

## Manager insight – 30 June 2009

The Dividend Yield Portfolio returned 0.77%<sup>1</sup> in June, while the NZX50 Index was up 1.2%<sup>2</sup>.

### **Manager insight: Fosters**

An exciting position that was added to the Portfolio in June was the Australian beverages company Foster's Group. Breweries are usually great businesses as they produce strong and steady cashflows and require low levels of ongoing investment (ie the input costs into producing beer – barley, hops, yeast and water, plus sugar, glass and aluminium – are negligible). They tend to be ideal companies for a dividend yield strategy as they do not need to reinvest much of their profits to grow the business and so are able to pay a high proportion of them out to investors. Moreover, breweries are resistant to recessions. The sentiment expressed by Benjamin Franklin that "beer is living proof that God loves us and wants us to be happy" is shared by many.

A great business however is not always a great investment. More often than not great businesses are so well recognised that their shares trade at very high prices. Often it is only when great businesses strike trouble that a value-focused investor can find an opportunity. The toxic tipple that caused many breweries to stumble in recent years has been wine. Sadly their taste wasn't limited to senior management buying the odd bottle of Bordeaux. Rather, brewers all around the world decided to buy the wineries outright. Foster's were particularly aggressive in this direction and have spent billions acquiring wine businesses in Australia and the US.

The problem with this strategy is that compared to breweries, wineries are terrible businesses. The wine market globally is ultra competitive and characterised by strong retailer power. Wine vintages are also hugely weather dependent and, in direct contrast to beer where volumes and revenues can grow without large marginal expense, producing more wine requires significant investment in land and vines. In the case of Foster's these structural industry issues have been exacerbated by poorly executed strategies, most notably its decision to amalgamate its beer and wine sales networks.

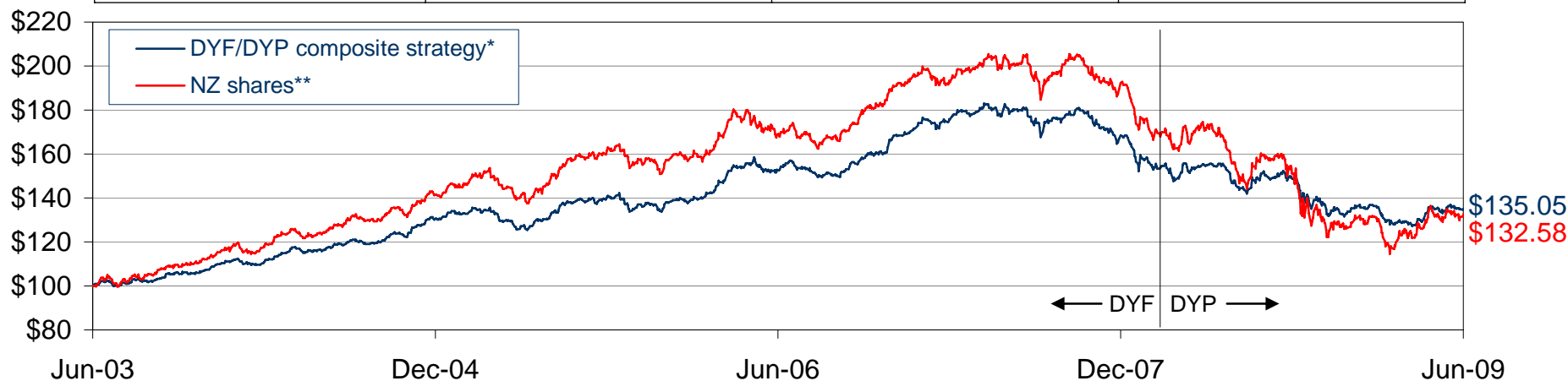
The potential value of a brewery that hasn't diluted its value by adding wine is illustrated by Lion Nathan. It was recently taken out by its major shareholder, Kirin, at a price of \$12.22 per share (an EV/EBIT multiple of 14x). If that multiple is applied to Foster's brewing business alone then the value reached (even if making the unreasonable assumption that the brewery assets assume the whole company's debts) is \$4.89 per share. Given that the share is currently trading at around \$5, an investor is getting the wine assets for free. Now while those businesses have provided a very poor return on the amount of money the company has invested in them, they did produce \$430m of EBIT over 2008 and are certainly worth a significant amount of money. Even on a conservative multiple of 6x this represents value of \$1.34 per share or 27% per share. The manager expects that in time the market will more fully reflect the value of the whole business and the Portfolio will benefit. In the meantime, investors can enjoy the 5.4% dividend yield.

<sup>1</sup> 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.

<sup>2</sup> Source: Bloomberg.

## Performance to 30 June 2009 for DYF/DYP composite strategy\*

Return attribution	One month	Three month	Six month
Positive	Restaurant Brands	-	-
Neutral	Auckland Intl. Airport	-	-
Negative	SkyCity	-	-



DYP return One-month	DYP return Three-month	DYP return Six-month	DYP return One-year	Composite strategy return Since inception pa
0.77%	4.80%	-0.11%	-6.80%	5.07%

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. \*Dividend Yield Fund (DYF) data from 6 Jun 03 to 28 Feb 08. Dividend Yield Portfolio (DYP) data from 28 Feb 08 to 30 Jun 09. \*\*Source: Bloomberg. NZ shares represented by NZX50 Index. The asset class index in the chart (NZX50 Index) is not for benchmarking purposes but rather to demonstrate the performance of the largest asset class allocation in the Portfolio.

# Dividend Yield Portfolio

## Portfolio summary as at 30 June 2009

Portfolio summary				
Number of securities	28			
Cash, capital notes & other	30%			
Shares	70%			
Weighted average yield	8.0%			
Average market capitalisation (share holdings)	\$2.0b			
Sector / Security	Proportion of portfolio	Market cap (\$m)	Yield*	Payout ratio
<b>Cash</b>				
Cash	35%			
Share hedge**	20%	-	2.8%	-
Share hedge**	15%			
<b>Cyclicals (Top 5 shown below)</b>				
Fletcher Building		\$3,929	8.5%	70%
Freightways		\$427	8.1%	67%
Mainfreight		\$411	6.2%	43%
Restaurant Brands		\$101	10.2%	59%
The Warehouse		\$1,167	8.1%	75%
Share hedge**	-4%			
<b>Non Cyclicals (Top 5 shown below)</b>				
Coca Cola Amatil		\$8,115	4.9%	72%
Fisher & Paykel Healthcare		\$1,483	6.1%	102%
Foster's Group		\$12,316	5.3%	70%
Telecom		\$4,935	8.8%	96%
Vector		\$2,031	9.4%	82%
Share hedge**	-11%			
<b>Capital Notes &amp; Other (Top 5 shown below)</b>				
Kiwi Income Property MCN		-	8.6%	-
Fletcher Building 7.5% 15 Mar 2012		-	8.9%	-
GPG Finance 9% 15 Dec 2013		-	10.9%	-
Infratil 8.5% 15 Sep 2013		-	10.0%	-
Sky City 8% 15 May 2010		-	8.5%	-
<b>Total</b>	<b>100%</b>		<b>8.0%</b>	

\*Yields forecast by NZ Funds for each company's current financial year. Where applicable, the security's yield reflects the benefit derived from imputation credits received.

\*\*The share hedge reduces the investment in shares and generates cash like returns when the Portfolio is hedged. Note: Rounding may affect the subtotals and totals.

# Dividend Yield Portfolio

Complete portfolio as at 30 June 2009

Portfolio summary				
Number of securities	28			
Cash, capital notes & other	30%			
Shares	70%			
Weighted average yield	8.0%			
Average market capitalisation (share holdings)	\$2.0b			

Sector / Security	Proportion of portfolio	Market cap (\$m)	Yield*	Payout ratio
<b>Cash</b>	<b>35%</b>			
Cash	20%	-	2.8%	-
Share hedge**	15%			
<b>Cyclicals</b>	<b>13%</b>			
Fletcher Building		\$3,929	8.5%	70%
Freightways		\$427	8.1%	67%
Mainfreight		\$411	6.2%	43%
Methven		\$90	12.9%	80%
Restaurant Brands		\$101	10.2%	59%
The Warehouse		\$1,167	8.1%	75%
Share hedge**	-4%			
<b>Non Cyclicals</b>	<b>42%</b>			
AMP NZ Office Trust		\$718	12.5%	98%
Auckland International Airport		\$1,935	7.4%	100%
Coca Cola Amatil		\$8,115	4.9%	72%
Contact Energy		\$3,366	7.0%	93%
Fisher & Paykel Healthcare		\$1,483	6.1%	102%
Foster's Group		\$12,316	5.3%	70%
Goodman Fielder		\$2,302	7.4%	77%
Goodman Property Trust		\$769	14.5%	100%
Infratil		\$898	5.1%	160%
Kiwi Income Property		\$731	11.4%	100%
Lion Nathan		\$7,817	4.0%	79%
Port of Tauranga		\$811	5.9%	79%
Sky City		\$1,484	8.1%	71%
Telecom		\$4,935	8.8%	96%
Trustpower		\$2,398	6.8%	114%
Vector		\$2,031	9.4%	82%
Share hedge**	-11%			
<b>Capital Notes &amp; Other</b>	<b>10%</b>			
Kiwi Income Property MCN		-	8.6%	-
Fletcher Building 7.5% 15 Mar 2012		-	8.9%	-
GPG Finance 9% 15 Dec 2013		-	10.9%	-
Infratil 8.5% 15 Sep 2013		-	10.0%	-
Sky City 8% 15 May 2010		-	8.5%	-
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<b>Total</b>	<b>100%</b>		<b>8.0%</b>	

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

Past performance is not necessarily an indication of future returns.

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