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

April 2009

BRUCE'S EDITORIAL – NUPLEX: CAPITAL RAISING COSTS – EXTREME.

Firstly the structure of the Nuplex offer to shareholders is transparent and fair. It is a rights issue; all who want to avoid dilution may take up their rights. Any small shareholder who wants to increase his stake can buy rights on the market; those who do not wish to take up their rights may sell them on market and be compensated. This is as good as it gets for small shareholders, and so it is unfair to say they are hard done by.

Rights issues of this nature do not guarantee that the company will get its money, thus it is reasonable to expect that Nuplex will require that the issue be underwritten, and that the cost of this underwrite should be shared by all shareholders pro rata, and it is. So this too is fair.

Over the years I have placed capital in private companies, and have observed the methods by which those who raise capital for others and those who underwrite the performance of others price their skills, and guarantees.

The first point the underwriter normally considers is the cash fee, and this is relative to the price of the share offer. If the share price that is underwritten is close to market, and the market is in a normal environment, then the underwriters fee is higher, but tempered by the underwriters desire to invest. Mostly underwriters are financiers and do not wish to hold the shares in the companies they underwrite, but this is not always so. For First NZ, (FNZC) this is first and foremost a financial transaction, and the share price is only relevant as a financial calculation.

The first thing they would have done is estimate the number of shares that they will be called on to pay for, the likely realization proceeds for off-loading them on to the market, and the time it would take to do that. The price is 23c a share for Nuplex rights, and at the time First NZ were considering their involvement the price was around 35c a share and free falling. If the head share price fell to 23c or less the uptake would be less and the underwrite call more. The financial exposure was $133m. They presumably assessed that the price would rebound or regardless that the rights would be substantially taken up. Thus the risk of a call was small. This said there are always unsophisticated or incapacitated people who do nothing, and this is a transfer of their wealth for free to the underwriters, assuming the discounted shares can be sold at greater than the issue price.

Thus the second step in assessing this transaction is to assess the likely call on the underwrite, the value of the discount handed over by the stupid, and the effect of this pool of shares on the market when it then represents a selling overhang.

Realistically the call should be less than 10% of the issued stock, or around $13m of outlay. An overhang of 10% of the share register will pull the price of the share down, and thus when First NZ Capital was looking at this deal they would have expected the $13m to sell at less than 35c, maybe even lower than 23c. Very hard to assess a likely gain on

this and most likely it was ignored in any calculations of return for risk. The world however is an uncomfortable and uncertain place at this time and certainly their analysis would have been more sophisticated than this.

At the end of this exercise the cash fee of $2.6m was tendered for the underwrite, plus some more on top undisclosed but understood to be a further 1 to 2% for advisory and management. Yes, Bancorp were the advisors to Nuplex and the task was set out for tender. FNZC won the tender, you must therefore assume that either they were the only tenders, (poor them), or they were the best value equation. So First NZ Capital's expected reward at the time the deal was done would have been around $4.5m, on a risk of $133m, i.e. just over 3%, in normal times this would be high, but these are not normal times.

Now for the kicker which makes this capital raising deal unusual.

Nuplex will issue 15% of the company for 23c per share if the call options are exercised. This brings the total capital raise to $156m and the cost to the company (not the stupid who do not take up their rights) to $10m. This is over 6% of the capital raised. I value the option at $10m, I understand that FNZC value it at $10m, but I understand that FNZC valued it at around $2m at the time of the underwriting, assuming it was fully exercised. .

For venture capital which is very risky the normal cost is around 10 to 20% of the capital raised, for private equity 5 to 12 is normal but for major listed companies with a long track record of profit, in a normal market the cost that would be expected is 1.5% to 4%. It is double, and the underwriters would argue that it reflects exceptional times. They would argue that the institutional and other shareholders might not take up their rights, i.e. join the stupid, thus increasing their exposure.

As always prime underwriters once they have a deal, move heaven and earth to off load the exposure to sub underwrites and thereby pocket a reduced-risk margin. We understand that approx 85% of the risk has been sub underwritten, and what is more that FNZC had to remain as a primarily liable party to procure some of the underwriters support. We also understand that they have had to transfer up to 75% of the cash fee to the sub underwriters and also transfer all of the benefit of the call option.

Apparently these options were required by the major institutions in order for them to offer their support to the issue. It was not clear whether this request was made before or after the head underwrite was signed with the company. We have now had it confirmed from FNZC that it was a condition imposed after the engagement letter was signed but before the terms of the underwrite were finalised. We have written to Nuplex to confirm this.

Obviously as part of FNZC due diligence they would have discovered that they would have had some difficulty in off loading their risk without a sweetener for the sub underwriters, who may well have had a different agenda to FNZC. - i.e. FNZC wants a financial outcome, money with as little risk as possible, and preferably none; while the sub underwriters may have wanted certainty that they would get cheap shares, either from the stupid or the company. So the cost has been increased by the possible issue of cheap shares with a cost that is hard to calculate, and the institutions get the shares.

But here is the real kicker. I have seen the call option agreement and it is truly extraordinary. FNZC holds the call option as principal, but for the benefit of all sub underwriters but themselves, to be exercised in such manner as they see fit. The sub underwriters are aware of the existence of the option but have no entitlement to any

shares at all. In short FNZC have set themselves the task of Solomon to decide to what extent the call is exercised taking into account the company's need for equity, the implied cost of dilution and the appetite of the institutions. What a wholly unpleasant task to balance competing and even conflicting interests. What this actually says is that the company, on its own and its existing shareholders' behalf, and the institutions as part of the Investing community, trust FNZC's judgment!

Now the final question for Nuplex, did they get a lock in arrangement for these shares or will the 15% be a market overhang thus depressing the price, they should have negotiated at least a 12 month lock up. I now know the answer to that question too, there is no lock up, and if the shares were called and there was a threat of a market overhang that would be damaging to the company. This is another factor that FNZC and Scott St "Solomon" will consider in deciding if to make the call at all.

Why did Nuplex's board allow this to happen? They let themselves run out of time, and with their back to the wall they had little choice but to do a deal and fast. You have all heard the marketing quote, "a customer always wants quality, cheap, and fast, but they can only ever have two of these." Nuplex got it's underwrite (quality) they got it fast and they got it expensive.

Bruce Sheppard

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SIGN A NEW MEMBER COMPETITION

As members have already been informed by email or post, the NZSA Board has approved funding for a competition to focus on increasing membership during the first 3 months of the new financial year. The financial rewards are significant – the Branch achieving the greatest % increase during the months of April, May and June 2009 will gain the $500 prize for its efforts. The individual member who introduces the greatest number of new members in the same period (signed up and paid up) will be similarly rewarded.
And the bonus is that one of those new members will be the winner of a lucky draw to have their 2009/10 subscription refunded and in addition receive a bottle of French champers to celebrate their good fortune. A minimum of 20 new members is all that is required to make the competition self-funding – the Board is looking forward to seeing this exceeded with the enthusiastic participation of Branches and members.

Patrick Flynn

FOREIGN BANKS QUIETLY PULLING CASH OUT OF NEW ZEALAND.

During my discussions with Fletcher Building (FBU) over their recent capital raising, the company reaffirmed it was under no financial pressure to raise capital.

Briefly, the placement was a pro rata offer to all of FBU's institutions and major shareholders,- favouritism, sure, but the Securities Act doesn't allow the company to make an offer to all share holders without a prospectus, and they wanted to raise the new capital fast and decisively. Why, when they have publicly stated that they didn't need the money?

Well actually they do. However, this has nothing to do with the business of FBU and more to do with the business of international banking. FBU has a significant amount of debt from foreign banks, and it has noted an evacuation of these lenders from NZ over recent months, and they have noted an acceleration of this. FBU were fearful that when their foreign debt was due to be repaid they would not be able to roll it over, and would thus potentially face debt default. They wanted domestic headroom to cover this.
FBU confirmed the NZ banks were doing what they could to buffer this migration of foreign lending out of NZ, but they, too, are constrained as most of their funding lines come from off shore. FBU stated to me that they get the strong feeling that foreign bankers are pulling their money out of NZ and what is more that they are not going to return to lending to NZ businesses any time soon, they are taking their capital home to look after their own people and to have their risk close, where they can see it.

FBU have done as good as they can in difficult circumstances and endeavoured to minimize the collateral damage to shareholders.

But the really interesting point that has come out of the FBU rights issue, and one I have been predicting for some time, is the migration of foreign capital out of NZ. It is not that NZ is a total basket case, but seriously, we are now one of the most indebted nations on the earth. On top of this we have declining national income, persistent balance of payments deficits, and, likely for the foreseeable future, internal deficits. Invisibles (the share of our GDP that is paid away to foreigners) are increasing leaving the balance, national income, in decline and it is this national income that services household debt. NZ is real ugly!

Now combine this with the simultaneous global panic of bankers. When risk increases humans want to do the modern equivalent of storing their wealth under the bed in negotiable currency. So we cash up risky investments, we don't make new investments and we store the cash in our home country and wait out the storm.

The discussion with FBU confirmed in real terms that this is now beginning to happen. Foreign banks are quietly pulling their cash out of NZ.

What this means is that this is another factor to consider in our exchange rate debate. Sure the US is printing money and that is why we jumped up from 51 to 59c in a week. Some economists are picking we might even be at 90c by the end of the year. I don't think so. Each time a bank pulls its cash out of NZ it is selling NZD and buying its home currency (unless it has lent in its home currency in the first place but, regardless, the balance of payments gets way worse, the reserve banks foreign reserves decline).

The withdrawal of foreign banking support to business is going to accelerate the credit crunch. The only answer to this is government-provided, business credit. Our Government needs to re-establish a NZ owned and Government funded business bank. NZ business is going to suffer worse than our trading partners. The time has come to either start a kiwi business bank fund it with money from the Crown, or better free money produced by the Reserve Bank, i.e. print money! "Heresy" you say. "Our currency will collapse, we will need barrow loads of currency to buy bread; it can't be done."

Well it can, this is how. Money exists to facilitate trade with the objective of ensuring stable prices. There are some elements of deflationary pressure in the world economy, and trade is going to be constrained by a liquidity crisis. Fix it by printing money, advancing it to a commercial bank, lend it out and progressively as the economy recovers withdraw this money from circulation as the loans fall due, thus relying on the quantity of money to regulate inflation rather than interest rates. This wont happened of course, as our Government so far wants to do things in small bites, but what is emerging is a trend towards protectionism, and nationalism, also a natural thing in tough times. NZ needs to start doing things in the interests of our people and stop trying to be a goody two-shoes on the international stage.

Bruce Sheppard

LOST IN TRANSLATION?

A few members have reported missing out on their emailed copy of the February Scrip, possibly due to Spam filters in their Internet Service Provider. If this should happen to you, please advise National Office by website email, phone or post (see panel above) as soon as possible so that you can receive a replacement copy.

Patrick Flynn

BOARD REPORT FOR MARCH

1. AGM. It was agreed that a formal request together with planning material be sent to Wellington Branch, for a July meeting, and that we would attempt to engage the Prime Minister as our speaker.
2. Task Force: The meeting pursued discussions with Adrian Orr (Task Force on Capital Markets) and Bryan Chapple (Ministry of Economic Development). These are reported separately in this month's edition.
3. In spite of the seeding funding lent to Flow, the association has sufficient cash to meet commitments to the end of the financial year. The current membership fees are to remain unaltered for the coming year.

Alan Best

WORKING WITH THE INSTITUTE OF CHARTERED SECRETARIES.

In the opinion of your Board, the relatively poor state of corporate governance has greatly contributed to the financial disaster that currently grips the globe. The wails of "if only..." are often directed at individuals. Yet much of the shambles was triggered by poor ethics, poor oversight and a lack of clear guiding principles to be adhered to by the various players.

Unfortunately the topic is not seen as "sexy" enough by most of the media. Many incumbent directors are reluctant to embrace sets of rules that may constrain their

behaviour (and sometimes their remuneration) and often the lines of responsibility are blurred. Achieving meaningful change is always a struggle, particularly if you are the lone voice as we seem to have been for 10 years.

Late last year the National Board decided that in the area of corporate governance your Association would be more effective if we were able to establish working relationships with other professional organisations to promote the necessary changes. This "backroom" stuff is often not very visible to the membership, but it is essential work towards improving investor confidence and ultimately the returns you receive.
We are also mindful that such arrangement must not hamper our ability to act unilaterally where necessary or to "rock the boat" when called for. Bruce is not quite ready to retire the Viking helmet yet!

Recently a meeting was held with Grant Diggle, CEO of Chartered Secretaries of New Zealand (CSNZ) who have a similar belief in the need to improve the standard of corporate governance and regulatory control in the NZ commercial environment. Those of you who attended the last AGM heard Grant's very interesting address which stimulated far more questions than we had time for answers.

The NZSA identified three initial areas where we would seek to work together with CSNZ:

1. The need to devolve regulatory and disciplinary functions from the NZX to a separate body, which in our opinion could be a suitably beefed up Securities Commission. Whether or not the Sec Com would currently have the appropriate resources is however of some concern.

   CSNZ's view is that the current situation is unsatisfactory for the same reasons that the NZSA has already identified.

   In addition, the 20 minute delay on information release by the NZX was discussed. NZSA is completely opposed to this as we believe it compromises the continuous disclosure regime. CSNZ have agreed to canvass their membership about this issue.

2. The need for a much more proactive role on the part of the Securities Commission to get away from the 'bottom of the cliff" mentality that seems to pervade the NZ regulatory framework.

   CSNZ are equally unhappy with the very light handed regulatory approach that has characterised the past several years.
   They raised the question of harmonisation of business law (as it applies to governance, disclosure and regulatory oversight) with Australia as an important step. This is important given that the NZ and Australian markets are so closely allied. CSNZ shares our view that the current lack of confidence in the ability of the markets to self regulate is having a serious consequence on investment activity generally.
   Our two boards will be considering this once the initial recommendations of the current MED Investment Taskforce are published. (See report elsewhere in the Scrip)

3. To achieve a more user friendly search facility on the Companies Office (CO) website.

This will require persuading government to institute a unique identifier number for directors. We have already been in discussion with the CO and there will be an NZSA representative on the test panel for the new system.

Given that the CO database is currently being upgraded, CSNZ sees it as an ideal opportunity to increase the transparency and user-friendliness of the whole record system at virtually no cost. They would like to have input to the test panel also.

Grant also pointed out that in many jurisdictions; only a “responsible person” can make changes to the online company records that reside on the CO website. This is very different to the NZ situation where at present anyone can do so. With the current database there is for example the possibility of people altering details (to make themselves a director of a large company for example), conclude a fraudulent transaction on the strength of this “identification” and then alter the details back so that nobody in the company concerned ever knows about it .
This type of situation is avoided if a “responsible person” (such as the Company Secretary) is the only person that can make alterations and filings. It also gives the CO a single point of contact if any issues or queries arise which greatly streamlines the process.

We are considering a joint approach to the Minister (Simon Power) in order to advance these matters.

Our discussions also considered some other issues of mutual interest. These included:

- The importance of truly independent directors. This is of great concern to CSNZ as well as ourselves and is one of the reasons why harmonisation with Australia is seen as important. Grant has supplied me with the appropriate Australian rules via his Australian counterpart and extracts are detailed below.

Principle 2: Structure the board to add value
Recommendation 2.1:
A majority of the board should be independent directors
Commentary
Independent decision-making
All directors – whether independent or not – should bring an independent judgement to bear on board decisions.
To facilitate this, there should be a procedure agreed by the board for directors to have access in appropriate circumstances to independent professional advice at the company’s expense.
Non-executive directors should consider the benefits of conferring regularly without management present, including at scheduled Sessions.
10 Their discussions can be facilitated by the chair or lead independent director, if any.
Independent directors
An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgement. Directors considered by the board to be independent should be identified as such in the corporate governance statement in the annual report. The board should state its reasons if it considers a director to be independent, notwithstanding the existence of relationships listed in Box 2.1, and the corporate governance statement should disclose the existence of any such relationships. In this context, it is important for the board to consider materiality thresholds from the perspective of both the company and its directors, and to disclose these.

11.Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

10 At times it may be appropriate for the independent directors to meet without other directors present.
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Family ties and cross-directorships may be relevant in considering interests and relationships which may affect independence, and should be disclosed by directors to the board.
Regular assessments
The board should regularly assess whether each non-executive director is independent.
Each non-executive director should provide to the board all information that may be relevant to this assessment.
If a director's independent status changes, this should be disclosed and explained in a timely manner to the market.
Recommendation 2.2:
The chair should be an independent director.
Where the chair is not an independent director, it may be beneficial to consider the appointment of a lead independent director.
The role of chair is demanding, requiring a significant time commitment. The chair's other positions should not be such that they are likely to hinder effective performance in the role.
Recommendation 2.3:
The roles of chair and chief executive officer should not be exercised by the same individual.
Commentary
There should be a clear division of responsibility at the head of the company.
The division of responsibilities between the chair and the chief executive officer should be agreed by the board and set out in a statement of position or authority.
The chief executive officer should not go on to become chair of the same company. A former chief executive officer will not qualify as an "Independent" director unless there has been a period of at least three years between ceasing employment with the company and serving on the board.
Box 2.1: Relationships affecting independent status12
When determining the independent status of a director the board should consider whether the director:
1. is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company13
2. is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
3. Has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
4. is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
5. Has a material contractual relationship with the company or another group member other than as a director.

Locally, if Contact Energy had consistently applied rules such as these, we would not have had the problems with Mr Saunders and Mr Pryke over the past few years and the interests of smaller retail shareholders would have been properly represented.

- The NZSA would like the Company Secretary (CS) position to again be made compulsory for all companies beyond a particular threshold – particularly public companies, SOE's and those obtaining funding from the public. Company Secretaries are compulsory in Australian PLC's. Their qualifications and experience must be disclosed, but there are no minimum standards prescribed which we do see as a weakness. Directors have unfettered access to the CS at all times.

  We think it desirable that Company Secretaries report directly to the Chairman (rather than via the CEO) and that both the Chairman and CS sign off on all significant documents. This is an effective limitation on the ability of domineering CEO's to push through policies that are contrary to good governance and in some cases downright illegal. The Enron and WorldCom collapses are just two stellar examples.

We also discussed our concerns regarding the small pool of directors available in NZ and the lack of a suitable pathway for younger potential directors. The UK Institute of Directors has a programme based on the parent ICSA International and CSNZ programme that covers Corporate Law, Corporate Secretaryship, Corporate Governance, Corporate Accounting, Corporate Financial Management and Corporate Administration. CSNZ offer this as a distance learning programme required for membership and also for CPD for existing members and non members. They have had approaches about this programme forming an Accreditation Programme for Directors both new and existing and would be happy to offer this as their parent does to the IOD in the UK. The UK authorities expect at least some of the FTSE directors to be Chartered Directors.

The NZSA sees this as an excellent educational pathway and intends promoting its use along with the possibility of a "junior" directorship on some larger boards.

- The NZSA's increasing focus on the education function was of great interest to the CSNZ and they have offered us some practical support in this area.

Ultimately the situation boils down to whether there is an appetite at government and regulatory level to raise the standards. The previous government showed little interest and it remains to be seen whether the new Government will be willing to make changes to increase the pool of talent and the standards they must meet.

This meeting was very worthwhile. The NZSA will be actively working to establish closer ties with CSNZ in order to better advance corporate governance in New Zealand.

John Hawkins

WHO SAYS WE WERE WRONG ABOUT GENEVA?

Readers will remember that in December we went to bat for the 2000 new small shareholders whose debenture bonds had in part (15%) been converted to shares. After research we decided to withdraw our objections to the current board, and to accept that it was getting on with the job of repaying depositors. We note that the 3rd payment under the scheme of arrangement has now been met, and that depositors have now recovered 40% of their loans, (ie 40% of the unconverted 85%) - considerably better than other sick finance companies. Geneva's bank has obviously accepted this position although we encourage the company to announce this, as further reinforcement of its programme. This continues to vindicate our decision which some found embarrassing at the time.
Alan Best

THE TASK FORCE ON NZ CAPITAL MARKETS.

Two meetings were held in February and March, the first with members of the Ministry for Economic Development, which has the administrative function for the Task Force, and the second as part of our March Board Meeting, with Adrian Orr, Task Force member, and CEO of the NZ Superannuation Fund.
A summary of the issues canvassed in these meetings was prepared for the last issue of The Scrip, and our thanks go those who added important points to this list. Members

should refer to Bruce's editorial in The Scrip of August 2008, and February 2009 for general background.
We were given a particularly good hearing in the second of the meetings and the subjects were wide ranging covering many of the issues we have raised in The Scrip. The following is a brief summary of the issues and recommendations:

1. Governance problems in NZ capital markets: We recommended incentives to take on younger directors and provide a pool of industry leaders for the future, as well as written standards and monitoring for public company boards.
2. Mandatory disclosure of Remuneration and consultancy contracts for boards, CEOs and their direct staff.
3. Standardised reporting of trend, profit, assets and liabilities, and cash flow in annual reports.
4. Independent monitoring of auditors, and expansion of the pool of auditors to avoid conflicts of interest.
5. Reform and enlargement of the Securities Commission to increase its early warning role, and monitoring of prospectus information.
6. Expansion of our separate financial literacy programme (FLOW) and our Research programme to the benefit of all investors.
7. Specific amendments to the Companies Act to cover groups of companies and autopilot regulations.
8. Continuous and immediate disclosure by NZX of company news.
9. Taxation incentives for investment in companies rather than extra housing, maintenance of tax concessions for research and development, and abolition of taxation on deemed (imaginary) rates of return.

Members who need a fuller set of notes of our meetings with the Task Force are welcome to contact the Editor.
Alan Best

CASH IS KING – OR IS IT?

In the last two months I have received letters from my broker advising that the interest rate on my Australian dollar balances and my Sterling funds have been revised down to zero. The sterling notice, I must say, came as no surprise but I did think that there might, at that time, have been room for some small return for my Australian funds. I cannot help thinking that we might well reach this situation in New Zealand in the near future and so this topic is a matter for all of us to consider, not just those who happen to be investing overseas.

This whole financial crisis came about through the ability of the banking industry to devise intricate ways of manufacturing and reselling products that were already in the market. Unfortunately these products had little underlying asset or value and were merely a recycling of assets (mortgage loans) already in place. The solution to this bout of greed and dishonesty has been for the USA to throw funds at the banks in an effort to prop up and save them from self- destructing. The manner in which toxic loans are to be acquired by governments has yet to be fully revealed but the mechanics of the operation are really unimportant because you and I know full well the consequences of printing too much money - it is a collapse of the value of that commodity - in other words inflation. There is now no possibility that we are going to avoid severe inflationary times. Inflation may be three or four or more years into the future but it must surely arrive. The timing of these inflationary pressures may well be hidden by a huge surge in equity market values anticipating the imminent demise of the recession. In this respect we will all have a warm feeling imagining things are not too bad. Those of us who have experienced inflation still recall the horror of this onset. We are now seeing the strange situation of governments

bailing out the very industry that has put us into this parlous state. Add to all this the bonus payments to management of the big banks and the anger of many people becomes understandable. If that were all, the price might be worth it. However the banks are creaming it through the widely increasing interest rate spread between borrowing and lending. So long as governments are prepared to bail out banks by buying toxic assets then it seems there is no means of making banks pay for their misdemeanours. If a straight loan were contemplated with the ability to ratchet up interest rates if bank spreads became too wide at least there would be some small hammer with which to rein in excess profits. This is a topic too large for a newsletter but to come to the point of this article – what can be done to earn some return on short-term assets?

Portfolio holders will have been conserving cash and selling those investments where the prospects of reduced dividends is likely. A reasonably large portion of portfolios will thus be retained in cash and this asset is now at risk of earning no interest for some period of time. In my view the finance industry offers no alternative to call funds at the moment (in spite of the government guarantee) and I sense that banks will continue to lower their deposit interest rates to meaningless figures.

I am now considering a select group of unsecured notes from investment grade listed companies as a means of temporary relief. Contact Energy has recently had an issue of Fixed Rate Bonds. These instruments are unsecured, unsubordinated loans with a maturity date in 5 years and they will be traded on the Stock Exchange. The interest rate of 8% is at present attractive but the risks need to be understood. The interest risk will be present when deposit rates for short term funds reach say around 5%. At that point it may be advisable to sell on the market. Other risks such as the Company dropping below investment grade (which would have an immediate effect on yield) and the risk that the bond may not be marketable particularly if small amounts are held must be considered.

This is not a solution for all equity investors but depending on the amount of call funds earning no return it is definitely a proposition. Consult your adviser for further information and look at the turnover of debt on a regular basis. Finally, funds placed in this form of security should be treated as being volatile and must be monitored frequently. Your Z Score analysis will be essential each year.

Oliver Saint

COMPANY REPORTS

DILIGENT BOARD MEMBER SERVICES INC – SGM 11TH MARCH

Brief background
Diligent is a Delaware registered company that has developed and provides an online software facility called Diligent Broadbooks which is a web based portal that enables directors and management to compile, update and examine Board material prior to and during Board meetings. The portal allows Boards of listed and other companies to provide corporate governance solutions with their software. The 'Broadbook' facilitates continual evaluation by directors of the financial position of their listed company. The company has been in existence since 2003 and was listed in New Zealand in December 2007 following an IPO at $1 per share.

Your representative knew nothing about this organization when he volunteered to attend this meeting. Since then, the NZX, other websites and of course Google have increased

my knowledge of the operations of this group. Being aware that I was lacking some basic information I arrived at the meeting earlier than usual in the hope of obtaining additional documents. Thus I was able to obtain the latest annual report to 31 December 2007 which disclosed that during the year the group had apparently spent its way through most of the net cash available of $13 million at 31 December 2007. There were a number of questions that come to mind when a special meeting of this type is called.

- Why the sudden rush?
- Why are preferred shares rather than common stock being issued?
- What is wrong with a rights issue to existing shareholders?

I managed to obtain answers to the above before the meeting. Responding to the reason for speed the usual retort that there was no time to go through the procedures of a rights issue (which Chairman does not give this as an answer in these situations?) was offered. The investors insisted on receiving preferred shares so this was the reason for the amendment to the Constitution and the issue of preferred stock. Whilst I could imagine that time was running out it does seem to me that the Board would have had ample time to see that funds would disappear rapidly by the end of the year. The website of the company is no help to an investor, the last update that I spotted prior to the meeting was in 2007.

There was only a handful of shareholders attending the meeting that were not Board members or lawyers and with the exception of your representative nobody spoke to the resolution. A link up to the American directors was in place but this was used on only one occasion by the chairman. The chairman advised that proxies amounting to 99% of the capital had voted in favour of the resolution. The resolution was carried and if the cash burn rate is similar to 2008 the company has another three months of cash available. I did comment that there was absolutely no information of the results for 2008 although the directors would undoubtedly have this information to hand – so much for continuous disclosure. It seemed abundantly clear that the company would not be trading by the end of the year and the 50% reduction in share price to 10 cents following the approval of the resolution only confirms this opinion. Hindsight is a wonderful facility but it does seem that if the company was unable to list in the USA there was no possible reason for the NZX to allow primary listing in New Zealand. For future reference it should be a requirement for all companies to have a website and for this website to be updated regularly.

Oliver Saint

FLETCHER BUILDING LIAISON MEETING 24th March

Des and Mathew met with Johnathan Ling, and covered the following topics:

Placemakers

Jonathan commented that Placemakers would be significantly down on last year but was holding up well in comparison to competitors. He noted that some smaller players were likely to drop out of the market and that Placemakers would be in a strong position for the recovery.

Formica

Jonathan gave us a run down on the progress at Formica, he broke it down into four divisions Asia , Australia and NZ the US and Europe. He was positive on Asia and felt it was doing very well, importing out of the factory in China was producing cost savings that were flowing through to NZ and Aust as well. He felt the US was starting to show some

fragile signs of recovery in the housing market and with all of the work completed on the plant now he hoped the US would break even for the year. Europe was the real worry particularly in Spain with new house sales down 80 % on the year, he felt there was more bad news to come in Europe. He felt Formica would at least break even this year. He noted that goodwill was reviewed every 6 months and impaired if required.

Infrastructure
Jonathan gave us an update on the infrastructure division. He said the division is performing well and is in a good position to capitalise on the large infrastructure projects the government was undertaking and the housing insulation programmes in NZ and Australia. He said Fletchers is well and truly the market leader in the $100m plus projects winning 90 % of contracts tendered for. He said they hold their market share of 25% in the 50m to 100m area. Overall the division was going well.

Executive remuneration and Directors Fees
Jonathan informed us the company has an incentive scheme where managers can earn up to 50% over their basic pay. It is based on 50% short term and 50% long term.Des pointed out we would prefer senior executives short term bonuses to be around 20 to 30% of their basic pay and long term bonuses to be around 70 to 80%.of their basic pay.

General
Jonathan noted that debt to equity was in line with long term projections and that return on capital was being affected by the Formica purchase short term. He also stated NPAT is unlikely to rise much above this year's number in the coming 12 months. He also said it was likely that the dividend policy would revert to its long rung average of 50% of net profit.

Jonathan also noted that he felt the two areas for growth for the company were the infrastructure area and Formica
Des Hunt

BRIAN GAYNOR GIVES US A GLOBAL PERSPECTIVE

Why is it that Brian Gaynor is consistently our most popular invited speaker to Auckland Branch? It is because he is able to take a broad view of the NZ economy, put it into terms the layman can understand, say unflinchingly what is wrong, and how we can fix it.
This year he gave us the recent history of the world wide boom in debt from the 70s when it was governments, to the 80s when it extended to companies, and from the 90s onwards when credit from the banking system affected the ordinary consumer. From 1979 when the Clinton administration set free the banks from the restrictive regulations on credit, managers came to be paid for exploiting an inverted pyramid of liquidity in which $100 of bank deposit was lent many times over, (up to 30 times according to a recent article in Time magazine,) so that by 2006 up to 75% of global liquidity was based on derivatives. If the main role of a reserve bank is to "take the punchbowl away when the party gets too hot", then most of the reserve banks in the world got it wrong.

McKinsey's table of major recessions showed that while there was a 29% contraction in GDP, in the Great Depression, the current contractions in NZ rate as minor – so far!
There is a tendency to think that NZ is not doing so badly in this global upset. However we have participated fully in the decline in the quality of bank lending, heaping up a huge increase in household debt. While banks took advantage of overseas money there is now a trend towards shorter term borrowing from overseas while the need for large house mortgages amongst the 25-40 year old working population has held up. From 31st March

this year when many longer term loans in the banking system fall due, there will be an increasing concern over the banks ability to borrow short (which is all that will be available) and to lend long (which is what the mortgagees are demanding.)

Brian asked "Why should the price of a house double?" It produces no overseas exchange, provides no efficiencies in local production or infrastructure. Like Japan in 1999 we may be in for a 14 year fall in house prices. Like USA, we should see a 25% fall in house prices since the peak in 2006. He then outlined 4 signposts in deflationary conditions: 1. housing, 2. finance, 3. retail spending, 4. unemployment, and suggested we watch out for unemployment increases over the winter period. We are not yet far into the major recession forecast by the Economist in a paper of January 2009 – predicting a downturn from 4-8 years, with an 86% increase in public debt, shares down 53% from their 2006 highs, and average house pricing down 35%. However in this period of "creative destruction" there will be companies which evolve and grow, creating opportunites for the perceptive investor.

The overall strategy in these conditions he concluded must be preservation of capital, which will demand a more active trading approach (rather than the buy and hold approach of the past.) In a final plug he distinguished between the usual managed fund in NZ – a Relative Fund whose prospectus defines the proportions allocated to equities, property, commodities, and bonds; and the Absolute fund which is measured only by its total return and does not prescribe the allocation to particular classes of asset. It is no coincidence that in Milford the Absolute fund is outperforming relative funds.

Disregarding the questions from the floor which were numerous, Brian's talk set me thinking:
If that inverted pyramid of global liquidity which in 2006 showed 75% of liquidity to be in hedge funds and recycled debt, what happens when this part of the pyramid is shrunk and controlled by regulation. The quantity and velocity of money circulating will never be the same again. Will American and European consumers be happy about this?
Also, now that money is being printed by the reserve banks of the world (euphemisticly called "quantitative easing") and again under the "Special Drawing Rights" approved by the G20 for the IMF, how long before inflation and interest rates take off again? We are in for an interesting and challenging time.
Alan Best

BRANCH REPORTS

AUCKLAND

Newsflash
Saturday May 9 - "Investing" An introductory course giving an overview of most types of investments.
Saturday May 23 - "Sharemarket basics" An ideal course for people starting out in the Sharemarket, or those who feel the need to refresh their knowledge or upskill.

Times: 10-12 and 1-3 both days. (4 hours per course)
Numbers: Limited to 12 participants for each course. Do one or both – your choice.
Location: Chartered Secretaries Boardroom, Level 2, Administration House, 44 Anzac Ave, Auckland Central.
Presented by: Auckland Branch

Cost: Members $40 per day. Non-members $55 per day. Includes comprehensive NZSA course material. Tea and Coffee.
Information and bookings: John Hawkins. Ph 478 3198 or email jhawkins@internet.co.nz

1. Branch Meeting – 18 February 2009
   Our guest speaker was the ever popular Brian Gaynor who had more of an intimate 'conversation' with an audience of members in excess of 120. We had the pleasure of Brian's company for over an hour and a half in which time he provided a useful update on the current investment climate and reasons for its sorry state. It was easily understood and appreciated by all those present. Following on from the guest speaker, John Hawkins provided information on the upcoming membership competition and also covered the tentative steps being taken on the education front.

2. Education / Company Visits
   There is nothing further to mention since the last report as we have not had a committee meeting since that time.

3. Scheduled Meetings
   The next committee meeting will be on 30 March and the next Branch meeting will be on 22 April with the guest speaker to be advised.

Ken Cook. – Chairman.

WAIKATO

Our February meeting was addressed by Ted van Arkel, Chairman of Charlies and member of Restaurant Brands board.
Ted outlined his life story, emigrating from Holland as a ten year old to the wilds of Ohakune, the family's retreat to Auckland and his subsequent recruitment as a Woolworth's cadet and his progress through the ranks to eventually becoming CEO of Progressive Enterprises. Ted had a stint at Fletcher Merchants from where he purchased and ran his own Placemakers franchise, before "retiring" and taking up his board positions.
Ted impressed as a "roll your sleeves up" type of guy,- very necessary if your directorship portfolio contains a few "problem children."
His talk was enjoyed by those present, indicated by the good level of questions asked. He thought prospects for Charlies and particularly Restaurant Brands were good, as was subsequently borne out in the Fourth Quarter Sales Report. In response to another question he expressed admiration and confidence in his fellow Charlies' Directors – Marc Ellis and Stefan Lepionka. Restaurant Brands directors make store visits and at Board Meetings sample both their own and opposition pizzas. In response to another question Ted felt that directors' responsibilities were firstly to the shareholders.
In April, Tauranga Branch have kindly invited us to join them in a visit to Trustpower. We look forward to this and thank them for extending the invitation.

Dates for the NZSA Education Courses "Investing Basics" and "Sharemarket Basics" have now been scheduled for 7, 14, 21, & 28 May, between 7-9pm.
The courses will be held at Hillcrest High as part of their Continuing Education program. Courses will cost $60 each with a discount if both courses are taken and include a comprehensive course book. Inquiries can be made to robertfoster@xtra.co.nz

Robert Foster – Waikato Branch

One of the most important functions of the NZSA branches is to provide activities for the local members. At the Waikato Branch, I have been our activities co-ordinator for the last

2 years, having taken over from the capable Malcolm Dunshea. The role includes the arranging of the monthly meetings, guest speakers, venue, catering, AGM and Xmas functions. Company and site visits are also arranged, although this can be difficult in Waikato, as there are fewer public companies available to visit than in larger centres. We are occasionally contacted by Bay Of Plenty and Auckland organisers about co-visits with their members in local areas and such offers are usually gratefully oversubscribed by Waikato members.
Coordinating activities calls for optimism and perseverance. The frustrating parts often arise from the speakers' end; - those who do not reply to enquiries despite repeated polite attempts to draw them out. At our last Committee meeting, thought was given to naming and shaming some of these, but in the interests of civility, I prefer to believe there is some underlying good reason that prevents certain Directors and public figures from deigning to return enquiry calls/emails. It may be an irritation to some of these to have to respond to requests to talk to our organisation, but certain people need to remember NZ is a small country and shareholders-even the little guys- are a crucial part of the economy. Those bonuses don't get viewed so favourably when you ignore the company owners.
On a positive note, we have interesting and informative speakers who make a lot of effort to get to Hamilton and the members who attend regularly know who these people are. Members need to also note that it cuts both ways. When speakers are engaged, a good sized audience is the least we can do to thank them,and help pay the venue costs!
The NZSA website seems to be performing well and the Waikato events are listed there to give members a "heads up" for what is coming in months ahead. Please keep an eye on it and do attend meetings as often as you can. Spare a thought for the organisers...the committee do a lot of work. We meet monthly and many of us spend hours on follow up jobs.
So, we are looking forward to seeing many of you at future meetings!

Bronwyn Smits- Activities' Coordinator

BAY OF PLENTY
The February discussion group meeting, because of unforseen circumstances was convened on Friday the 6th of March 09. 37 members were treated to a well received talk from Hamish Colman, the Tauranga branch manager of ABN AMRO Craig.
His address gave an overview of the current market situation. He discussed where the market was going and concluded with some strategies for the confusing situation in which the investors find themselves.
The second session of the afternoon was a general discussion on what trades members had made during recent times. Generally they showed a flight to quality or a speculative theme, though most had incurred a small drop in market value. The discussion was notable for its humour and allowed some of us to go home feeling that our own experiences were little different from that of others around us.
Our March discussion group is due on March the 27th . Our guest speaker is Kenneth Brown who is a liquidator/receiver and a principle of Rodewald Hart and Brown. His subject is “Insolvency”.
The April meeting is to take the form of a company visit to Trustpower Ltd. A company with a good story to tell. The number attending is required and the attendees list is being keep by Jane Lyndon Phone 5765395.
The numbers are filling steadily.
Lloyd Christie – Chairman

WELLINGTON
Our first meeting this year was at the online, accounting software-as-a-service, e company, Xero (NZX XRO). In the year since we last visited Xero the company has made substantial progress with Australian, UK and International versions being added along with significant new functionality. There is a feeling at Xero that they are reaching a tipping point with uptake accelerating as the word of mouth effect kicks in. Watch out for their 31st March 2009 subscriber numbers – Xero are targeting 6,000 and estimate that they will reach break-even by April 2010.

This year's AGM will be in Wellington – late July – Watch this space.
Over the last two years the Auckland and Tauranga branches have run very successful AGMs and we will be doing our best to follow their model. The AGM will be a full day event with a variety of speakers and will include morning tea and lunch. As in the past there will be no charge for members to attend so this really is exceptional value! If ever there was a reason to come and spend some time in Wellington then this is it.

Brendan O'Donovan – Chief Economist for Westpac – will be speaking at our next meeting on Tuesday 14th April. This will after the Q1 Consumer Confidence survey is released so it will be interesting to hear his view on this.
For details of upcoming Wellington Branch meetings check out the Wellington branch website page at www.nzshareholders.co.nz.
Martin Dowse - Chairman

CANTERBURY
Branch members attended a presentation by economist Robin Clements giving his appraisal of the recent and evolving world economic situation and its impacts on New Zealand. Robin Clements is well placed to provide this assessment. He is Director of Clements Economic Services which provides advisory services to UBS (NZ) as Chief Economist. He also prepares the quarterly Mainland Monitor for the Press, Christchurch and is actively involved in preparing NZ market commentaries, analyses and forecasts for domestic and international clients. Robin has previously worked for United Bank, the Reserve Bank of NZ and the NZ Treasury.

The evening presentation lasting over 90 minutes was attended by some 25 members. Robin Clements made extensive use of statistical information including some 36 charts to illustrate trade, financial and economic trends in NZ and her trading partners. He gave valuable insights into the nature of our deepening recession but was far removed from the alarmist opinions of some media commentators. Robin's view of NZ's current situation was well short of optimistic, but he looked towards a scenario of recovery starting in 2010 with NZ holding onto the coattails of an Australian resurgence.
The next event is a visit to Wind Flow Technologies (Tuesday 7th April) at 4 pm. This should be a very illuminating and enjoyable experience for several reasons but particularly because it is a New Zealand company providing renewable energy in a very environmentally sustainable way!
Our June meeting will be on Wednesday, 3rd June -a talk by John Cochrane of Murray & Co.
Further information is available on the NZSA web site page for the Canterbury Branch: www.nzshareholders.co.nz/branches/canterbury.

Robin Harrison - chairman

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MEMBER'S ISSUES

FELTEX UPDATE

There are currently three actions underway against the directors of Feltex

1. The Registrar of Companies has laid criminal charges under the financial Reporting Act against five Feltex directors, alleging that the half year accounts to December 2005 did not disclose that the carpet- maker was in breach of its loan agreement with the ANZ Bank, the agreement being incorrectly classified as non current when it was current.
2. The NZ Institute of Chartered Accountants is investigating a complaint from The Securities Commission that Ernst and Young's auditing of the Accounts was misleading. NZSA advocates that the supervision of auditors be conducted by an independent body.
3. Shareholders of Feltex had until Easter to sign up for an action against the original directors of Feltex over the prospectus and promotion of the float. The high Court ordered changes in the way the case could be brought but ruled that the central action could proceed. Legal fees will be taken out of the settlement, if any.

Alan Best

ASA & UKSA NEWSLETTERS

I have, from time to time, reminded our members that we receive copies of the newsletters of our fellow associations in Australia and the UK. It surprises me that so few seem to be interested in the monthly Australian publication which is filled with quite valuable information for those of you, and I am sure there are many, who have investments across the Tasman. At present only 13 members receive the Australian newsletter and 14 the UK publication which, since last month, has become a monthly issue. Russell Hodge (rusorjudy@paradise.net.nz) will be happy to place you on the emailing list. There is no cost to you for this facility.

Oliver Saint

DIVIDENDS ACCOMPANIED BY SHARE ISSUES

Gladys Zanders wrote:

We have received in the post today a pamphlet outlining Contact Energy's new method for paying dividends to shareholders.

However, we are suspicious about their motivation and intentions, and are seeking reassurance that they are being upfront and considerate of their shareholders.

Of particular concern is the issue of paying dividends as bonus shares. Contact will issue our dividends as bonus shares. If we want the dividend as cash, we then have to sell the bonus shares back to Contact.

We replied:
You are right to be suspicious on various grounds.
On the face of it, Contact needs capital and doesn't want to raise money from the Bank. The documentation on a major fund raising is expensive and time consuming (see Bruce's editorial last Scrip), and so it raises capital by asking shareholders to accept shares instead of dividend, and note that this is a means of making the dividend tax free, while keeping the payout to a minimum. The argument goes: Why pay a cash dividend when we need the cash for investment in the business?
There are several complicating factors:
1. Future Dividends: when shareholders increase the capital Contact is obliged to consider whether it will be able to pay dividends on the increased shareholding in future. If it spends the capital on increased production eg a wind farm, or steam energy, it will generate future profits and be abled to pay increased dividends in future. Because the price is low at present it is a good time for Contact to redeploy dividends into capital, but when the share price firms it may have to pay increased dividends. Contact Management will have thought of this.
2. Dilution: When the share capital is increased, it is spread over the same number of shareholders, and each share represents a lower proportion of the total. Once again, if it is deployed to increase earnings per share, the dilution will not matter. The price has yet to be struck based on the weighted average early March, but Contact calculates that if it is $6.50/share the dividend will be .016923 new share for each existing share- ie dilution is 1.6923%, and the cash dividend when the underwriter, (Origin) buys the shares foregone by small shareholders, will be 11cents.
3. However most of Contacts small shareholders rely on income from dividends, while one, Origin Energy has expressed interest in acquiring more shares. So we can expect Origin to leave its dividend in the company as shares, while the small shareholders cash in their shares to receive a normal dividend, and this will allow Contact to creep into a more dominant position. As it already controls the company it wont make much difference, and again it is a good time from Origin’s point of view to do this.
4. We have noted the departure of Tim Saunders as an Independent Director, but while Origin is in such a dominant position on the board we dont expect this will make much difference to the day to day running of the company. Phil Pryke the other independent director was the one who recommended Origin's takeover offer to small shareholders a few years ago, and so the governance of the company is unlikely to alter as a result of Contact’s dividend distribution

D Grindell wrote;
We have seen companies paying dividends and then asking for all the money back and more, including even the tax paid on dividends, by having cash issues. By contrast Fairfax in Australia lowered its payout to 20% of profit – much better than having cash issues. This is an area I would like the association to give a viewpoint on.
Our reply;
The raising of capital by cash issues is a legitimate activity of companies and what better time when the company knows its shareholders have just received a payout? Sir Ron Brierley built a larger and larger investment company on just this technique, and it continues in GPG today. All of the issues outlined above – dilution, maintenance of future dividends, and the ambitions of major shareholders are relevant in this situation. Companies are obliged to say how they will use the cash, and if it appears that the new capital will generate better income, then shareholders have the choice of maintaining their share of the company or investing in something more attractive. In general, I favour the full dividend and then cash issue, over the reduced dividend, because it preserves the maximum choice for the shareholder, and makes the company aim for the best investment of shareholders’ funds when compared with other investment opportunities in

the market. Nevertheless there are times of low profit when a reduced dividend is necessary.

BREAK FEES.

HEH Perkins wrote:

The divergent views about Banks' break fees as expressed in The Scrip were very interesting.

It is significant that publicity only arose once floating rates fell below fixed. When the reverse applied, those on fixed were probably congratulating themselves on their wisdom in not opting for floating at the outset. As soon as they became losers they wanted to change the deal, and with blithe disregard for contract law seemed to think they have every right to do so……… In the various letters of complaint to the papers, very seldom was the reason for wanting to break given. This leads me to suspect that in most cases it was simply an opportunistic ploy to plug into anti bank sentiment to obtain sympathy for their case.

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