

MANAGER INSIGHT – 31 MAY 2010

This ‘Manager insight’ takes a closer look at Corporate Express, a company which the Portfolio held.

Share insight: Corporate Express

Corporate Express is an investment opportunity that ‘Mr Market’, as Benjamin Graham termed the famously fickle share market, appears determined to offer the patient investor. When the share market decides that a company is a growth company, but in reality is more of a steady Eddie, share price performance fluctuates dramatically even though earnings are remarkably stable. In the case of Corporate Express, investors became highly optimistic about the impact that e-commerce would have on the business. In the late 1990s and through the early 2000s, there was a buzz about the cost savings that could be made by business-to-business transactions that were effected through the booming popularity and sophistication of the internet. Corporate Express is one such company that, through technology adoption, would see strong EBIT margin expansion and hence some serious growth in earnings. It is a one-stop shop for all types of office supplies – paper, pens, stationery, business machines, mail room supplies, briefcases and luggage, toner cartridges, CD-Rs, DVDs, computer peripheral and more. In effect, this is a business that supplied businesses and was clearly in the sweet spot to benefit from e-commerce.

However, the reality was far less exciting for Corporate Express. The bulk of its business is now indeed handled over the internet, with 76.5% of all 2009 orders made on-line. As can often happen, cost savings were passed on to its customers. The result was that the EBIT margin has remained rock steady at around 8% for the past 10 years, despite the migration to the

internet. That is not to say that Corporate Express has not delivered growth – it has, but not to the degree that ‘Mr Market’ had hoped for. This created the recipe for the steady growth in profits, but a highly volatile share price – which in turn created an opportunity. In the third quarter of last year, the Portfolio was able to build a position around \$4.00 a share. At those levels, it had a forecast yield of 7% on a very sustainable payout ratio of 67%, with modest debt levels and strong free cash flow. A few months later, the upside was realised when the company was taken over by its parent and majority owner Staples Corp for a 40% premium. The position was subsequently sold at this level – an express return for the Portfolio.

The Portfolio does not invest in companies hoping for a takeover premium, but it is believed that because of the emphasis on quality companies with strong cash flows, there will always be several positions in the Portfolio that are ripe for a takeover bid, just like Corporate Express.

Corporate Express share performance



TAX-ADJUSTED PERFORMANCE TO 31 MAY 2010 FOR DIVIDEND YIELD COMPOSITE STRATEGY* (PART 1)

DYP PERFORMANCE ATTRIBUTION	1 MONTH	3 MONTH	6 MONTH
Positive	Restaurant Brands	Trustpower	Mainfreight
Neutral	Goodman Property Trust	Air New Zealand	Port of Tauranga
Negative	Fisher & Paykel Healthcare	Goodman Fielder	The Warehouse



COMPARISON	DYP 1 MONTH	DYP 3 MONTH	DYP 6 MONTH	DYP 1 YEAR	DYP 2 YEAR PA	COMPOSITE 5 YEAR PA	COMPOSITE 7 YEAR PA	COMPOSITE SINCE INCEPTION ¹	COMPOSITE MAXIMUM DRAWDOWN ^x
Dividend Yield Composite Strategy*	-5.02%	-2.65%	-3.94%	4.18%	-5.27%	2.61%	7.55%	348.48%	-36.26%
Comparative index**	-4.80%	-2.01%	-1.23%	7.91%	-4.59%	1.80%	5.55%	241.95%	-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 31 MAY 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 31 MAY 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.

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COMPLETE PORTFOLIO AS AT 31 MAY 2010

PORTFOLIO SUMMARY

Number of securities	27
Yield ¹	7.1%
Weighted average market cap (share holdings)	\$9.6b
Cash, capital notes & other	10%
Shares	90%
Total economic exposure	100%

SECTOR / SECURITY	COUNTRY	PORTFOLIO VALUE	PORTFOLIO ALLOCATION	MARKET CAP (NZ\$M)	PRICE/EARNINGS	PRICE/BOOK	PAYOUT RATIO	YIELD
CASH			4.3%					
Bank deposits / Bank bills	New Zealand	\$669,962	4.3%	n/a	n/a	n/a	n/a	2.7%
CYCLICALS			30.6%					
Freightways	New Zealand	\$1,170,491	7.5%	\$453	13.0	2.8	76.0%	7.1%
The Warehouse	New Zealand	\$1,140,377	7.3%	\$1,099	12.0	0.8	78.0%	9.0%
Fletcher Building	New Zealand	\$813,106	5.2%	\$4,977	12.7	0.6	55.0%	4.9%
Mainfreight	New Zealand	\$500,925	3.2%	\$611	11.7	0.5	48.0%	4.3%
Hallenstein Glassons	New Zealand	\$394,017	2.5%	\$197	11.0	1.0	95.0%	10.0%
Air New Zealand	New Zealand	\$354,326	2.3%	\$1,238	9.7	0.7	70.0%	7.8%
Restaurant Brands	New Zealand	\$329,000	2.1%	\$228	8.8	0.5	52.0%	5.4%
Skellerup Holdings	New Zealand	\$87,946	0.6%	\$128	10.0	0.6	55.0%	5.8%
NON CYCLICALS			59.9%					
Trustpower	New Zealand	\$1,186,235	7.6%	\$2,248	16.5	1.6	93.0%	7.5%
Fisher & Paykel Healthcare	New Zealand	\$777,017	5.0%	\$1,629	17.6	5.6	95.0%	5.5%
Goodman Property	New Zealand	\$771,095	4.9%	\$790	11.2	0.9	93.0%	13.2%
Auckland International Airport	New Zealand	\$763,428	4.9%	\$2,424	20.6	1.2	100.0%	6.2%
Goodman Fielder	New Zealand	\$731,310	4.7%	\$1,877	9.3	1.1	80.0%	7.5%
Coca Cola Amatil	Australia	\$494,857	3.2%	\$8,305	15.0	5.1	70.0%	3.6%
ANZ Banking Group	New Zealand	\$414,232	2.6%	\$55,970	10.7	1.8	64.0%	5.1%
Port of Tauranga	New Zealand	\$405,900	2.6%	\$890	17.6	1.4	79.0%	5.8%
Foster's	Australia	\$403,432	2.6%	\$10,675	14.3	2.8	77.0%	4.2%
Westpac	New Zealand	\$398,089	2.5%	\$66,720	10.4	1.8	69.0%	5.6%
AMP NZ Office Trust	New Zealand	\$398,062	2.5%	\$698	11.7	0.8	96.0%	11.6%
Contact Energy	New Zealand	\$394,060	2.5%	\$3,484	19.5	1.2	96.0%	6.8%
Spotless	Australia	\$391,165	2.5%	\$586	9.9	0.6	60.0%	6.7%
Commonwealth Bank of Australia	Australia	\$390,479	2.5%	\$77,947	11.4	2.3	76.0%	5.5%
Kiwi Income Property	New Zealand	\$389,821	2.5%	\$743	13.5	0.6	98.0%	11.6%
Sky City	New Zealand	\$375,692	2.4%	\$1,656	11.9	2.1	69.0%	7.7%
Metcash	Australia	\$366,820	2.3%	\$3,078	11.2	2.4	79.0%	5.4%
STW Communications	Australia	\$306,170	2.0%	\$353	8.5	1.1	39.2%	5.2%
CAPITAL NOTES & OTHER			5.2%					
Kiwi Income Property MCNs	New Zealand	\$817,432	5.2%	n/a	n/a	n/a	n/a	9.0%
TOTAL ECONOMIC EXPOSURE²		\$15,635,446	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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