

Portfolio Strategy

14 August 2007

Analyst:

Cameron Watson

Income investors should consider shares

Many New Zealand shares today offer excellent income streams of between 6.0% and 10%. As well, most provide the chance of growth in income over coming years. For people dependent on the income from their investments, shares can be a powerful ally.

We research around 80 companies on the New Zealand market. At last count, 18 of these currently provide pre-tax dividend yields of over 8.0% per annum.

However, many folks desperate to earn higher levels of income are preferring term deposit look-alikes such as finance company debentures to shares. It is not difficult to understand why. While finance company debentures are higher risk than term deposits (finance companies undertake higher risk lending overall than do banks and the risk of default is higher) they look and feel like term deposits.

Shares on the other hand go up and down like yo-yos every day. There is also a perception in New Zealand that the sharemarket is a gambling den. Yes, shares are volatile, but there are ways of lessening this, which will be discussed later. As for the sharemarket being a 'gambling den', it can be, and many stubbornly treat it as such, but many more (probably wealthier!) people use it for the role it was designed for 300 years ago; to buy stakes in good companies which they hold on to for a long time.

Turning again to the volatility of share prices. Most people simply detest watching the value of their savings toss and turn and this volatility is probably a major barrier to many people investing in shares. There are three ways to lessen volatility: 1) Don't read the sharemarket table in the business section every day - this will prevent you making any rash decisions based on price changes; 2) take a long term view, volatility smoothes out over time; 3) hold a good number of shares in your portfolio to provide safety in numbers; 4) buy companies that have lower risk businesses, like utility companies, as these tend to be less volatile than a small tech company for instance; and 5) invest in shares that pay good dividends.

This begs the question, what is a "good" dividend. The best dividends are not necessarily the highest. An excessively high dividend can indicate the company is going through hard times and that the dividend may fall in coming years. When considering shares we look for those that provide a reasonable dividend yield, but that also have the potential to grow this dividend.

This dividend growth is arguably the crux of share investing. The ability to produce growth in income over time is what stands shares apart from all other investments.

Consider the table on the following page, which shows examples of dividend growth over the past 10 years. An investor who had the foresight to buy Port of Tauranga in 1997 received a dividend yield of 3.36% in that year. Because the Port has grown its dividend payments so much since this time, the investor

would today be enjoying a gross dividend yield of 22.08% based on their initial entry price of \$1.69.

Table 1: Examples of dividend growth over the past 10 years

	Original cost	Original gross yield	Gross yield today
Port of Tauranga	NZ\$1.69	3.36%	22.08%
Commonwealth Bank of Australia	A\$16.00	6.06%	15.81%
Woolworths	A\$4.35	3.45%	16.55%
Fletcher Building	NZ\$4.35	4.46%	15.44%
Ryman Healthcare*	NZ\$0.27	3.85%	14.81%

Source: Craigs Investment Partners; Bloomberg

* Ryman Healthcare dividend growth since 1999

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Dividend growth comes from profit growth. Companies that are stagnant or shrinking may have a high dividend, but little or no dividend growth. This income growth is also important as a protection against periods when interest rates rise. Increasing interest rates usually cause share prices to weaken. According to a study by David Blitzler and Srikant Dash from Standard & Poor's, when interest rates rise (as they inevitably do from time to time) the shares that are most resilient are those that provide not only a dividend stream, but also dividend growth. There are a number of other spin-offs from investing in dividend shares.

Firstly, investing for dividends reduces the risk of accounting fraud. As we have seen overseas, ill-meaning management can quite easily tamper with profit figures. Dividends provide a protection against such shenanigans. Because a company can't pay a dividend unless it has cash in the bank to do so, dividends provide a measure of reassurance that the company does actually earn what it says it earns.

Secondly, shares that pay dividends tend to be less volatile because the dividend provides a sort of air-bag under the share price. If a share that provides a solid dividend stream suddenly falls sharply it often attracts buyers who buy in to capture the dividend yield, which will rise as the share price falls, i.e. the same dividend for a lower price.

Once income investors become comfortable with the natural ups and downs of share prices and understand that the sharemarket doesn't have to be the gambling den it is sometimes made out to be, dividend shares can be a very positive addition to your investment portfolio.

Disclosure Statement

Pursuant to the provisions of the Securities Markets Act 1988 and the Securities Markets (Investment Advisers and Brokers) Regulations 2007 this Disclosure Statement provides you with important information about your Craigs Investment Partners Limited ("Craigs Investment Partners") Advisor, the firm of Craigs Investment Partners and the investment advice you will receive. This document was prepared in August 2009.

1. Advisor Details

Name | Cameron Watson

Phone | +64 (7) 577 4758

Freephone | 0800 272 442

Facsimile | + 64 (7) 571 8625

Email | cameron.watson@craigsip.com

Year joining Craigs Investment Partners | 1998

Branch | 158 Cameron Road, PO Box 13155, Tauranga 3141

Disclosure of Craigs Investment Partners:

Cam Watson ('your Investment Advisor') is employed by Craigs Investment Partners, an NZX Firm and one of New Zealand's largest investment advisory firms. Craigs Investment Partners is 100% owned by certain Craigs Investment Partners staff and close business associates.

2. Qualifications

Cam Watson holds the following qualifications:

1994 | NZX Diploma

1989 | Bachelor of Arts, Victoria University

In Craigs Investment Partners' pursuit of excellence, Investment Advisors are required to maintain continuous internal performance modules, covering topics such as industry and regulatory developments. Craigs Investment Partners Advisors are supported by a global research network.

3. Experience

Cam Watson has been employed with Craigs Investment Partners* since 1998, becoming the Chief Investment Officer in 2007. Previous work history details:

1995-1998 | Tower
Business Development Manager

1993-1995 | Southpac
Investment Management, Investor Services
Manager

1992-1993 | Prudential
Client Services Manager

1990-1992 | Tower Trust Services
Head of Client Services

Craigs Investment Partners* was established in 1984 and has operated as an Investment Advisory Firm since that time.

4. Professional bodies

Cam Watson is a member of or accredited with the following organisations:

- NZX Advisor
- Current Sharebrokers Licence

Craigs Investment Partners is an NZX Firm and must comply with the NZX Participant Rules.

5. Range of investment advice given

Your Investment Advisor is able to provide advice on all mainstream financial products and investments both listed and unlisted, including, but not limited to, advice on Australian and New Zealand Equities, International Equities, Public Offerings, International Bonds, New Zealand Government Stock, Kiwi Bonds, Local Authority Stock, Corporate Bonds and Capital Notes, Debenture Investments, Money Market, Managed Funds, Investment Trusts, Savings Plans, Superannuation Schemes, Unit Trusts, Margin Lending, Foreign Exchange, Fixed Interest, Private Equity and at Call Investments.

Craigs Investment Partners gives investment advice on, but not limited to, the following services and securities; Australian and New Zealand Equities, International Equities, Public Offerings, International Bonds, New Zealand Government Stock, Kiwi Bonds, Local Authority Stock, Corporate Bonds and Capital Notes, Debenture Investments, Money Market, Managed Funds, Investment Trusts, Savings Plans, Unit Trusts, Private Equity, Fixed Interest, Investment Banking and Corporate Advice, Share broking and Company Research, Portfolio Services, Margin Lending, Foreign Exchange, Superannuation, at Call Investments and Funds Management.

6. Types of services

Your Investment Advisor provides the following services: Share broking, Portfolio Strategy and Management, Retirement Planning and Superannuation, Investment Advisory, Custodial Services, Foreign Exchange, Asset Allocation, Cash Management, Portfolio Lending, Research and such other services as introduced from time to time by Craigs Investment Partners.

Craigs Investment Partners Terms and Conditions for Services Provided to Clients (as amended from time to time) apply to all advice given by your Investment Advisor.

7. Dispute resolution

If you have a dispute with your Investment Advisor or Craigs Investment Partners in connection with any investment advice given you should promptly (either in writing and/or verbally) detail the particulars of the dispute to The Compliance Manager:

The Compliance Manager
C/- Craigs Investment Partners Limited
PO Box 13155, Tauranga
New Zealand
Telephone +64 (7) 577 6049.

In the first instance the Compliance Manager will, in good faith, try to resolve the dispute. If an appropriate outcome cannot be achieved the matter may be referred in writing to the NZX at:

NZX Limited
NZX Regulation
PO Box 2959, Wellington
New Zealand
Phone: +64 (4) 472 7599

8. Disclosure of certain criminal convictions

Neither your Investment Advisor, Craigs Investment Partners nor the directors of Craigs Investment Partners have, within the last 5 years:

- had a conviction under the Securities Markets Act 1988, or the Securities Act 1978 (as amended), or for a crime involving dishonesty (as defined in the Crimes Act 1961);
- been a director or principal officer of a Company convicted of any of the above offences;
- been adjudged bankrupt;
- been prevented by a court from taking part in the management of a company or business;
- been the subject of an adverse finding by a court in any proceeding that has been taken against the Investment Advisor or broker in the Investment Advisor or broker's professional capacity;
- been expelled from or been prohibited from being a member of a professional body.

Craigs Investment Partners has not, within the last 5 years, been placed in statutory management or receivership.

9. Fees

Detailed information regarding fees is set out in the schedule to this Disclosure Statement.

10. Other interests and relationships

Craigs Investment Partners has the following relationship(s) with the following relevant organizations:

Relevant Organisation	Description of Relationship
NZX Limited (NZX).	Craigs Investment Partners is an NZX Participant and must comply with the NZX Participant Rules.
Craigs Investment Partners Cash Management Trust Limited (CIPCMT)	Craigs Investment Partners, through their wholly owned subsidiary CMT Management Limited is the Manager of CIPCMT. CIPCMT was established for accepting on-call and term deposits from clients through the Craigs Investment Partners Cash Management Account.
Custodial Services Limited (CSL)	CSL, a wholly owned subsidiary, provides custodial services to Craigs Investment Partners' clients as well as a number of clients independent of Craigs Investment Partners.
Craigs Investment Partners Investment Management Limited (CIPIML)	CIPIML, a wholly owned subsidiary was formed to develop and manage a range of funds portfolios available to Craigs Investment Partners' clients as well as direct investors.
Craigs Investment Partners Superannuation Management Limited (CIPSML)	CIPSML, a wholly owned subsidiary, was formed to develop and manage a range of Superannuation and KiwiSaver schemes available to Craigs Investment Partners' clients as well as direct investors.
Pohutukawa Private Equity Limited (PPE)	Craigs Investment Partners owns 50% of Pohutukawa Management Limited, which provides Private Equity Management Services to PPE.

Details of the commissions Craigs Investment Partners receives from the above organisations are included in the schedule to this Disclosure Statement. Craigs Investment Partners may be the sponsor, promoter or manager of a security, which has been recommended to you and may receive a fee for the services it performs in such capacity. Such fees are disclosed in the Investment Statement or Explanatory Document for each relevant security or offering. As at the date of this Disclosure Statement Craigs Investment Partners are the Sponsor and Promoter of SuperSTART[®], a registered superannuation scheme and KiwiSTART[®] Defined and KiwiSTART[®] Personalised, KiwiSaver Schemes offered by Craigs Investment Partners.

Your Investment Advisor or an associated person may have a direct or indirect pecuniary or other interest in giving investment advice to you. Your Investment Advisor or an associated person will or may receive remuneration directly or indirectly, from a person other than yourself as an investor and in connection with the giving of investment advice to you or a transaction resulting from the giving of advice to you.

An Investment Advisor receives either commission from Craigs Investment Partners of up to 50% of the total gross revenue generated by the Investment Advisor, or a fixed salary. These are paid from fees, brokerage and margins earned by Craigs Investment Partners which are included in the schedule to this Disclosure Statement. If staff are also a shareholder in Craigs Investment Partners, they will receive any distributions paid by Craigs Investment Partners to its shareholders.

Your Investment Advisor or their Prescribed Persons (as defined in the NZX Participant Rules) may, from time to time, hold securities, which are the subject of advice given to you. These holdings may constitute a threshold interest in the security, which they are recommending to you or which you may buy or sell. A threshold interest is an interest that exceeds \$100,000 NZD, or equivalent value, of the security on issue.

11. Money handling procedures

Payment of Money

Money for 'Buy' transactions can be made:

- by personal or bank cheque made payable to "Craigs Investment Partners Limited Client Funds Account" and crossed "non transferable" and "A/c Payee only";
- by Craigs Investment Partners debiting your Craigs Investment Partners Cash Management Account;
- by you direct crediting or sending by telegraphic transfer to a Craigs Investment Partners Limited Client Funds Account.
- Payment by cash is not accepted.

Payment of 'Sale' transactions will be settled by Craigs Investment Partners by cheque, telegraphic transfer or direct credit into your Craigs Investment Partners Cash Management Account or nominated bank account.

12. Investment money

Money received from you will be held on trust for you in the Craigs Investment Partners Client Funds Accounts and will be held in the Craigs Investment Partners Client Funds Accounts until it has been disbursed in accordance with your instructions. We may however, withdraw money from funds held on trust for you for Fees and Charges owed by you to Craigs Investment Partners. Money paid by you to Craigs Investment Partners or money held by Craigs Investment Partners for you pending investment, reinvestment, payment to you, or for any other reason, may attract interest from the bank where it is deposited. Such interest will be deducted from the bank account and retained by us.

Craigs Investment Partners and your Investment Advisor keep electronic records of all property and monies received on your account, these records detail:

- The person on whose account the money/property is received.
- The date of receipt.
- The amount of money or nature of the property.

KPMG currently undertake the statutory audit of Craigs Investment Partners.

You may request a statement of your account by contacting Craigs

Investment Partners or your Investment Advisor.

Except as detailed above, Craigs Investment Partners and your Investment Advisor will only apply money or property received from you for the benefit of Craigs or any other person in accordance with instructions given by you.

13. Investment property

Other valuable property or documents should be delivered to: Craigs Investment Partners Limited
158 Cameron Road, PO Box 13155, Tauranga
Telephone: +64 (7) 577 6049 or 0800 272 442,
or other Craigs Investment Partners offices.

14. Professional indemnity

Craigs Investment Partners maintains professional indemnity insurance, which is consistent with standard commercial terms, which covers all employees and members of the Craigs Investment Partners Group of Companies and is commensurate with the nature and scope of the business, which Craigs Investment Partners conducts.

15. Fees schedule

Your Investment Advisor provides a range of investment related services on which Craigs Investment Partners charges may apply:

- Share broking: Transactional brokerage is charged on the purchase and sale of listed and unlisted securities, dependent on the value of the transaction, of up to 2.5% plus any stamp duties, trade levies and other agency charges. A minimum charge may apply.
- Portfolio Strategy and Management: An annual fee of up to 1.25%, based on the market value of the portfolio, will be charged.
- Superannuation and Funds Management: Craigs Investment Partners offers a range of superannuation and KiwiSaver products and a range of Portfolio Investment Entities (PIEs). Entry, Exit, Custodial and Management fees may apply, for specific details please refer to our latest investment statement.
- Custodial Services: An annual fee of up to 0.50%, based on the market value of your portfolio will be charged. Alternatively a fixed dollar charge per security held can be applied.
- Foreign Exchange: No fixed fee is charged in relation to providing foreign exchange services, although Craigs Investment Partners may earn a margin between the wholesale rate and the client rate.
- Cash Management: Cash Management Accounts operate free of account and transaction charges although we reserve the right to impose transaction fees in certain circumstances for specific clients (please refer to a copy of our latest Investment Statement). Craigs Investment Partners, through their wholly owned subsidiary CMT Management Ltd, is responsible for the payment of Trustee Fees, Manager Fees and Brokerage Fees as set out in the Trust Deed and detailed in the Prospectus. Interest rates are offered to investors net of these fees.
- Portfolio Lending: Craigs Investment Partners charges an

Application fee (\$125), a Margin Call (\$30 per margin call) and an Administration fee (\$500 per 6 months, offset against any interest charge) in relation to providing Portfolio Lending services. Craigs Investment Partners may also earn a margin between the interest rate charged to Portfolio Lending clients and the interest Craigs Investment Partners is charged through their wholesale lending arrangements.

- Private Equity: Craigs Investment Partners, through their 50% joint venture, Pohutukawa Management Limited, may earn management and performance fees as detailed in the relevant Investment Statement.

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* Craigs Investment Partners was formerly known as ABN AMRO Craigs Limited. Prior to 2001, operated as Craig & Co. Limited.