

MANAGER INSIGHT – 28 FEBRUARY 2010

The Portfolio returned -0.53%¹ in February, while the NZX50 Index returned -0.27%².

Share insight: Freightways

Freightways has been a core Portfolio holding for several years. The courier and information management business is a well-managed company that has an impressive record of revenue and earnings growth. It has consistently paid a good yield and its dividend has grown along with its earnings. It has also demonstrated a strong element of defensiveness as the economy slowed.

However, its most recent result covers the period when the economy was at its weakest. The company's results showed that there was no escape for its core express package division (which accounts for around 80% of revenue and a similar proportion of earnings). In that division, the volume of business from existing customers was 5% lower than the previous period. Although the company has a high degree of variable costs (because its owner drivers get paid per parcel they deliver), a volume decline of that amount cannot help but affect margin. Earnings before Interest and Tax (EBIT) were 17% of revenue, more than a percentage point lower than the same period last year. The result is a reminder, if any was needed, that the recession we have recently emerged from was long and difficult.

Yet the manager remains confident that Freightways should remain a sizable position in the Portfolio. Although this recent result was weaker than many

expected, the overall investment case for Freightways remains sound. As the economy grows, so too will physical movement of packages and Freightways will benefit. In fact, this soft result paradoxically confirms the investment case because it emphasises that Freightways remains a cyclical business. It could not cut its fixed cost base enough to deal with a 5% volume decline. But when volume growth returns, fixed costs will not grow. Although the variable costs will grow, earnings will grow faster than revenue.

Freightways is currently trading at just above \$3. The stock is priced at an enterprise value to EBIT multiple of 11.4x which is not overly cheap. However, this figure represents earnings at a cyclical low. When volume growth returns, margins will widen and earnings will rapidly improve. If historic margins are applied to the relatively weak revenues expected for the full 2010 financial year, then the stock would earn EBIT of \$64 million, an operating earnings yield of more than 10%. This does not take into account the very strong record the company has of growing sales. In addition, the investors are getting a cash dividend yield of 5%, equivalent to a pre-tax yield of 7.15%. If the company's earnings return to a growth path and margins recover, as the manager fully expects over the course of this year or the next, then the company could easily achieve earnings per share of 26c in 2011. If the market valued that at a Price Earnings Ratio of 15x, that would equate to a stock price of \$3.90, a premium to today's price of 28%.

¹ Returns are stated after Portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns. ² Source: Bloomberg.

TAX-ADJUSTED PERFORMANCE TO 28 FEBRUARY 2010 FOR DIVIDEND YIELD COMPOSITE STRATEGY* (PART 1)

DYP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	AMP NZ Office Trust	Hallenstein Glasson	Restaurant Brands
Neutral	Air New Zealand	Kiwi Income Property	Goodman Property Trust
Negative	Freightways	The Warehouse	Trustpower



COMPARISON	DYP 1 MONTH	DYP 3 MONTH	DYP 6 MONTH	DYP 1 YEAR	COMPOSITE 2 YEAR PA	COMPOSITE 5 YEAR PA	COMPOSITE 7 YEAR PA	COMPOSITE SINCE INCEPTION ¹	COMPOSITE MAXIMUM DRAWDOWN ^x
Dividend Yield Composite Strategy*	-0.53%	-1.33%	0.39%	10.52%	-3.65%	2.16%	10.55%	360.67%	-36.26%
Comparative index**	-0.15%	0.79%	1.53%	17.66%	-2.94%	1.51%	7.02%	248.97%	-31.30%

¹ Pre-tax equivalent gross return. IMPORTANT: Please refer to the slide that follows for the footnotes relating to this slide

TAX-ADJUSTED PERFORMANCE TO 28 FEBRUARY 2010 FOR DIVIDEND YIELD COMPOSITE STRATEGY* (PART 2)

Tax-adjusted Performance

- * The Dividend Yield Composite Strategy is a tax-adjusted composite strategy stated after portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns.

Dividend Yield Composite Strategy

The Dividend Yield Composite Strategy is made up of the New Zealand Equity Trust (EIT) from 2 December 1992 to 6 June 2003, the Dividend Yield Fund (DYF) from 6 June 2003 to 28 February 2008, and the Dividend Yield Portfolio (DYP) data from 28 February 2008 onwards.

EIT was a New Zealand Unit Trust. DYF was established as an Australian Unit Trust. DYP is a PIE. The tax-adjusted composite strategy is designed to remove, as much as possible, the impact of the different tax regimes that applied during the calculation period. By doing so it enables the returns from EIT, DYF and DYP to be represented in a substantially consistent manner without tax distortions.

The Dividend Yield Composite Strategy covers five different tax regimes, and accordingly the use of different calculation methods is necessary to remove the impact of the various regimes. These are:

- i) The period to 6 June 2003. New Zealand Unit Trust returns were reported net of tax and have been grossed up by 33% (being the tax rate applicable to New Zealand Unit Trusts) to reflect the pre-tax position.
- ii) The period 6 June 2003 to 30 September 2005. Australian Unit Trust returns were generally not taxable to investors, and to provide a comparison the returns have been grossed up by 33% to reflect that actual returns were after tax.
- iii) The period from 1 October 2005 to 31 March 2007. Investors were only taxable on distributions made by Australian Unit Trusts. The returns have therefore been grossed up by 33% and adjusted for any tax payable on distributions made.
- iv) The period from 1 April 2007 to 28 February 2008. Australian Unit Trust holdings were subject to the Fair Dividend Rate regime. The returns have been grossed up by the tax amount payable under the Fair Dividend Rate regime.
- v) The period from 28 February 2008. PIE returns are reported gross of tax, and as such no adjustment has been made to returns attributable to DYP.

This calculation is undertaken for comparative purposes only, and should not be confused with the portfolio return generated from either EIT, DYF or DYP. More details on these calculations, together with the formulae used, are available on request from New Zealand Funds Management.

TAX-ADJUSTED PERFORMANCE TO 28 FEBRUARY 2010 FOR DIVIDEND YIELD COMPOSITE STRATEGY* (PART 3)

Comparative Index

** The comparative index is made up of 70% NZX50 Index and 30% 90-day bank bill rate. All index figures are sourced from Bloomberg. A fee of 0.60% pa has been deducted from the NZX50 Index to reflect the cost of obtaining a passive New Zealand share market exposure using an Exchange Traded Fund and the brokerage associated with purchasing it. A fee of 0.20% pa has been deducted from the 90-day bank bill rate as bank bills are usually accessed by retail investors through a managed fund. The 90-day bank bill rate has been included in the comparison because the mandate allows the manager to invest up to 30% of the Portfolio in cash and capital notes. The comparative index is stated on a pre-tax basis.

Maximum Drawdown

x Returns should be looked at in conjunction with the level of risk associated with an investment. For this reason, the 'maximum drawdown' is included for both the strategy and the comparison. The maximum drawdown is a measure of volatility and represents the largest decline in value experienced during the reporting period.

* The Dividend Yield Composite Strategy is a tax-adjusted composite strategy stated after portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns.

COMPLETE PORTFOLIO AS AT 28 FEBRUARY 2010

PORTFOLIO SUMMARY

Number of securities	27
Yield ¹	7.3%
Weighted average market cap (share holdings)	\$2.2b
Cash, capital notes & other	11%
Shares	89%
Total economic exposure	100%

SECTOR / SECURITY	COUNTRY	PORTFOLIO VALUE	PORTFOLIO ALLOCATION	MARKET CAP (NZ\$M)	PRICE/EARNINGS	PRICE/BOOK	PAYOUT RATIO	YIELD
CASH			5.0%					
Bank deposits / Bank bills	New Zealand	\$802,004	5.0%	n/a	n/a	n/a	n/a	2.8%
CYCLICALS			29.3%					
The Warehouse Group	New Zealand	\$1,158,155	7.2%	\$1,176	13.3	3.6	79.0%	8.4%
Freightways	New Zealand	\$1,138,405	7.1%	\$467	15.4	2.9	78.0%	7.3%
Fletcher Building	New Zealand	\$634,357	3.9%	\$4,813	15.7	1.5	58.0%	5.1%
Restaurant Brands	New Zealand	\$569,310	3.5%	\$172	9.5	3.8	56.0%	6.8%
Mainfreight	New Zealand	\$423,980	2.6%	\$576	14.9	1.9	51.0%	4.5%
Hallenstein Glasson	New Zealand	\$413,440	2.6%	\$211	13.4	3.7	95.0%	9.5%
Air New Zealand	New Zealand	\$385,659	2.4%	\$1,406	14.7	0.9	60.0%	7.0%
NON CYCLICALS			59.6%					
Goodman Fielder	New Zealand	\$1,201,718	7.5%	\$2,741	10.9	1.2	80.0%	7.5%
Trustpower	New Zealand	\$1,198,559	7.4%	\$2,311	18.6	1.6	92.0%	7.4%
Fisher & Paykel Healthcare	New Zealand	\$818,698	5.1%	\$1,732	25.6	6.3	95.0%	5.3%
Kiwi Income Property	New Zealand	\$786,900	4.9%	\$815	12.9	0.8	97.0%	11.0%
Goodman Property Trust	New Zealand	\$776,210	4.8%	\$873	11.5	1.0	93.0%	12.3%
Corporate Express	Australia	\$562,300	3.5%	\$933	11.8	4.0	66.0%	5.6%
Coca-Cola Amatil	Australia	\$527,382	3.3%	\$10,895	17.0	4.8	73.0%	4.2%
Foster's Group	Australia	\$522,965	3.2%	\$13,346	15.0	2.6	70.0%	5.0%
Spotless Group	Australia	\$518,079	3.2%	\$976	13.2	1.6	79.0%	5.0%
Metcash	New Zealand	\$493,463	3.1%	\$4,093	13.1	2.7	54.0%	6.1%
Sigma Pharmaceuticals	Australia	\$459,592	2.8%	\$1,363	9.7	0.6	72.0%	7.4%
Port of Tauranga	New Zealand	\$396,134	2.5%	\$939	20.1	1.5	81.0%	5.7%
Contact Energy	New Zealand	\$395,867	2.5%	\$3,707	21.6	1.2	96.0%	6.9%
AMP NZ Office Trust	New Zealand	\$373,900	2.3%	\$768	12.2	0.9	97.0%	12.0%
STW Communications	Australia	\$244,420	1.5%	\$393	8.2	0.7	32.0%	4.8%
UXC	Australia	\$165,964	1.0%	\$171	6.2	0.7	57.0%	9.1%
Photon Group	Australia	\$163,330	1.0%	\$258	5.5	0.5	46.0%	8.2%
Energy Developments	Australia	\$8,273	0.1%	\$483	10.4	1.3	59.6%	6.0%
CAPITAL NOTES & OTHER			6.1%					
Kiwi Income Property MCNs	New Zealand	\$719,104	4.5%	n/a	n/a	n/a	n/a	9.0%
Sky City Capital Notes	New Zealand	\$269,584	1.7%	n/a	n/a	n/a	n/a	8.0%
TOTAL ECONOMIC EXPOSURE²		\$16,127,753	100.0%					

¹ The yield calculation represents an estimate of the yield on the Portfolio, calculated using yields forecast by New Zealand Funds Management for each company's current financial year. Where applicable, the security's yield reflects the benefit derived from imputation credits received. The yield is not the return on the Portfolio, nor is it a projection or forecast. The Portfolio's return could be less than the Portfolio's yield. Details of the yield calculation are available on request from New Zealand Funds Management. ² Total economic exposure represents the total economic value of a Portfolio, which is the gross asset value of the Portfolio adjusted for the effect of direct or indirect derivative positions taken by the Portfolio. Note: Rounding may affect the subtotals and totals.

For further information or to request a copy of the Investment Statement, please contact New Zealand Funds Management Limited.

Past performance is not necessarily an indication of future returns.

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