

## Manager insight – 31 December 2009

The Portfolio returned 1.74%<sup>1</sup> in December, while the NZX50 Index was up 3.35%<sup>2</sup>. For the year the Portfolio is up 9.37%<sup>1</sup> against the NZX50 Index's performance of 18.94%<sup>2</sup>. The recent performance is consistent with the long-term goal of growing investors' capital for future needs by investing in well-analysed, high-dividend-yielding shares.

### Share insight: UXC

Another Australian position that has recently been added to the Portfolio is a company that is not well known in the market – software consultancy, UXC. Based in Melbourne but with businesses all around Australia and New Zealand, UXC is a provider of a huge range of IT support services. It operates through a number of small companies that it owns and which are specialists in their particular area.

One of the interesting things about UXC is the fact that it has little institutional ownership and consequently is not covered by large investment bank research analysts. Surprising as it may sound, this is actually a positive. Shares that are very well covered are often very well understood. Shares like UXC can be hidden gems.

Despite the fact that it has a low investment community profile, UXC is actually a company of reasonable size. It generated revenue of A\$714m in its most recent financial year and is on track to get near to A\$800m this year. It is the third largest IT consulting business in the Australian market, ahead of global giants like PricewaterhouseCoopers and EDS, and behind only IBM and Accenture.

The combination of size and a low profile makes this share interesting but raises the obvious question, why aren't other institutions interested in owning the company? The answer is that the company had a very poor first half in 2009 and this has scared investors away. Having grown strongly for several years, UXC moved into the new financial year with aggressive growth plans. IT consulting is a labour-intensive business and for growth to occur it means that teams of consultants are needed. As the economy stuttered through late 2008, UXC kept contracted teams on in the expectation of work that never arrived. Corporates slashed IT budgets and planned work simply stopped. Consequently, UXC's costs stayed high as its revenue fell – a classically toxic stew that saw EBIT margins collapse from 8% to less than 2% in its Business Solutions division. However, since then the company has aggressively reduced costs and the second half of the 2009 financial year saw its margins return to a far more respectable 6%.

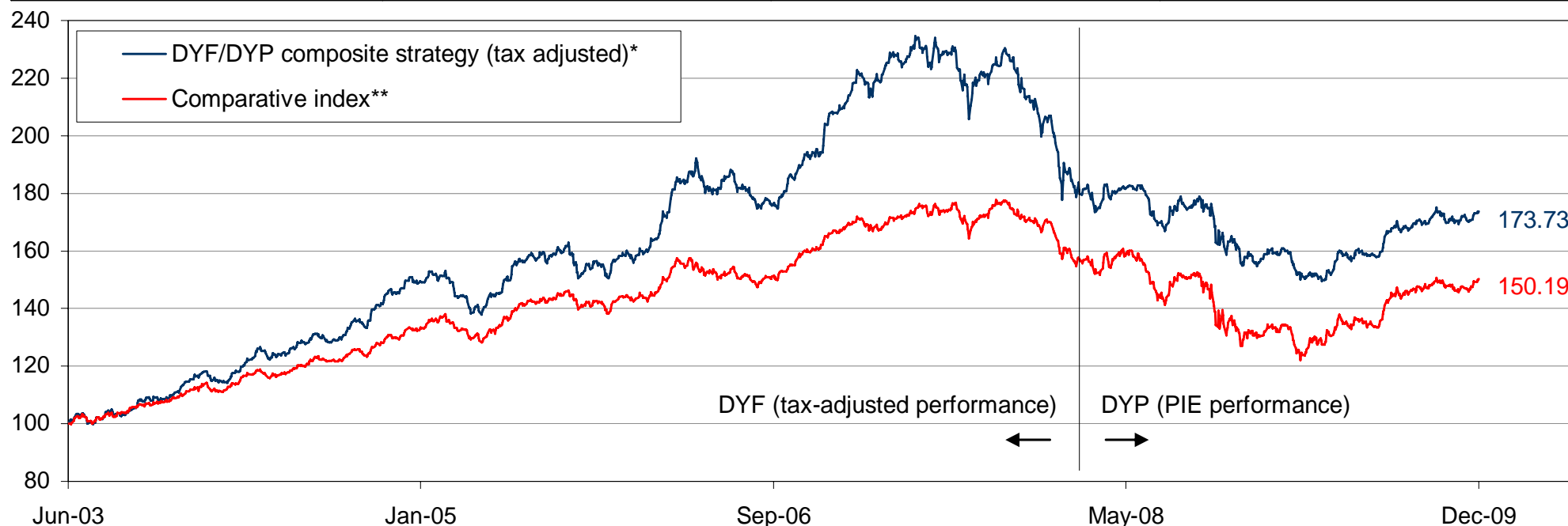
Even if revenue stays flat and margins in the overall business can be maintained at the level of the second half of FY09 (still significantly lower than its historic levels), the company should return EBIT in the current year of more than A\$40m – an EBIT yield on its current enterprise value of 15%. If we value those earnings at a conservative multiple of 8x then we get a premium to the current share price of around 30% without taking growth into account. This low-profile company may yet offer high returns.

<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.

# Dividend Yield Portfolio

Tax-adjusted performance to 31 December 2009 for DYF/DYP composite strategy\* (Part 1)

DYP performance attribution	1 month	3 month	6 month
Positive	Hallenstein Glasson	Freightways	Restaurant Brands
Neutral	Goodman Property Trust	Fisher & Paykel Healthcare	Kiwi Income Property Trust
Negative	Goodman Fielder	AMP NZ Office Trust	TrustPower



Comparison	DYP				Composite				Composite maximum drawdown*
	1 month	3 month	6 month	1 year	2 year pa	5 year pa	7 year pa	since inception pa	
DYF/DYP (tax adjusted)*	1.74%	2.00%	9.49%	9.37%	-8.37%	3.01%	-	8.76%	-36.26%
Comparative index**	2.37%	1.64%	10.90%	13.72%	-6.03%	2.53%	-	6.38%	-31.29%

IMPORTANT: Please refer to the slide that follows for the footnotes relating to this slide.

## Tax-adjusted performance to 31 December 2009 for DYF/DYP composite strategy\* (Part 2)

### Tax-adjusted composite strategy

\* Tax-adjusted composite strategy is stated after portfolio fees and expenses, but before any advisory fees or investor tax. Past performance is not necessarily an indication of future returns. The composite covers Dividend Yield Fund (DYF) data from 6 June 2003 to 27 February 2008, and Dividend Yield Portfolio (DYP) data from 28 February 2008 to 31 December 2009.

DYF was established as an Australian Unit Trust (AUT). In calculating the tax-adjusted composite strategy, for DYF the return has been 'grossed up' at 33% (being the tax rate applicable to New Zealand Unit Trusts) to reflect the fact that the return was generally not taxable to an investor. 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 DYF and DYP to be represented in a substantially consistent manner.

The tax-adjusted composite strategy covers three different tax regimes, and accordingly three different calculation methods are applied over the course of the strategy. The three calculation periods are:

- i) the period pre 31 March 2007 (being the period prior to the introduction of the FDR regime);
- ii) the period from 1 April 2007 to 28 February 2008 (being the period that a New Zealand investor in DYF was subject to the FDR regime);
- iii) the period post 1 March 2008 (establishment date of DYP under the PIE regime).

This calculation is undertaken for comparative purposes only, and should not be confused with the portfolio return generated from DYF or DYP.

More details on these calculations, together with the formulae used, are available on request from NZ Funds.

### 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

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

# Dividend Yield Portfolio



## Portfolio summary as at 30 November 2009

### Portfolio summary

Number of securities	26
Yield <sup>1</sup>	6.8%
Weighted average market cap (share holdings)	\$2.7b
Cash, capital notes & other	16.9%
Shares	83.1%
Total economic exposure	100.0%

Sector / Security	Country	Portfolio value	Proportion of portfolio	Market cap (\$m)	P/E	P/B	Payout ratio	Yield <sup>1</sup>
<b>Cash</b>			<b>5.9%</b>					
Cash	New Zealand	\$997,544	5.9%	-	-	-	-	2.8%
<b>Cyclicals (Top five shown below)</b>			<b>25.9%</b>					
Freightways	New Zealand	\$1,260,512	7.5%	\$485	15.7	3.0	67.0%	7.2%
The Warehouse	New Zealand	\$1,164,986	6.9%	\$1,260	14.1	3.8	75.0%	7.9%
Fletcher Building	New Zealand	\$771,984	4.6%	\$4,788	16.0	1.5	70.0%	5.2%
Restaurant Brands	New Zealand	\$468,268	2.8%	\$157	9.0	3.6	59.0%	9.1%
Mainfreight	New Zealand	\$447,168	2.6%	\$547	15.6	1.8	43.0%	4.9%
<b>Non cyclicals (Top five shown below)</b>			<b>57.2%</b>					
Goodman Fielder	New Zealand	\$1,217,457	7.2%	\$2,788	11.2	1.3	77.0%	7.3%
Trustpower	New Zealand	\$1,187,029	7.0%	\$2,296	18.5	1.6	114.0%	7.2%
Metcash	Australia	\$879,724	5.2%	\$4,470	14.5	2.9	60.0%	5.5%
Coca-Cola Amatil	Australia	\$855,691	5.1%	\$10,706	18.3	5.5	71.9%	3.9%
Foster's	Australia	\$836,063	4.9%	\$13,670	14.3	2.3	69.7%	5.1%
<b>Capital notes &amp; other (Top five shown below)</b>			<b>11.0%</b>					
Kiwi Income Property MCN	New Zealand	\$724,727	4.3%	-	-	-	-	8.1%
Sky City 8% 15 May 2010	New Zealand	\$330,295	2.0%	-	-	-	-	9.8%
GPG Finance 9% 15 Dec 2013	New Zealand	\$242,179	1.4%	-	-	-	-	9.5%
Fletcher Building 7.5% 15 Mar 2012	New Zealand	\$213,502	1.3%	-	-	-	-	10.1%
Infratil 8.5% 15 Sep 2013	New Zealand	\$176,761	1.0%	-	-	-	-	8.3%
<b>Total economic exposure</b>		<b>\$16,899,720</b>	<b>100.0%</b>					

<sup>1</sup> The yield calculation represents an estimate of the yield on the Portfolio, calculated using 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 yield is not the return on the Portfolio, nor is it a projection or forecast. Rather, it is an estimate of the pre-tax and fees income stream generated from investing in the Portfolio. The Portfolio return consists of yield and capital gains and losses (also calculated on a pre-tax and fees basis). Therefore, the Portfolio's return could be less than the Portfolio's yield. Details of the yield calculation are available on request from NZ Funds. Note: Rounding may affect the subtotals and totals.

# Dividend Yield Portfolio



Complete portfolio as at 30 November 2009

## Portfolio summary

Number of securities	26
Yield <sup>1</sup>	6.8%
Weighted average market cap (share holdings)	\$2.7b
Cash, capital notes & other	16.9%
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Total economic exposure	100.0%

Sector / Security	Country	Portfolio value	Proportion of portfolio	Market cap (\$m)	P/E	P/B	Payout ratio	Yield <sup>1</sup>
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Freightways	New Zealand	\$1,260,512	7.5%	\$485	15.7	3.0	67.0%	7.2%
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Mainfreight	New Zealand	\$447,168	2.6%	\$547	15.6	1.8	43.0%	4.9%
Hallensteins Glassons	New Zealand	\$264,453	1.6%	\$191	13.3	3.3	94.0%	10.4%
<b>Non cyclicals</b>			<b>57.2%</b>					
Goodman Fielder	New Zealand	\$1,217,457	7.2%	\$2,788	11.2	1.3	77.0%	7.3%
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Foster's	Australia	\$836,063	4.9%	\$13,670	14.3	2.3	69.7%	5.1%
Kiwi Income Property	New Zealand	\$800,205	4.7%	\$836	12.8	0.8	100.0%	10.8%
Corporate Express	Australia	\$791,572	4.7%	\$907	12.9	4.3	70.0%	5.1%
Fisher & Paykel Healthcare	New Zealand	\$746,315	4.4%	\$1,647	24.4	6.0	101.6%	5.5%
Goodman Property	New Zealand	\$711,166	4.2%	\$896	11.8	1.1	99.9%	11.3%
Port of Tauranga	New Zealand	\$424,325	2.5%	\$942	20.3	1.5	79.0%	5.7%
Sky City	New Zealand	\$413,997	2.4%	\$1,961	15.6	2.5	71.0%	6.4%
Contact Energy	New Zealand	\$377,974	2.2%	\$3,533	19.5	1.2	93.0%	6.5%
AMP New Zealand Office Trust	New Zealand	\$367,997	2.2%	\$758	12.5	0.8	98.3%	11.3%
UXC	Australia	\$58,987	0.3%	\$259	8.6	1.4	129.0%	5.3%
<b>Capital notes &amp; other</b>			<b>11.0%</b>					
Kiwi Income Property MCN	New Zealand	\$724,727	4.3%	-	-	-	-	8.1%
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Infratil 8.5% 15 Sep 2013	New Zealand	\$176,761	1.0%	-	-	-	-	8.3%
TrustPower 8.5% 15 Mar 2014	New Zealand	\$168,839	1.0%	-	-	-	-	7.4%
<b>Total economic exposure</b>		<b>\$16,899,720</b>	<b>100.0%</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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