerous as to make compliance impossible.

2. There is now international acceptance of the IOSCO adage, that the audit profession be subject to independent scrutiny.

New Zealand still operates with a self regulating regime which is not in line with our membership of IOSCO. This is accepted by government, but it is wary of the increased cost that independent monitoring would have. The Securities Commission needs beefing up to take a more active role in auditing the auditors

3. Removal of the monitoring and discipline functions of NZX from the Discipline Committee of NZX to the Securities Commision. The Securities commission monitors the performance of NZX, the company. It has noted the conflict of interest that arises between its business and its regulatory function, but so far says it is managing the problem. We believe there should be clear separation of the business from the discipline function and that the Securities Commission is the logical organization to take over the regulatory and discipline functions.
4. Outlawing of breakfees and incentives(bribes) for company officers to complete takeovers. During the takeover offer for Tourism Holdings it was evident that company directors viewed special bonuses paid to key staff for the successful completion of a takeover was a perfectly normal situation, and that the staking of shareholders' funds against large break fees was also acceptable. We will continue to object to these practices until they disappear.
5. Outlawing of naked short selling as fraudulent. There is very little if any short selling in New Zealand shares at present, but we believe that "naked short selling" where the buyer does not own what he is offering for sale is fraudulent and should be seen as such by sharebrokers.
6. Repeal of the Fair Dividend Rate Tax regulations, and return to the taxing of dividends. The regulation has resulted in lower taxes on Australian shares last year and will result in even lower taxes this year. It was introduced unconstitutionally without being tested in Select Committee hearings, and has resulted only in higher costs of preparation to the tax payer. We believe an immediate return to the taxing of actual dividends as in the past is the sensible course.
7. Proper disclosure of payments to directors and senior executives in all annual reports of public companies. The remuneration report is always tabled for discussion in the Annual General Meetings of Australian Companies, but we do not insist on full disclosure in New Zealand. How long will it take us to catch up?
8. Funding for financial literacy education programmes such as that mounted by Flow(sponsored by NZSA.) The Labour Government reluctantly funded shareholder education in Secom and NZX who promptly spent the money on website development. This is completely inadequate and fails to reach the target market for essential savings, and capital formation in New Zealand. The new Government need not reinvent the wheel, when NZSA has the FLOW education trust and its own Investor education programmes established.
9. Independence of reporting from Company Secretaries directly to the Board of Directors and shareholders. We support the Institute of Chartered Secretaries in advocating for this move.
10. Redefine National's policy to invest 40% of NZ Super in the NZX, to effect a staged plan and avoid swamping our tiny market. We applaud the objective to supply development capital to NZ businesses, and would like to see the Kiwisaver directed towards this.

11. Remuneration of Directors. Directors should not be paid retirement allowances, or any special service or consulting fees. They have been paid already. In the event that they are required to do extraordinary hours( as in a merger or acquisition, or avoiding insolvency) the extra payments policy must be part of the remuneration report to shareholders,in which payments are supported by timesheets, and accepted by the board. Where a remuneration consultant is used the board should publish the full report to stop selective quotations in support of pay increases.

10\. A Board of directors should include in its annual report, the preferred competency profile of itself, and the skills of current members.

Members who feel we should be making other points to the Task Force, should contact a board member with a brief submission by the end of February.

***Alan Best***

## BOARD REPORT FOR FEBRUARY

1. MED: Alan reported that in an initial meeting with Ministry of Economic Development,Submissions followed Bruce's last two articles in The Scrip and the above summary.
2. Membership: Chris reported that there had not yet been a noticeable reduction in membership, but that the acid test would come with the end of the financial year. The Board therefore decided that the branch membership competition should be mounted on 1st April continuing through three months to end June. Patrick is to advise branches of the details.
3. It was also resolved to pursue the membership drive amongst students at a discounted rate during their enrolment week, and that this should be piloted in AUT, AU or Waikato at the earliest opportunity.
4. Finance Companies: Further to our efforts to protect debenture holders in Hanover Finance, it was confirmed that NZSA's focus would in future be on publicly listed Finance Companies, and shareholders rather than debenture holders.
5. Contact Energy: The issue of majority shareholders dictating to shareholders over the election of independent directors (Contact Energy), it was noted that NZSA had some support from Mark Weldon of NZX, but that there was a general reluctance amongst directors to overturn the voting rights of majority shareholders. Des Hunt will be pursuing this issue.Our view is that if an independent director is to represent minority shareholders, then minority shareholders should have the sole right to approve or appoint that director.
6. Register of Directors: John Hawkins reported that the Registrar of Companies did not have a unique identifier for individual public company directors. It was felt that several organisations (Institute of Chartered Secretaries, Ministry of Economic Development, and other Departments) would be our allies in trying to secure this minor legislative change.
7. Australia:It was resolved to develop our relationship with Australian Shareholders Association, and noted that The Australian AGM and conference was charging members A$595 for attendance ( that is in addition to membership subscription.)
8. Education: Kevin reported that Flow Trust has been formed as a separate entity from NZSA and that arrangements for the roll out of its education programme amongst companies were in hand. It was also noted that Branches were making progress with their own education programmes.

***Alan Best***

## RESTRAINT AND LEADERSHIP – PLEASE!

Under the current economic climate where New Zealand and many of our other trading partners are in a recession, senior executives who have a performance bonus scheme in place should not expect to receive an increase in their basic pay for the coming 12 months. With many employees' facing unemployment it is time for those at the top to show some leadership in holding their basic pay at their current levels. Shareholders need to raise their objections to any attractive share option packages being presented in the current climate.

This should also apply to our members of parliament, senior civil servants and senior local body executives. The civil service and local body wage packages have crept ahead of the private sector these past few years which is not a trend the country can afford. There is no doubt shareholders will receive reduced dividends in the next twelve months so we will be one of the first to feel the pain. Unless things pick up soon we are unlikely to see an improvement in companies NPAT until 20011 at the earliest.

***Des Hunt***

## BRANCH PORTFOLIO COMPETITION

The portfolio values of both branches are set out on the following page.

The first point to make is that both branches have performed extremely well in difficult circumstances. The decision to hold cash was just the right one to make. The next hard decision will be when to enter the market and spend some of the cash that has accumulated and will be earning practically nothing in interest. You will see that there is a short commentary from each branch. Waikato Branch gives an insight into the decisions made after the 30 September period and it is interesting to note that they do not see recovery within the time frame of the competition (31March 2011). I am inclined to agree with this comment and it becomes all the more important that these competitors show us how they approach investment opportunities in this climate.

An important feature of any equity investment programme is to set indicators to which performance may be compared. The only clearly advertised Index for equities in New Zealand is the NZX 50 Index and I am using this to judge how the competitors are measuring up.

On 1 May 2006, the NZX 50 Index was 3795. On 30 September 2008 the Index stood at 3090 and this showed a fall of 18.5%. On the portfolio values shown overleaf, Auckland Branch shows a drop of 10.8%, and the Waikato Branch 12.8%. When it is considered that the Index incorporates gross dividends whilst our branches only show the net position (if at all) then the performance of both teams is excellent.

In view of the drastic reduction in interest rates now being offered by banks would branch teams please note that with effect from 1 February 2009, notional interest will be reduced from 7% to 3% per annum.

***Oliver Saint***

## WAIKATO BRANCH PORTFOLIO 30/09/2008

| Company | Quantity | Latest Price $ | Value |
|---|---|---|---|
| Fisher & Paykel Health | 645 | 2.93 | 1,889.85 |
| Infratil | 1,068 | 2.01 | 2,146.68 |
| Kingfish | 665 | 0.96 | 638.40 |
| Kermadec Property | 1,300 | 0.61 | 793.00 |
| Mozy Smartshares | 425 | 5.55 | 2,358.75 |
| Nuplex | 155 | 5.90 | 920.40 |
| Northland Port | 344 | 2.75 | 946.00 |
| NZ Oil & Gas | 2,335 | 1.28 | 2,988.80 |
| NZ Farming Systems Uruguay | 541 | 1.27 | 688.34 |
| Port of Tauranga | 477 | 6.60 | 3,148.20 |
| Pike River Coal | 1,461 | 1.60 | 2,416.00 |
| Provenco Cadmus | 838 | 0.15 | 125.70 |

| | | | |
|---|---|---|---|
| Rakon | 1,293 | 2.20 | 2,844.60 |
| Sanford | 182 | 5.85 | 1064.70 |
| Cash | | | 2,304.74 |
| Totals | | | 25,274.16 |

Branch commentary:
A feature of the last 6 months has been the huge volatility in the markets. This has led to some good buying and also not so good purchases. We have largely bought export companies which we thought had good prospects and energy companies. The events of the last few weeks have certainly impacted badly on our portfolio and our summary date of 30/09/2008 was very unfortunate. Where to now? That will be the question at our next meeting. No short term recovery looks likely. Thankfully the competition still has some time to run to try to recover our position.

Summary to 31/01/2009
Our portfolio suffered further heavy declines to the end of January. Fortunately perhaps, we have only made one purchase in the period, wishing to preserve our cash. We invested $2,000 in Ebos.

With the advent of a lower Kiwi dollar we favour export stocks; and for their defensive characteristics – health stocks.

We perhaps belatedly, do not see much prospect of an economic recovery within the timeframe of the competition. Accordingly we will look to cull out some of our deadwood and concentrate on our favoured sectors.

We recognise that there is still likelihood of further heavy sharemarket falls but we intend to remain invested.
The competition now is certainly a challenge as opposed to 15months ago, with many divergent thoughts and uncertainties regarding economies and outcomes.

| AUCKLAND BRANCH PORTFOLIO 30/09/2009 | | | |
|---|---|---|---|
| Investment | No. of Shares | Price | Value |
| AIA | 725 | 1.95 | 1413.75 |
| FPH | 2293 | 2.93 | 6718.49 |
| Kingfish | 1493 | 0.96 | 1432.28 |
| Mainfreight | 140 | 6.40 | 896.00 |
| Marlin Options | 6000 | 0.081 | 486.00 |
| Nuplex | 293 | 5.90 | 1728.70 |
| Opus | 650 | 1.60 | 1040.00 |
| Rakon | 1351 | 2.20 | 2972.20 |
| Trustpower | 132 | 7.85 | 1036.20 |
| Vector | 387 | 2.09 | 808.83 |
| Cash | | | 7339.56 |
| **TOTAL** Notional Funds to date$29000 | | | 25872.01 |

Branch commentary:

| | |
|---|---|
| Our cumulative return on our funds to | 31 March 07 was 27% |
| | 30 Sept. 07 19% |
| | 31 March 08 (13%) |
| | 30 Sept. 08 is (11%) |

For the 6 months period we lost $183 mainly due to increased cash holding, gains on our single purchase FPH and Vector and a loss on Rakon. The others only show minor variations to the March 08 valuation. Since this balance date our investments have deteriorated significantly. At our May meeting we compiled a list of Fletcher, Infratil, Contact, Ryman and Opus as to further investment on price weakness. The decision to purchase further FPH was made on the basis that we considered it to have very strong recovery prospects. We only met twice since May in the period and made no further investment decisions - being pre occupied with other Branch business. This has been fortunate for us with our accumulated cash balance as the market and our portfolio has deteriorated since.

*Noel Thompson*

## COMPANY REPORTS

## PROXY REPORT FOR 2008

During 2008 there were 60 Annual General Meetings and Special Meetings attended by proxy representatives of the Association. This was up from 54 in 2007 - so a big thank you is given to those Board and Branch members who acted as proxy representatives for us all.

Breakdown by region:

| | |
|---|---|
| Auckland | 41 |
| Hamilton | 1 |
| Christchurch | 7 |
| Tauranga | 2 |
| Wellington | 9 |

This was a good achievement, but we are in need of additional people from our membership who would be willing to attend meetings as proxy representatives.
If you feel you could and would like to participate, please talk to your Branch Chairman or get in touch with me via the NZSA website proxy email address:

proxies@nzshareholders.co.nz

It is really useful if you let the proxy co-ordinator know that you have appointed the NZSA as your proxy. In future could you please use the NZSA proxy address, rather than my private email address. This will allow someone else to look after the proxy co-ordination role in my absence.

We would ask you to consider that if you cannot attend a shareholder meeting yourself that you appoint the NZSA as your proxy.

For those of you who are unsure of how to complete the proxy forms, please look at our web-site.

*Jacquie Staley*
proxies@nzshareholders.co.nz

## DELEGATS GROUP 2nd December 2008.

ZSA Proxies 7, totalling 64,607 shares

The only reason to report this meeting was the confidence with which the Chairman and CEO addressed members. There were some off-the-cuff comments that tended to disrupt the even flow of the addresses but the tone was plain and confidence oozed. The speeches are on the company website for all to view - (click on 'investors' and then 'documents'.)

At question time a NZSA member questioned the small increase in profit expectation for the second half of the year given that the first six months to 31 December 2008 were expected to earn $15.5. With $24.7 forecast for the full year this represented a solid drop for the second half and with exchange rates looking favourable clarification was sought. The CEO advised that any exchange rate benefit would be unlikely to kick in until late in the 2009 year when exchange cover ceases to operate at the higher rates, and the first half usually results in a larger portion of sales. Jim Delegat acknowledged that they may have been a bit conservative for the full year, but it was certainly too early to signal a revised position. Both directors up for reappointment, Rose Delegat and John Maasland addressed the meeting and were duly reappointed to the Board for a further term. A final questioner asked the Chairman if there were any unsolicited takeover offers for Delegats. The response after a moment's hesitation was 'unsolicited – No'
***Oliver Saint***

## INFRATIL. Auckland branch meeting. Speaker: Tim Brown

Tim commenced his talk with an outlook on the global financial markets and economies , which was appreciated by all attendees.
<u>Summary of Key Points</u>
All markets are exhibiting full capitulation.
Listed markets are near cyclical bottom, but there will be many false starts before true recovery. Expect a third leg down turn in markets and an L shaped recovery.
Economic trough likely to be extended out to 2Q 2009.
Expect a third wave of financial crisis to come.
Hedge funds are being forced to deleverage and will throw up more assets at even lower prices, while private equity concerns will find it much harder to leverage.
Asset price valuations likely to reset at a structurally lower level than last cycle to reflect unleveraged returns.
Need to remodel for next growth cycle with a structural growth in cost inflation and lower operating margins.
Tim's talk was held just before the announcement of half year results. He was very open in his discussion, but at times needed to be cautious in terms of disclosure issues.
Tim covered the Infratil bond programme which he likened to the Company holding an insurance policy. At the time of issuing their long dated bonds, they were paying up to 1.5% pa above bank rates. However, their view was that they should have another avenue of funding, ie through the debt markets and this strategy has paid off well during this time when banks are playing tough!
Infratil's largest holding is Trustpower. He noted that as sustainable energy production costs (eg wind) were now at least 10c/unit, this was effectively the base level cost for all generation, and higher consumer costs reflected this reality.

Tim accepted that some of their airport holdings were not performing to their expectations but Infratil believes once global economic recession abates, then the performance will improve. Again Infratil is taking the long view, based on lower costs of air travel, improved air freight throughput, and growing middle classes wishing to travel. They would also like to buy more AIA shares.

Summary of Infratil Results released since the meeting

Infratil has reported a 23 per cent rise in earnings for the six months to September, buoyed by strong performance from its subsidiaries Wellington Airport and Trustpower.

The company said the global credit crisis had dominated everything in the period under review. However, Infratil's businesses were relatively well positioned to cope with the upheavals.

Wellington Airport contributed profits of $32.2 million, up from $27.7 million in the latest period. Trustpower's contribution surged to $136.7 million from $116.2 million.

Infratil Energy Australia also made a strong contribution - up to $28.1 million from $7.8 million, though this was boosted by non-recurring gains.

The company reported that like most listed entities Infratil's shares had been affected by the global turmoil, but they continued to have robust cash flows. The company believed that society wants good infrastructure, and governments are encouraging investment in these sectors because of social pressure to offset declining consumer spending. Infratil's record, expertise and credibility make it a natural partner in such developments.

It is also valid that investors remain strongly interested in infrastructure. Stabilisation of the credit and capital markets will in due course result in greater confidence in valuations.

TRUSTPOWER delivered record half-year earnings despite facing very difficult generation and spot market conditions over the first quarter. Trustpower's diversity of generation catchments and risk management practices again showed their worth.
A question was asked about why Trustpower are paying a special dividend when they are raising further loans. It was explained that the bond issue is a long term financing structure - the special dividend is a short term once off payment made as part of regular consideration of what is good for shareholders and the company.
However, this does not mean Trust Power is borrowing to pay a dividend. Over the last two and half years (a period chosen as it is covered by the last annual report and the most recent half year) TPW's net operating cash flows were $422m. Over the same period dividends were $217m, ie about 50% of free cash flows, which has left TPW holding $205m.

Over the period capex amounted to $445m, so in effect $205m was funded with equity and $240m with debt, ie 46/53 equity/debt.

WELLINGTON AIRPORT produced record earnings as efforts to attract and develop services paid off during the period with continued growth despite the emerging weak economic picture.

INFRATIL ENERGY AUSTRALIA delivered a strong contribution. The result included non-recurring gains but also reflected good risk management, responsiveness to changing market conditions and the increasing scale of the retail operations.

NEW ZEALAND BUS experienced a decline in earnings due to increases in maintenance expenditure required to improve service reliability. Otherwise, increased patronage, fares and regional council contract payments balanced-out higher costs. Notably NZ Bus's road user charges were over $5 million for the period due to a 14% increase in this Government levy.
Snapper, the new ticket and payment system was warmly received in Wellington. Over 30,000 cards are now being used over 16,000 times a day for transport and merchandise transactions.

INFRATIL AIRPORTS EUROPE recorded an earnings loss of $6 million for the half, which reflected the loss of major freight services at Glasgow and Kent and the failure of charter operators using the smaller German airports. The suddenness of the reduction of services means that the airports have incurred adjustment costs (including bad debts) and it is likely that the full year outcome will be consistent with the first half trend.

CAPITAL & RISK MANAGEMENT
The world's capital markets are undergoing their most stressful and difficult period for two generations and the economy now faces a potentially prolonged period of recession. Infratil's share price has been affected, but the impact, both as regards immediate financial circumstances and the strategic positions of its businesses has been modest.
Infratil's goal of delivering good returns to its shareholders is based on:
- Positioning in infrastructure sectors which offer growth and investment outperformance over the long run.
- Proactive management of risk.

On both criteria Infratil's performance over the half year was satisfactory. The total return to shareholders was less satisfactory at negative 4% due to global developments.
Infratil's commitment to risk management is one of its key defining characteristics. Through proactive measures taken in past years Infratil remains comfortably positioned despite the weak economic conditions.
Debt Profile: During the period $140 million of debt facilities were renewed to 2011. Infratil has $174 million of its bank facilities falling due in 2009, being the annual roll of one third of its core banking facilities. IEA also has $54 million of working capital facilities for renewal in 2009.
As at 30 September Infratil had undrawn bank lines and cash deposits amounting to $254 million.
Infratil remains well placed to ride out the current economic conditions, its businesses are mostly in sectors which offer structural advantages as opposed to those where consumption is more discretionary or where suppliers with over-capacity will come under greater pricing pressure. As with past recessions and financial crises, there will be a recovery.

***Jacquie Staley***
*Editors note: Since this report, CEO Lloyd Morrison has announced that through bad health, he will be taking leave of absence. Your Board has written to Lloyd wishing him well, and thanking him for his support of our activities.*

## RICHINA PACIFIC LTD SPECIAL MEETING 15th December 2008

Richina’s complicated capital arrangements and its listing in Bermuda finally caught up with it, in a special general meeting. It was trying to secure a separation of the different areas of investment into 4 different listed companies. In a New Zealand listed company this would be relatively straight forward, involving first a separation of the management

and assets into trading entities, followed by separate listings as happened with Fletcher Challenge a few years ago. However the valuation of the Shanghai Leather Company (SLC) with its 25% minority interest, and its tracking security formed in 2004, paying a fixed 15% of distributions from SLC to the associated-party, funder Richina Enterprise Holdings Ltd, became too open to challenge and too complicated. So under Bermuda law, an amalgamation was proposed between Richina Pacific, Richina Enterprise Holdings and Shanghai Leather Company, with the purpose of subsequently separating the four trading divisions into separate listed entities. Several problems arose from this.

1. The listed shares would become unlisted and untradeable during the period between amalgamation ( restructuring) and relisting. It was proposed to preserve liquidity by trading on the unlisted exchange, with no guarantees as to the timing of listing the four trading divisions.
2. The proposed amalgamation involving payments under the tracking security would be conducted without scrutiny of shareholders, by the directors who have in some cases conflicts of interest.
3. Dissenting Shareholders would need to be offered a reasonable opportunity to apply to the court to sell their shares at the courts valuation. Richina set the level at $0.4547 per share a 98% premium to the November price to overcome expensive applications to the court. The company promises further opportunities for dissenting shareholders to sell on 27th February, 30th June and 30th December 2009, subject of course to the company being solvent.
4. Eventually there will be 4 separate boards and 4 separate annual reports, though only one annual general meeting in New Zealand.

Remember Warren Buffet: companies you understand; directors you trust; and priced well in relation to potential? Many shareholders have had difficulties with the first two but now they have an opportunity to exit at a premium. Predictably there were a stream of questions and comments from the floor.

1. There was no statement from Price Waterhouse the “independent “ reporters on the scheme as to whether the offer to dissenting shareholders was “fair and reasonable,” when the book value of the shares appeared to be 76c each. Answer: the boards decision was taken in the light of current market conditions.
2. Forsyth Barr’s Graham Mellor stressed the liquidity problem for shareholders with shares on the unlisted exchange, Mainzeals continuing management problems, and asked whether the payout to subsidiaries would be in proportion to the price of the group shares, and whether a floor price could be arranged until the final separation of subsidiaries. The chairman replied that while no floor price or formulae for separations could be confirmed at present, Mainzeals management changes had already been implemented, and the he was confident that separations into 4 operating entities would improve management and accountability in each subsidiary.
3. Brian Gaynor spoke for the Buffetites, saying that directors were not confronting the problems of poor disclosure in their reports, poor liquidity of shares resulting from poor performance of the company, and confusion of investors and management reaching deep into the tasks for each division.
4. Paul Collins spoke up for his 9m shares. He defended the governance of the company, the creation of four letter stocks as a means to the end, and the use of “unlisted” as a temporary medium of exchange.
5. Questions over the dates of delisting, Unlisted trading and the fact that the costs of the exercise were easily outweighed by the benefits were all disposed of by the Chair.

The proposals were easily carried. We will watch for the results of the amalgamation and separations with interest, but do not expect this company to get any easier to value in the short term.

***Alan Best***

## GUARDIAN CASH PLUS FUND SPECIAL MEETING 8th December

With seating for about 30, a big attendance was clearly not expected.
Purpose of meeting to amend the Trust Deed in order to qualify the Cash Plus Fund for the Crown Retail Deposit Guarantee Fund announced by the Government on 12/10/2008. It could not do so, as previously constituted because an estimated 35% of the funds were tied up in mortgage investments. The scheme therefore needed to be restructured in order that at least part of the fund might qualify for the guarantee while the rest of the fund went along with the possible sad fate of mortgage funds.
Investors did appear to fill the few seats and suited gentlemen - some even in darkish suits - stood around the walls of the smallish venue while a Barrister, at the request of the Public Trust Office, chaired the meeting to obtain Shareholder Approval.

It was a saddish morning. Fully a quarter of the affected attendees professed total ignorance of their money being tied up in any sort of mortgage fund arrangement. They were convinced (like your correspondent) that their cash was at all times instantly accessible. There was clear inference on the part of some that the company had been less than honest.

The GM of the company - a seeming very recent appointment to the position - did his best to cope with the questions. A stony silence from the Chair or any from the be-suited gentlemen greeted the suggestion (put by a proxy for Wellington investors) that in the light of these developments the organisation should waive or at the very least lower the fees they charge. This suggestion was emphatically carried by acclamation but evinced not even a comment from the Chair or any of the sundry other seemingly official attendees.

As expected investors voted in favour of a restructure of the Guardian Plus Cash Fund to ensure that the fund held cash only investments, and was aligned with the Reserve Bank's criteria for the eligibility of Collective Investment Schemes in the Crown Deposit Guarantee Scheme. Guardian Trust held that where a guarantee is available, the most responsible course of action is to seek that guarantee for unit holders.

Following the restructure in December 2008, the fund held only eligible bank deposits and registered deposit certificates and an application was submitted for the Crown Deposit Guarantee. The application is progressing with Treasury and Guardian Trust is looking forward to the successful conclusion of the process,

In effect this means two thirds of your deposit in the above Cash Plus Fund is available to you as of now, and one third remains frozen, but Guardian Trust seems hopeful this will also be freed up in the not too distant future.

In these troubled times an almost successful conclusion - May God help us all. !!!!

***Joe Turnbull***

*Editor's note: While The Guardian Cash Fund is not normally in our sphere of action, it was noteworthy that such a fund should be frozen to investors.*

## VISIT TO FISHER AND PAYKEL HEALTHCARE 2nd December 2009

Matt Lucas and I visited the company, and held discussions with Michael Daniel (MD) and Tony Barclay (CFO and Secretary). We were very interested to hear from Michael and Tony what they felt the new government should focus on to support manufactures

and exporters to grow their businesses. Two of the issues mentioned by Michael was the National Party wanting to drop the R&D grant without announcing any alternative support and if the economy does start to expand making sure there is qualified labour force available to take up the new jobs which will be created at that time. In the past two years it has not always been easy to fill vacancies because of the shortage of experienced labour.
For the year ending 2009 financial accounts we clarified with Tony that the New Zealand currency rate used for the USA dollar was $0.69. In the share brokers forecast for 2010 they have used approximately US$0.60 in coming up with the forecast NPAT of between US$90 and US$105 million depending on which broker you want to believe.
The company is very well managed which is a good sign in these difficulty trading conditions. They continue to increase their market share in the key market segments they target. The health sector is one area which is still growing and this is likely to continue even through this current recession.
Michael confirmed the company has increased its expenditure on R & D and this is obvious when you see all the new products that have been introduced in the past year. For further information on Fisher & Paykel Healthcare we recommend you read their annual report or get an update from your share broker.

***Des Hunt***

## BRANCH REPORTS

### AUCKLAND

1. Branch Meeting – 12 November 2008
   Tim Brown gave a presentation to members on behalf of Infratil. Tim had an easy style and kept members entertained for a full hour. Unfortunately, members' question time had to be limited as Tim needed to leave promptly to catch the late evening flight to Wellington.

2. Guest Speakers / Company Visits
   With the new year just under way, we are a bit slow out of the blocks but Jacquie Staley and Joe Turnbull are working to organise a full programme for 2009.

3. Education
   This was discussed again at our recent committee meeting and we are still working to try and meet the challenge of presenting the material supplied in a competent and coherent way.

   We do not have a committee member appointed as an education officer yet but John Hawkins is working through the material to try and come up with a solution. One suggestion was that we may need to investigate the possibility of paying a fee to a qualified person to present the material on our behalf.

Auckland Branch Meeting
Our next meeting is scheduled for Wednesday 18 February and the guest speaker will be Brian Gaynor. This is bound to be a well attended meeting because Brian is such a good speaker and always provides interesting information on the markets and investment environment.

***Ken Cook.Chairman – Auckland Branch.***

**WAIKATO**
The Waikato Branch held their Xmas function at The Pavillion (Frankton Bowling Club). Guest speaker was Carmel Fisher from Fisher Funds. Carmel gave a polished off the cuff presentation. She remains reasonably upbeat despite Fisher Funds languishing in value. Brokers came in for some criticism in response to a member's question of wondering if he had done the right thing to sell his shares, following his broker's recommendation that he do so. Members appreciated Carmel fronting our meeting in these challenging times. Thanks to Bronwyn and her team for making a successful function.
Jim Haisman and Bronwyn Smitts have been busy in arranging a schedule for the coming year. In the pipeline is a visit to Kaimai Cheeze Ltd and talks from NZ Windfarms and Kiwi Income Property Trust. We propose to commence the NZSA Education courses in April.
The first meeting in 2009 will be on March 5 with Ted van Arkle – Chairman of Charlies Group and director of Restaurant Brands Ltd.

***Robert Foster – Waikato Branch***

**WAIKATO BRANCH INVESTMENT EDUCATION 2009**
**INVESTMENT COURSES**
**1.Investing –** Choices, Risks and Rewards. Property, Shares and Fixed Interest, Advisors and Agents. An introductory course. No experience needed.
**2.Starting in the Sharemarket –** Buying & Selling, Share tables, Risk and return, 4 Key Financial Ratios, Simple share analysis and how to get going.
Basics you need to know. No experience needed.
Course Location – Hamilton, April
Time and venue to be arranged
Registrations of interest: John Davies cjdavies@xtra.co.nz Ph (07) 823 7388
Robert Foster robertfoster@xtra.co.nz Ph (07) 827 8026

**BAY OF PLENTY**
The BOP branch is gearing up for a busy crunch year.
We open with a discussion group meeting on Fri 27th of Feb at 3pm. The speaker is a branch member, Rob Miller, lawyer who has extensive experience in NZ and overseas.
His subject will cover:-
A summury of international events beginning from Enron.
A description of the sub-prime problem.
The powers & responsibilities of shareholders in general.
The myth of secured debentures.
Remedies for those who have suffered.
Entries for our sharepick competion will close with Howard Zingel on the 6th of March. While different from portfolio management our competion does provide a worthwhile focus on company evaluation as well as a bit of fun. The prizes are donated.
All NZSA members can note that after pressure from some of our members and others, companies such as Australian Foundation and Argo that were removed from the ASX 200 have now been reinstated to their tax exempt status under the FIF tax rules by the ASX which has created an index for LICs.
Two interesting speakers have been arranged for the March discussion group, their topics will cover:-
The current investment environment.
Insolvency – with emphasis on recognising the danger signals.
In April we look forward to a company visit to Trustpower Ltd. Details later.

***Lloyd Christie – Branch Chairman***

**WELLINGTON**
Last year we moved to having monthly branch meetings and it proved to be very successful so in 2009 we will continue this theme. We will hold our meetings on the second Tuesday of each month and will have ten meetings this year, the first in February and the last in November, with a guest speaker presenting at each meeting. Once again First NZ Capital has offered us the use of their meeting rooms in Fujitsu Towers on the Terrace. We really appreciate their ongoing support of the NZ Shareholders Association.

However, our first meeting for this year (on 10th February) isn't at FNZC; it's at the offices of the Wellington based online accounting "software as a service" company Xero (www.xero.com NZX XRO). We visited Xero almost exactly a year ago and CEO Rod Drury gave an inspiring presentation of where Xero had come from and where it was going. It was a great story and they had a lot planned. One year later we are going back to check on progress. In particular we have asked for an update on what's been achieved in the last year, what's intended over the next year and what changes are planned for the capital structure going forward – i.e. what plans do Xero have to improve the liquidity of their shares.

The other activity we are looking at for 2009, is running shareholder education courses – details will be emailed out as they come to hand and will be published on the Wellington branch website page at www.nzshareholders.co.nz.

***Martin Dowse***

**CANTERBURY**
Christchurch Branch will be running two site visits and several guest speakers in the coming months. Please mark the following dates in your calendars:

| | |
|---|---|
| Robin Clements of Clements Economic Services | Wednesday 7th March, 7.30pm |
| Windflow Technology – Presentation and tour | Tuesday 7th April, 4.00pm |

Our immediate target is the Education Day on February 28th – spread the word!

**CANTERBURY BRANCH INVESTMENT EDUCATION 2009**
Beginning to invest? Need an introductory course? No experience necessary!
Course: INVESTING
Date: 28 February 2009
Time: 0930 – 1230
Registration: by Friday, 20th February
Cost: $70.00 includes complete course notes.
Contact: Margaret at 021 100 3630 or
canterburyeducation@nzshareholders.co.nz

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## MEMBERS ISSUES

### IFRS ACCOUNTING CONFUSION

**Bernard Ivory writes:**

There are big problems for shareholders understanding company results following the adoption of IFRS and companies' subsequent reluctance to make a clear distinction in presentation of financial statements between operating results (revenue account) and capital matters. This especially applies to real estate investment companies and agricultural companies where land and buildings and biological assets have to be revalued and changes in 'fair value' reported through the profit & loss account. UK investment trusts make a clear distinction between revenue & capital items. I don't see why all companies cannot.

This issue has been bugging me for some time and it was last week at the AGM of Terra Vitae Ltd that I saw how confusing the financial statements were for many shareholders. One of the other silly complications introduced by IFRS is the need to provide for income tax on revaluation surpluses relating to fixed or biological assets that are intended to be held for the long term. Look at the ridiculous headlines that journalists write when a big property trust's assets are devalued as a result of selecting a higher discount rate while its operating profits increase!

**Oliver's reply.**

The basic idea behind IFRS is that all readers of annual accounts around the world will be aware and have the certainty of knowing that valuations and presentations have been carried out on a unified basis. I, and I am sure the bulk of investors around the world, welcomed this initiative with open arms. Due to the power of the personality of the instigator, Professor Tweedie, it seemed at first that all the work put in would come to fruition. However due to the peculiar legal arrangements in the state of Delaware where, most US companies are established, the USA were unable to change from their own more specific accounting rules. Thus we are now being led into a compromise which I personally find abhorrent. That seems to be the way of the world. Then we have the debt crisis and the "mark to market" concept suddenly means that most banks are now bankrupt if they follow "mark to market." So rules have to be bent once again.

I suggest that there is very little we can do,with our limited resources,to change the world. We unfortunately have to be spectators to what is being acted out. We have done our bit though. Please read the NZSA submission on 1 November 2006 to the Financial Accounting Standards Board of the Financial Accounting Foundation, USA. We were very direct and pulled no punches. We were also only one of three submitters in New Zealand and less that 200 world wide.

**Editor adds:**

It is not just IFRS that prevents companies from presenting their information clearly. We all need to push for the clear separation of revenue and capital items, and explanatory notes where necessary. We spend a good deal of time conveying what information shareholders need, to boards – see Des's article in our December issue. After all, these reports are presented for shareholders, not just the auditors.

## THE BREAK FEE BRAWL

*This debate is so topical that your editor felt it was worth airing.*

**Ross's idea:**

Looking at the spread between the OCR and the mortgage rate reductions, and hearing about the break fees that banks are imposing on people wishing to refinance, in circumstances where the banks have not provided advice to their clients about what they should have done - and in many cases the Banks have said that they intentionally "don't give advice" - perhaps there is an argument that the imposition of any charges on a refinance by way of a "break fee" (not only a mortgage, but any refinancing activity) be make illegal, by statute.

The Banks justify the costs they impose on the basis first that it is a matter of contract, and second that there is a real cost to the bank in finding a new investment proposal for any money repaid when the contract is broken.

As to the contract argument - the terms imposed are unilateral and the customer generally has little influence on these types of detail. So it is a classic multinational v. widow in Pakuranga situation. Something the government can legitimately protect its citizens from.

As to the real cost of finding an alternative - if you look after your customers in the first place, they have no reason to leave. If you are not competitive and the customer doesn't value what you now provide, then perhaps you have to change. In other words, the fees are a reason that the changes to the OCR don't flow through to the customers.

As the fees are anti-competitive in nature and effect, they should be declared illegal and unenforceable, with appropriate penalties as per the old Credit Contracts Act, which multiplied the interest rate by a few factors, so that it was worth getting things right, and worth claiming if the bank stuffed up.

As most of the money for these fees goes offshore anyway, there is no political problem (although KiwiBank is apparently one of the worst offenders).

The risk is that in doing this, all rates effectively become one month terms, even if stated to be 5 years - increasing the cost to everyone. On the other hand, the ability to change banks without penalty, will curb every type of impost the Banks dream up - as customers can flea in droves. But further, if you have to attract new customers, I would wonder what you would have to offer them? Better services? Lower interest charges? Doesn't look to me like a problem at all.

If the Banks suggest that they are competitive anyway, then the answer is - excellent, then there can be no objection to this, as it will not harm any competitive bank who is already looking after it's customers best interest, and thus as they are saying that they are competitive anyway, it will have no operational effect on them at all, in any way, and thus there is no reason not to do it. In fact, it could almost be said that the Banks are embracing this initiative as it is proof of just how well they are serving the NZ public.

This may not be strictly an NZSA issue on it's face, but as every business we invest in has finance as a large part of it's business, it is one of those systemic issues which, if it works, would benefit everyone (except those holding Aussie Bank shares, perhaps).

**John is immediately concerned to clarify NZSA's position.**

I am concerned that the NZSA may be seen to be endorsing Ross's position which effectively promotes the overthrow of financial contract law. The board has not discussed it, nor has there been any research done by the NZSA into the implications of such a move. Should we publish Ross's letter, it must be clear that this is his personal opinion and is in no way endorsed by the NZSA.

The basic flaw with the argument is that if customers can refinance despite their contract obligations when rates are moving down, then in fairness, banks will want to have the unilateral freedom to impose higher rates when the reverse is true.

Not to allow this would fly in the face of the law of supply and demand. Make things too one sided, and capital will simply be diverted to somewhere more attractive. The end result is less capital, less competition and higher lending rates. Is that what people really want?
There is of course a case for much improved transparency and clarity in the mortgage contract documents. It is only fair that both parties have an unambiguous understanding of the basis and result of early termination. Possibly borrowers should have e-access to the dollar quantum of any early repayment fee on a daily basis, as of right? Probably quite simple and inexpensive for the banks to introduce and maintain.
Ultimately, it comes down to financial education and a willingness of borrowers to actually read and understand what they are signing as well as asking questions and seeking appropriate advice.
This is an area where the NZSA is currently committing a lot of time and resource thru both the FLOW and Investor Education initiatives.

**Bruce upholds the sanctity of a contract, but….:**
Banks endeavour to match their risks, so when they offer you a fixed rate on your loan they endeavour to balance their book with a converse exposure to the same maturity thus locking in their margin.

When you break a term loan fixed interest deal if it is out of the money i.e. rates are lower, the bank will suffer costs ( on the fixed rates they have committed to on the other side), and it is only fair that you should pay them.

But don't start feeling sorry for the banks because they don't play this game straight, no matter which way the market moves, the bank always wins, and perhaps the answer is not what at first seems obvious.

Let us first take the terms deposit side. If you break a term deposit early when if ever have you been paid compensation if you are letting the bank off the hook on a rate that is currently higher than market? Never. If it is out of the money, i.e. rates have risen, the bank will sock you a penalty. The penalty varies from bank to bank and they all approach this differently. Some banks simply recast your term deposit back to the rate they would have paid you at the time you made the deposit for the term that you have had it with them, some drop it back to a call rate, others try to apply the logic of the loss sustained by them over the remaining term of your deposit, but you always suffer a penalty if you break a term deposit if rates have risen.

Now the loan side. If rates fall then the bank will charge you a penalty, they all approach this differently, and mostly they price it to win more than their loss. The theory should be that the difference between the rates you have contracted to pay and the rate they could lend it out today at, at a fixed rate for the remainder of the term should be your loss, converted back to a net present value as in essence the penalty is you prepaying the excess. But as I said banks always win and most of them work out the difference at the buy rate of money not the sell rate so in essence the penalty includes full compensation to the bank for the margin for the entire remaining period of the loan. This is clearly unfair and banks should be pushed to price the penalty at opportunity cost.

If conversely you want to repay a loan early where your fixed rate is in the money, most banks specifically exclude compensation to you for the value you are surrendering to them. In short every time a house sells in a trade-down situation, the bank gets repaid early and they pocket the gain with no compensation to the borrower. Hardly a fair game - heads I win; tails you lose.

So the fair solution might be as follows:
Banks should price the penalties on a consistent basis and it should be based on the opportunity cost not the " buy cost'.
Banks should pay out to customers, compensation on the same basis.
Term deposit breaks should result in penalties calculated on the same basis, i.e. what interest rate would we pay today for the remainder of the term. Net Present Value of this equals a penalty or a bonus.

It is time for transparency and consistency rather than protective penalties.

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