Bay Brokers Limited

PER ARDUA SURSAM

PO Box 880, Tauranga 3140, New Zealand
Ph: 07-578 7453 Mobile: 021-762 440 Email: andrew@vond.co.nz

Investment Strategies

DECEMBER 2014

Welcome to my fourth newsletter. Don't forget to let me know if you no longer want to receive these newsletters. I am not here to annoy you!! Just reply -UNSUBSCRIBE

NZ Market Summary

Economic activity data releases over November have again highlighted a profile of NZ's annual rate of GDP growth easing back from its midyear high, but continue to remain well above its trend rate.

In particular, supportive economic factors over the past month have included the release of data showing a robust rise in third quarter retail sales, continued employment growth, an up-tick in business confidence, together with a historic high in annual net migration flows.

While the negative impact of the sharp decline in dairy prices have yet to fully feed-through into export incomes, there appears to be sufficient momentum in domestic activity – particularly with the continued support from the Canterbury earthquake rebuild – for economy to maintain above trend annual growth rates into the middle of 2015. Moreover, inflationary pressures remain subdued, with a number of recently released pricing surveys showing an easing in one and two year ahead inflation expectations.

Set against a backdrop of heightened global growth risks, together with a modest domestic inflationary environment, **expect any recommencement of the RBNZ's tightening cycle to be very much a 2015 second half of the year story**.

The Market Performance chart to the right shows the value in remaining overweight in New Zealand Equities. Why take the currency risk!

Equity Market Performance

Region Annual % Change	Local Currency	NZ Dollar
Denmark	28.0	22.2
Belgium	22.5	16.6
Finland	17.0	11.4
USA	16.8	21.4
Sweden	15.6	5.6
Spain	15.2	9.7
Ireland	14.6	9.1
Japan	14.1	2.4
Canada	14.1	10.2
Switzerland	13.8	11.0
NZ (NZX50)	**13.1**	**13.1**
Netherlands	11.9	6.6
Hong Kong	9.8	14.1
Italy	8.9	3.7
Singapore	6.3	6.4
France	6.3	1.2
Germany	6.0	0.9
UK	4.5	3.9
Australia	4.2	1.2
Greece	0.0	4.0
Norway	-1.8	-10.9
Austria	-16.4	-20.4
Portugal	-25.9	-29.5

SOURCE: Datastream, First NZ Capital

Please remember that investment views are provided for general information purposes only. To the extent that any such information, and views, constitute advice, they do not take into account any person's particular financial situation or goals and, accordingly, do not constitute personalised financial advice under the Financial Advisers Act 2008, nor do they constitute advice of a legal, tax, accounting or other nature to any person. I recommend that recipients seek advice specific to their circumstances from their investment adviser before making any investment decision or taking any action.

NEW ZEALAND versus AUSTRALIA

The New Zealand economy looks likely to outpace our Tasman rival again in 2015. 2014 has been a very good year for the kiwi economy with growth (3.2%) outstripping Australia (2.7%) by 0.5%. The downturn in dairy prices has hurt New Zealand, but not as much as the 50% drop in iron ore price that accounts for 25% of Australian exports. New Zealand has lower inflation, lower unemployment and stronger business and consumer confidence.

	Australia	NZ
Sharemarket	+1.2%	+16.1%
GDP Growth	2.7%	3.2%
Unemployment	6.3%	5.4%
Inflation	2.3%	1.0%
Budget Deficit (% of GDP)	2.5%	0.2%
Consumer Confidence	110.2	126.5

Immigration numbers reflect the confidence in the New Zealand economy, with a positive inflow back into this country for the first time in several decades.

Treasury now predicts New Zealand's unemployment to decline in 2015 from 5.4% down to 5.1%. And with inflationary pressures muted, the Reserve Bank of New Zealand appears to remain comfortable in keeping the OCR unchanged (at 3.5%) until at least late in the 2015 year.

As New Zealand heads towards a Budget Surplus, Australia's Budget is expected to blow out to A$40.4bn. While New Zealand Dairy Farmers are likely to be heavily affected by the downturn in dairy prices, they are not big tax payers, especially when compared to Australian mining companies – so the New Zealand Government will be minimally impacted, when compared to Australia.

With luck dairy prices will claw their way back in the global auctions over the summer, and even a 10% to 15% uptick would build renewed farmer optimism. That said, the key drivers of our economy remain residential construction, business development and population growth.

Australian Resources	% of Aust GDP	12 months ago	Current
Iron Ore	25.5%	US$136/tonne	US$68/tonne
Coal	13.8%	US$84/tonne	US$62/tonne
Oil & Gas	11%	US$100/bbl	US$58/bbl

Australian Mining Sector

Bulks and oil reduced, base metals hold up

Commodity price estimates have been revised by our analysts, with substantial downgrades to bulks and oil. They now forecast an extended period of low iron ore prices at close to current spot prices but see ongoing downside risk to their base estimates due to over-supply and falling industry costs. In coal they now forecast a delayed (2016+) and more muted price recovery with China import demand remaining the key downside risk. They maintain a more constructive outlook for base and precious metals; zinc being the most preferred (falling inventories, major closures in 2015), in nickel they continue to forecast a deficit but now not until 2016.

Sector impact: 2016 earnings forecasts for BHP, RIO, & WSA are reduced by ~20%; FMG & NHC by 45%, and IGO by 7%. ILU 2016 earnings per share (EPS) has been raised 35% on US closures/inventory gains while AWC's EPS has been raised 36% on a weaker AUD and higher alumina prices.

Stock picks: On a risk-adjusted basis their preferred order is RIO, AWC, WHC, WSA, IGO, BHP, FMG, NHC and ILU. They have upgraded Alumina (AWC) to OUTPERFORM. They note that going into this commodity downturn balance sheets are in good shape with the exception of FMG and WHC.

Balance sheet-fixing capital raisings at current low share prices would still see FMG's DCF at A$3.10/share and WHC's at A$1.70/share. Despite investor sentiment, they are more positive now that share prices have reset and they have raised their 2016 dividend forecasts for NHC, IGO, WSA, AWC and ILU.

	Discounted Cashflow (A$/share)			Target Price (A$)		Upside to target	Latest Recom'd
	OLD	NEW	Change	OLD	NEW		
BHP	34.2	32.4	-5%	35.00	32.00	13%	Neutral
RIO	77.1	71.6	-7%	68.00	65.00	21%	Outperform
FMG	6.4	3.4	-47%	4.50	3.00	21%	Outperform
WHC	2.1	2.0	-5%	2.30	2.00	75%	Outperform
NHC	3.0	2.4	-20%	2.80	2.50	11%	Neutral
IGO	4.9	4.8	-1%	5.10	4.90	20%	Outperform
WSA	5.4	5.2	-3%	5.20	5.00	36%	Outperform
AWC	1.7	2.0	21%	1.80	2.00	23%	Outperform
ILU	6.6	6.0	-9%	8.50	6.00	7%	Outperform

SOURCE: Company data, Credit Suisse estimates

"The 50-50-90 rule: Anytime you have a 50-50 chance of getting something right, there's a 90% probability you'll get it wrong."
Murphy's lesser know Laws

NEW ZEALAND " 3RD MOST PROSPEROUS COUNTRY"

Over the last six years, the world has become more, not less, prosperous – according to the International Report of the Legatum Institute (A London based charitable public policy think-tank with 27 years of ranking prosperity across 142 countries).

"This *may be surprising given the negative impact of the financial crisis. But economic growth is just one dimension of national success. In order to determine a nation's true prosperity we must consider a broad set of measures",* says Executive Director Sian Hansen. *"The Prosperity Index identifies eight core pillars of prosperity. On average, over the last six years, global performance on each of these has improved."*

The past six years have seen the onward march of democracy. Emboldened citizens across multiple continents have led protests calling on their governments to grant them greater freedoms and a more open democracy.

In health, we have seen positive advancements in some of the poorest places in the world. Across Africa, life expectancy has started to increase while infant mortality has decreased. Yet, this too is under threat in parts of West Africa as nations struggle to contain the worst recorded outbreak of the deadly Ebola virus.

OVERALL PROSPERITY	COUNTRY	ECONOMY	ENTREPRENEURSHIP & OPPORTUNITY	GOVERNANCE	EDUCATION	HEALTH	SAFETY & SECURITY	PERSONAL FREEDOM	SOCIAL CAPITAL
1	Norway	3	7	7	5	5	6	2	1
2	Switzerland	1	3	1	21	3	11	12	9
3	New Zealand	15	18	2	7	20	10	1	2
4	Denmark	18	2	3	3	13	8	9	3
5	Canada	5	17	8	2	11	9	5	4
6	Sweden	4	1	4	16	12	4	6	11
7	Australia	12	13	9	1	14	16	3	6
8	Finland	26	4	5	6	15	3	16	5
9	Netherlands	25	10	11	4	6	18	7	8
10	United States	17	11	12	11	1	31	21	7
11	Iceland	35	9	18	9	16	2	4	13
12	Ireland	29	16	14	8	17	5	11	10
13	United Kingdom	28	8	10	20	19	21	10	12
14	Germany	8	14	17	10	7	22	14	17
15	Austria	19	15	15	25	8	15	18	14
16	Luxembourg	11	5	6	45	2	17	32	29
17	Belgium	23	23	16	19	10	19	13	20
18	Singapore	2	12	13	22	18	14	40	45
19	Japan	7	24	19	27	4	25	28	22
20	Hong Kong	21	6	22	60	26	1	23	26
21	France	22	22	20	24	9	30	17	56
22	Taiwan	14	21	36	13	23	7	31	28

In recent years the importance of education has been brought to global prominence through the inspiring work of Malala Yousafzai, the Pakistani schoolgirl who has become the youngest ever winner of the Nobel Peace Prize.

According to Sian Hansen *"**The 2014 Prosperity Index provides a lens through which to view a comprehensive assessment of national success. The Index measures the broad set of indicators that tell us not only how nations perform economically but in vital areas of education, health, freedom, opportunity, social capital, and more. The Prosperity Index covers 142 countries in the world, accounting for 96 per cent of the world's population and 99 per cent of global GDP making it the most comprehensive tool of its kind.**"*

NEW ZEALAND RISES TO 3RD OF 142 COUNTRIES

New Zealand is a big winner this year climbing to third. Despite ongoing productivity concerns, New Zealand has risen 12 places in the Economy sub-index in just two years, from 27th in 2012 to its highest ever rank (15th) in 2014. However, New Zealand's success is also driven by strong freedom and civil society. The country records the highest tolerance levels in the world: 92% and 93% of citizens report the country to be a good place to live for immigrants and minorities, respectively.

The result (20th) for Health was a bit disappointing for New Zealand. Research shows that as the quality of governance increases the effect of healthcare spending increases. Put simply, healthcare spending goes further in better governed countries.

It is also 2nd on the Social Capital sub-index, with 96% of New Zealanders able to count on friends and family in times of need, the 2nd highest in the world. Similarly, 44% report donating to charity, the 4th highest in the world.

Optimism has flourished with an additional 14% of citizens reporting that working hard gets you ahead compared to 2008. "***Coupled with the fact that New Zealanders also now worry less and report greater satisfaction with their freedom of choice, this is a nation that is optimistic, prosperous, and free,"*** **according to this Legatum Institute report.**

Chorus (CNU)

- $2.62 Target price $2.80

The Commerce Commission delivered a positive draft regulatory pricing decision which if implemented should result in a material increase in Chorus's future profits. However, uncertainty remains until the final pricing decision is made (scheduled for April 2015). The final decision will need to take account of submissions which will be made by CNU and other affected parties. If the draft decision is confirmed we expect CNU to start paying a dividend again in early 2016. The cost of building CNU's Ultra-Fast Broadband network is another key issue for CNU. As this construction project has matured it's cost has fallen much as expected.

Longer term we look for a resolution of the post-2020 regulatory framework. CNU has a high level of debt and hence its share price is highly sensitive to changes in future assumptions.

Diligent Board Member Services (DIL)

- $5.00 Target price $5.80

Diligent offers its customers a web based solution for the management of company board meeting papers (Boardbooks) on a subscription basis. Following a turbulent 20 month period which included issues relating to the option grants, revenue recognition, management and Board changes and a sudden drop in customer acquisition, we see greater stability going forward. DIL has normalised operations by reaccelerating customer growth and expanding profit margins. Potential future catalysts are new product development, what DIL does with its large and steadily growing cash balance (forecast to be $70 million by December 2015) and a potential US NASDAQ listing.

EROAD (ERD)

- $3.80 Target price $4.95

EROAD is a transport technology company that has created an electronic solution to manage Road User Charges (RUC) and regulatory compliance for the truck industry. ERD has a dominant position in NZ with 23% market share and also has a presence in Australia and the state of Oregon, USA. The long term opportunity for ERD is replicating its NZ business in Oregon, expanding its product footprint and the potential for other US states to move away from their current paper based systems to an electronic Weight Mile Tax (WMT) to fund road maintenance and construction.

Fletcher Building (FBU)

New structure: More than just tinkering

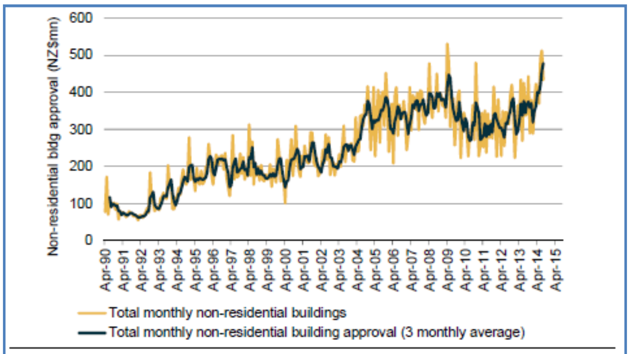
- $8.25 Target Price $10.80

Significant consolidation in businesses across the five divisions: The new organisation structure will consolidate currently in excess of 30 businesses to approximately 20 business units across the five reporting divisions—Construction, Laminates and Panel, Distribution, Heavy Building Products and Light Building Products. With fewer but larger business units, the net effect is the leadership team should have a clearer line of sight to operating performances and on the execution of key initiatives under FBUnite. These changes for long-term gains make sense to us, but we should acknowledge some disruption to business momentum is likely to due to management changes.

Risk reward looks positive. Fletcher Building provides a diversified exposure to the present and ongoing recovery in the NZ building market; a pick-up in the Australian detached home building sector; a projected recovery in the US non-residential sector in 2015; potential upside in terms of cost savings from the FBUnite programme; and the tailwinds from a weaker NZD. Our analyst's rating reflects further earnings recovery for FBU in the next three years, their DCF valuation, FBU's peers and NZ equity market valuations.

The NZ building sector is expected to deliver further growth, and NZ's lead building activity indicators suggest further strengthening of approval levels and for more work to be put in place in the 2015 financial year. This is driven by a combination of residential and non-residential work in Auckland and Christchurch, and generally assisted by strong net positive migration in NZ.

The chart below shows that non-res approvals now back to historic highs.



Source: Stats NZ, FNZC estimates

Freightways (FRE)

- $5.74 Target price $5.60

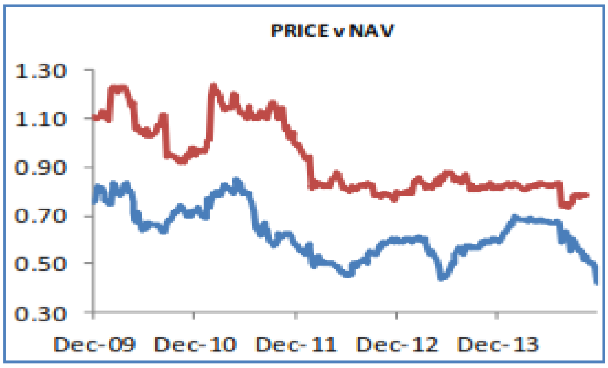
FRE operates in the express package, business mail and information management markets. FRE has recently benefited from increased activity by customers and market share gain in the business to business (B2B) delivery market. FRE has also been successful in increasing profit margins through raising prices and greater efficiency. FRE has solid exposure to the growing business to consumer (B2C) delivery market which is being driven by internet sales delivered direct to the consumer. Critical to FRE's business model is how management execute further pricing initiatives that will target improved profit margins driven by higher B2C delivery volumes. The information management business which gets 60% of its revenue from Australia is performing well.

Guinness Peat Group (GPG)

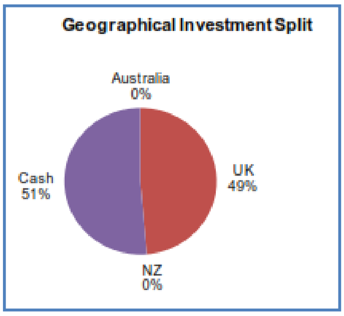
Continued uncertainty through 2015

- $0.41 Target Price $0.44 (down from $0.54)

GPG has received a Warning Notice from the UK Pension Regulator (tPR) in relation to the Coats Pension Plan. tPR believes the Coats Plan was insufficiently resourced at the relevant date (31 December 2012). GPG disagrees with tPR's assessment but it is unlikely an independent hearing via the Determinations Panel will occur before the first half of 2016 at the earliest.



Given the different positions between tPR and GPG it is a real possibility that this issue hangs over the stock for at least another 18 months. Not knowing the amount of Coats' potential pension liability makes it difficult to assess value. When combined with the risk that this process drags on for at least another 18 months, it is hard to see GPG's share price performing in the medium term. At $0.385, the market is implying GPG loses all its cash and the value of Coats is circa US$430m (ignoring uncertainty of time to resolve the issues).



Hallenstein Glasson (HLG)

- $3.14 Target price $3.60

Hallenstein Glasson is a women's (Glassons) and men's (Hallensteins) retail clothing chain that caters for the medium price quality end of the market. HLG experienced difficult trading conditions in FY14 which saw revenue down 5.5% and net profit down 24.3%. However, HLG reported a 4% increase in revenue in the first seven weeks of FY15 and hence we would be surprised if HLG can't improve on the 1H14 profit of $6.2 million, which was 40% below that of 1H13. While online retailing is a constant threat to HLG the lower NZ dollar makes online purchases from offshore less attractive. HLG currently appears to offer good value, although it is worth noting that HLG has historically experienced volatile annual investment returns.

Infratil (IFT)

- $2.97 Target price $3.20

IFT is a holding company specialising in long-lived, growth infrastructure assets in the energy (mainly renewable), airport and public transport sectors. Following the profitable sale of its Australian assets, Lumo and Direct Connect, IFT has paid shareholders $84m in special dividends and is expected to commence a $35m share buyback in the March 2015 quarter. We expect the balance ($550m) will be used for new acquisitions, possibly in the retirement/aged care sector. IFT currently trades at a 20% discount to our estimated net asset value and after adjusting for the special dividend trades on a FY15 gross dividend yield of 6.0%. Future dividends are expected to grow by 11%pa.

Mainfreight (MFT)

- $16.04 Target price $16.25

Global freight forwarder MFT recently reported a strong start to its 2nd half following a somewhat disappointing 2nd quarter of the current financial year. The operating environment is positive for MFT's businesses in NZ, Australia, US and Asia, while Europe continues to track ahead of last year. New accounts are expected to be a primary driver of growth in 4th quarter, following a 3rd quarter which is expected to be driven by the seasonally strong pre-Christmas period. With market share gains in a recovering world economy and better cost management, earnings growth is forecast to exceed 10% in each of the next three years.

PGG Wrightson (PGW)

- $0.45   Target price $0.53

Our analysts anticipate PGW earnings to benefit from ongoing recovery in rural farm gate returns (dairy sector being an exception) in 2015 Financial Year. This is continuing to translate into improvement in PGW merchandising, other agri-services, livestock operation and Agritech division across New Zealand and Australia. Management is focussed on lifting earnings beyond the benefits from the cycle through a combination of operational efficiencies, market share gain, and expansion into new segments and markets. Dividends look likely to have peaked in 2014 at 5.5c/share (12.2% net yield), but look likely to consolidate at 4.5c/share (10% net yield) for the next three years.

Summerset Group Holdings (SUM)

- $2.84   Target price $3.45

SUM is the third largest operator and second largest developer of retirement villages and aged care facilities in NZ. While SUM is in rapid expansion mode we expect earnings growth to slow as SUM develops further villages and the associated effect of low occupancy results in cost escalation which temporarily crimps profit. As the build rate stabilises at 350 units per annum in FY16 we expect earnings growth to accelerate materially. Long term the demographic drivers of baby boomers aging should support SUM's business, although SUM must ensure successful execution of its new retirement village developments.

Trustpower (TPW)

- $7.79   Target price $7.75

TPW is the fifth largest electricity generator/retailer in New Zealand and owns hydro and wind electricity generation assets in NZ and Australia. It appears to offer good value having underperformed its larger peers. Through the provision of multi-utility offerings – a bundle of telephone, gas and electricity services – TPW has been able to reverse the decline in the number of retail customers seen in recent years. TPW's revenue is growing thanks to new revenue coming from the recently completed Snowtown II wind farm in Australia. The construction of this wind farm has seen debt rise, pushing up gearing to 45%. Australian wind electricity developments provide long term growth opportunities for TPW. However, before they can proceed, the uncertainty around the future of the Renewable Energy Target (RET) scheme needs to be resolved.

Z Energy (ZEL)

- $ 4.64   Target Price 4.45

Our analysts are forecasting aggregate Gross Margin at $243m, reasonably in line with the 1st Half 2014 financials. Adjusting for unrealised forex losses, which they estimate at $10m, they are forecasting EBITDAF at $100m, down 9.1%.

The key is to look past those factors that are expected to distort the result. These include the disproportionate weighting of low (to no) yielding supply/export fuel volumes, the unrealised forex loss, and the negative impact from NZR (including lower GRM, the one-off impact from the refinery shut down, and the fee floor payment made to NZR). They have assumed adjusted fuels margins at closer to 19cps, and adjusted EBITDAF (ex-unrealised forex losses) at $100m (headline at $90m).

The market will be looking for any evidence that ZEL has started to recoup market share, ideally without conceding much on the yield front.

Preferred NZ Property Stocks

Argosy Properties (ARG)

- $1.11   Target price $1.03

FY15 dividend yield 8.6%*

ARG is a diversified, low risk, internally managed company, whose income is solely derived from rental income. It has now largely completed its redevelopment programme. Modest earnings growth is generated from increased occupancy, rental growth, vacant land disposals, lower debt costs and redevelopment completions.

Goodman Property Trust (GMT)

- $1.14   Target price $1.10

FY15 dividend yield 8.8%*

GMT should benefit from its strong development pipeline which is to be funded by the sale of non-core assets. While distributions are likely to exhibit negligible growth as over-renting unwinds, we applaud management efforts in moving to a more sustainable distribution and the proposed governance and fee structure changes.

NOTE: * PIE gross dividend yield for these property stocks, assuming a 33% marginal tax rate.

NZ LISTED COMPANIES EARNINGS FORECAST – as at 15-Dec-14 Source: First NZ Capital, CSFB	Ticker	Market Cap (NZ$m)	Price 28/4/14 (NZ$)	Price 15/12/14 (NZ$)	Fair Value	Price Earnings (x)		Gross Yield (%)	
						FY14	FY15	FY14	FY15
OIL & GAS & CONSUMABLE FUELS									
New Zealand Oil and Gas	NZO	274	0.77	0.65	0.98	12.0	16.3	12.8%	8.5%
The New Zealand Refining	NZR	710	1.74	2.27	3.88	12.3	9.8	4.3%	4.9%
Z Energy	ZEL	1,772	3.92	4.43	4.29	16.8	14.2	6.9%	7.8%
INDUSTRIALS									
Capital Goods									
Fletcher Building	FBU	5,572	9.72	8.10	9.65	15.4	14.1	5.3%	5.8%
Opus International Consultants	OIC	213	1.94	1.42	2.05	7.9	7.7	8.8%	9.3%
Methven	MVN	78	1.24	1.20	1.40	13.3	11.5	9.5%	9.5%
Nuplex Industries	NPX	565	3.49	2.85	3.50	10.8	11.2	7.4%	7.4%
Steel & Tube Holdings	STU	252	3.05	2.85	2.65	14.1	11.9	7.8%	8.8%
Agriculture									
Fonterra Shareholders' Fund	FSF	749	6.17	6.10	7.40	36.6	10.9	1.6%	6.4%
PGG Wrightson	PGW	332	0.40	0.44	0.48	9.9	9.6	17.4%	14.2%
Airlines									
Air New Zealand	AIR	2,762	2.10	2.47	1.95	11.3	8.7	11.2%	6.2%
Road and Rail									
Freightways	FRE	878	4.90	5.68	5.20	20.4	17.5	5.2%	5.9%
Mainfreight	MFT	1,523	13.20	15.30	14.70	19.6	17.6	2.9%	3.3%
Transport Infrastructure									
Auckland International Airport	AIA	5,024	3.97	4.22	3.35	32.2	30.2	2.3%	4.6%
Port of Tauranga	POT	2,287	14.18	16.80	16.00	28.8	27.3	4.1%	4.5%
Infratil	IFT	1,629	2.27	2.90	3.08	38.2	22.7	5.1%	13.2%
CONSUMER DISCRETIONARY									
Hotels, Restaurants and Leisure									
Sky City Entertainment Group	SKC	2,326	4.08	3.96	3.30	18.5	17.5	6.2%	6.2%
Restaurant Brands	RBD	368	3.10	3.76	3.05	19.5	16.2	6.1%	7.4%
Media									
Sky Network Television	SKT	2,315	6.47	5.95	6.30	14.0	12.6	6.8%	7.5%
Retailing									
The Warehouse Group	WHS	1,058	3.34	3.05	2.55	17.4	16.7	8.7%	8.7%
Briscoe Group	BGR	661	2.49	3.05	2.70	19.3	17.4	5.7%	6.3%
Hallenstein Glasson Holdings	HLG	189	3.39	3.19	3.40	13.2	12.6	10.5%	11.0%
Kathmandu Holdings	KMD	592	3.70	2.94	3.35	14.0	12.6	5.7%	6.3%
Michael Hill International	MHI	479	1.33	1.25	1.50	14.0	11.6	5.2%	5.4%
CONSUMER STAPLES									
Delegat's Group	DLG	465		4.65	4.60	14.8	13.1	3.3%	3.6%
Sanford	SAN	449	4.32	4.80	5.20	19.6	30.2	6.7%	6.7%
Synlait Milk	SML	467	3.64	3.19	4.28	18.7	23.8	0.0%	0.0%
HEALTH & AGED CARE									
Ebos Group	EBO	1,448	8.93	9.67	9.55	15.6	15.3	4.8%	4.9%
Fisher & Paykel Healthcare	FPH	3,407	4.05	6.12	5.00	34.6	30.7	2.8%	3.0%
Ryman Healthcare	RYM	4,090	8.29	8.18	7.89	34.6	30.0	1.4%	1.7%
Summerset Group Holdings	SUM	611	3.37	2.81	3.45	26.7	23.7	1.5%	1.9%
FINANCIAL									
Diversified Financials									
NZX	NZX	294	1.22	1.15	1.29	18.4	17.4	7.2%	7.4%
Guinness Peat Group Plc	GPG	683	0.59	0.49	0.54	-14.7	11.2	0.0%	0.0%
Hellaby Holdings	HBY	321	3.18	3.35	3.35	11.9	10.5	6.2%	7.0%
Heartland New Zealand	HNZ	537	0.85	1.15	0.97	13.1	11.2	7.2%	7.5%
Property									
Precinct Properties	PCT	1,208	1.01	1.14	1.06	19.0	18.7	7.1%	7.1%
Argosy Property	ARG	878	0.91	1.10	1.06	16.3	18.6	8.2%	8.2%
DNZ Property Fund	DNZ	553	1.56	1.86	1.71	19.5	19.0	7.2%	7.6%
Goodman Property Trust	GMT	1,382	0.99	1.13	1.08	14.7	14.5	8.3%	8.5%
Kiwi Income Property Trust	KIP	1,266	1.14	1.24	1.18	17.8	18.4	7.7%	7.9%
NPT	NPT	100	0.62	0.62	0.63	21.2	18.0	7.7%	7.7%
Property For Industry	PFI	607	1.29	1.48	1.35	20.2	19.6	7.3%	7.5%
Vital Healthcare Property Trust	VHP	523	1.33	1.54	1.36	15.8	16.5	7.7%	7.8%
INFORMATION TECHNOLOGY									
Diligent Board Member Services	DIL	436	4.49	5.02	5.50	52.2	29.4	0.0%	0.0%
EROAD	ERD	231		3.85	4.95	78.6	427.8	0.0%	0.0%
Trade Me Group	TME	1,392	3.90	3.53	3.59	17.8	17.5	4.5%	4.5%
Xero	XRO	2,111	31.00	16.48	24.50	-57.0	-34.3	0.0%	0.0%
TELECOMMUNICATION SERVICES									
Chorus	CNU	1,050	1.78	2.65	2.80	7.1	9.1	0.0%	0.0%
Spark New Zealand	TEL	5,669	2.62	3.09	2.80	17.5	16.6	7.4%	8.1%
UTILITIES									
Contact Energy	CEN	4,591	5.69	6.26	6.30	20.2	22.2	5.8%	8.9%
Genesis Energy	GNE	2,080		2.08	1.99	36.2	19.6	8.7%	10.7%
Meridian Energy (full paid)	MEL	5,867	1.70	2.29	2.04	30.1	30.9	7.7%	6.4%
Mighty River Power	MRP	4,268	2.29	3.18	2.76	23.1	25.2	6.1%	8.5%
Trustpower	TPW	2,353	6.65	7.52	7.60	21.7	17.9	6.8%	6.8%
Vector	VCT	2,786	1.70	2.78	2.71	16.4	17.7	7.6%	7.6%
MARKET SUMMARY									
Market Average (excl. ATM & XRO)						**20.0**	**24.8**	**6.0%**	**6.4%**

Australian Equities Outlook

Investor sentiment in Australia appears gloomy. The main equity market index, the S&P ASX200 index, is down 0.9% year to date. But is it really that bad?

Economic Outlook

While Australian economic growth continues to face the negative impact of falling mining investment, the pick-up in housing has plateaued and the signalled spending on major road projects is still a couple of years away, forecast economic growth is reasonable, particularly in a global context.

Perhaps the real concern relates to the level of household spending. Wage growth is low (2.9%) particularly when compared to the level of inflation (2.3%). While debt servicing is certainly not an issue the level of household debt relative to income remains very high. These factors plus a twelve year high in the unemployment rate, although only 6.3%, appear to be enough to encourage Australian households to save rather than spend. However, there is potentially light at the end of the tunnel with an increase in the number of job advertisements, suggesting that the employment growth should accelerate. No doubt this reflects a rebound in business conditions following the fall in the value of the Australian dollar accompanied by low and stable interest rates. This is likely to remain the case for some time with Australian inflation comfortably within the Reserve Bank of Australia's 2-3% target range and the positive impact of the removal of the carbon tax offsetting the impact that a lower Australian dollar will have on the price of imported goods in Australia.

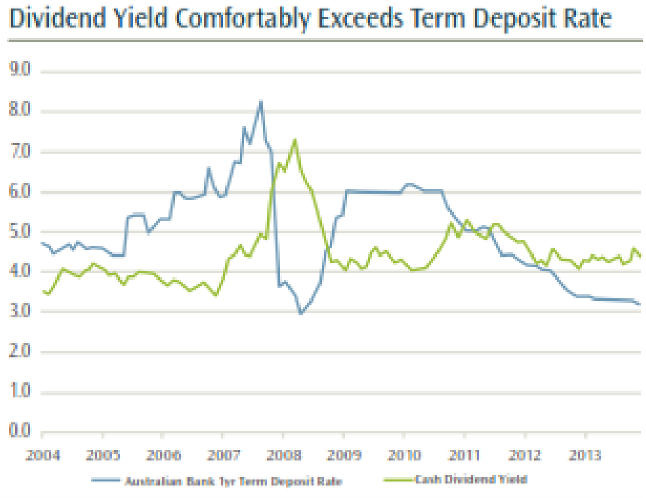
The recently announced China Free Trade Agreement should make a measureable difference to the rate of Australian economic growth in coming years.

In aggregate the Australian economy is not without problems. However, it looks okay and is possibly on the improve. We look for a peak in unemployment, further weakness in the Australian dollar and further improvement in business confidence to support this expectation.

Valuation

Unlike many other equity markets the Australian market's valuation ratios are broadly within a fair value range. However, they look to be relatively good value relative to bonds and are attractively priced relative to global equities. It appears that Australian dollar weakness has caused global investors, in particular those based in the US, to reduce allocations to Australian equities. Conversely Australian domiciled investors are likely to find Australian equities very attractive given the level of the cash dividend yield relative to the one year term deposit interest rates (Refer to the graph over the page).

We conclude that the Australian equity market appears to be reasonably attractively valued. While the economic outlook appears okay there is a need to see better momentum in the economy.



Source: Bloomberg

Activism

In this environment we are attracted to "activism" opportunities. Such opportunities require activist shareholders to agitate for one of the following – corporate governance changes, operational gains, company break-up or asset sale, capital returns, sale of the company or to block inappropriate acquisitions. The legislative environment in Australia is very supportive of shareholder activism with a minimum 5% of shareholders being able to requisition an extraordinary meeting and the ability to effectively remove all non-executive directors from the Board if a company receives more than 25% of votes cast against it's remuneration report two years in a row.

Stocks which fit the asset sale theme are Asciano, Myer, National Australia Bank, News Corporation, Toll Holdings and Woolworths. Stocks which fit the capital return theme include BHP Billiton, Boral, CSR, Downer EDI, Resmed, Rio Tinto and Woodside Petroleum.

James Hardie Industries (JHX)

- $13.19 Target price $14.60

JHX is the world's largest producer of non-asbestos fibre cement board. With 75% of profit derived from the US JHX is a major beneficiary of a lower Australian dollar. Following a poor June quarter profit JHX announced a much better September quarter profit. It is encouraging to see the increase in profit margin, growth in volumes sold, modest price growth, improved plant performance and increased research and development spend to help commercialise new products. Expect to see further improvement in the US housing market, in particular the renovation and remodelling market which consumes a lot of fibre cement board.

National Australia Bank (NAB)

- $33.19 Target price $38.00

As well as paying an attractive cash dividend yield NAB fits our asset sale theme. Assets to be sold include Clydesdale (NAB's UK bank), the MLC life insurance business, UK property and its portfolio of specialised group assets. We estimate the resulting upside to be around 14%. In our last Investment Outlook NAB faced the risk of additional costs relating to a successful Scottish independence vote- this didn't happen. However, now NAB faces the Murray Inquiry into the Australian financial system. On the positive side NAB should benefit from changes to business lending (NAB has a 23% share of business lending in Australia), but may be adversely affected by the need to raise additional equity capital in order to comply with higher capital requirements.

Rio Tinto (RIO)

An Alternate core portfolio stock to BHP

- $57.73 Target price $68.00

The fall in the iron ore price since early August has had an adverse impact on RIO's share price. This is not surprising as around 90% of RIO's earnings come from iron ore production. Emphasising the high quality of RIO's assets we note that it can maintain its current strong balance sheet, increase dividend payments and generate investment returns of 20%pa on new iron ore production (production is forecast to increase from 270mtpa to 340mtpa) even if the iron ore price drops to US$60-65/t. Focusing on the capital return theme we believe RIO can buy back US$5.9 billion of shares and still retain a high credit rating. We also note that the giant mining giant, Glencore, has shown an interest in RIO. While nothing is likely to happen in the short term, RIO would be an excellent acquisition for Glencore. Even if Glencore does not buy RIO, the associated threat of acquisition may spur RIO on to investigate cost reduction opportunities with Glencore and/or return capital to shareholders.

Both RIO and BHP are working to reduce production costs. However, RIO will continue to have lower production costs. Despite having lower forecast capital expenditure than BHP, RIO is expected to be able to increase iron ore production from 270 mtpa to 360 mtpa. RIO's stronger balance sheet and stronger cash flow should enable it to boost dividends and return capital to shareholders via share buybacks ahead of BHP. Finally, the immediate outlook for aluminium appears to be better than oil which should help improve RIO's operating performance relative to that of BHP.

Oil Search (OSH)

- $8.06 Target price $10.00

In common with other companies involved in the production of hydrocarbons, OSH's share price has declined as a result of the fall in the oil price. Importantly the current OSH share price reflects the current oil price into perpetuity – certainly not our analyst's central scenario. They like OSH for its stable production profile and opportunities to increase future earnings from the development of additional LNG trains in Papua New Guinea, improving the production capability of the two existing LNG trains, appraisal and development of the Elk/Antelope gas field and future potential appraisal drilling at Taza in Kurdistan.

Toll Holdings (TOL)

- $5.92 Target price $6.70

TOL is the largest integrated transport company in Australia, where it generates 70% of its profit. We see upside in TOL from operational gains and/or the sale of some of the 48% of assets which generate the remaining 30% of profit. Specifically upside exists from merging duplicated depots, greater integration of sales teams, improved network density, reduced unit costs and obtaining a greater share of the business to consumer market (online retail is expected to grow by 17%pa over the next five years). Given the track record to date there is some scepticism that management can achieve the benefits expected and consequently TOL is attractively valued.

2014 Brokers top picks:

Macquarie Securities
Summerset Group
Diligent
Pumpkin Patch
Air New Zealand
Chorus

Goldman Sachs
Trade Me
Tower
Air New Zealand
Infratil
Nuplex

Forsyth Barr
Air New Zealand
Contact Energy
Sky Television.
Mainfreight
Opus Int. Consultants

McDouall Stuart
Telecom
Diligent
Infratil
Heartland Bank
VMob

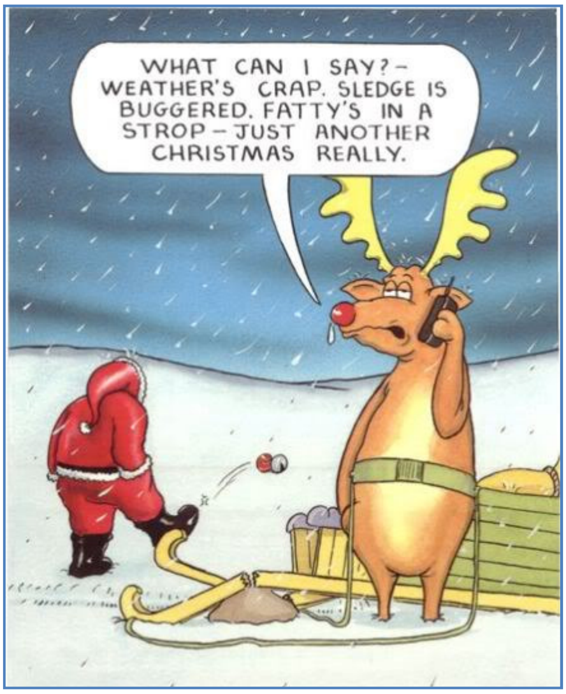
First NZ Capital
Fisher and Paykel Healthcare
Hellaby Holdings
Airwork Holdings
Z Energy
Contact Energy

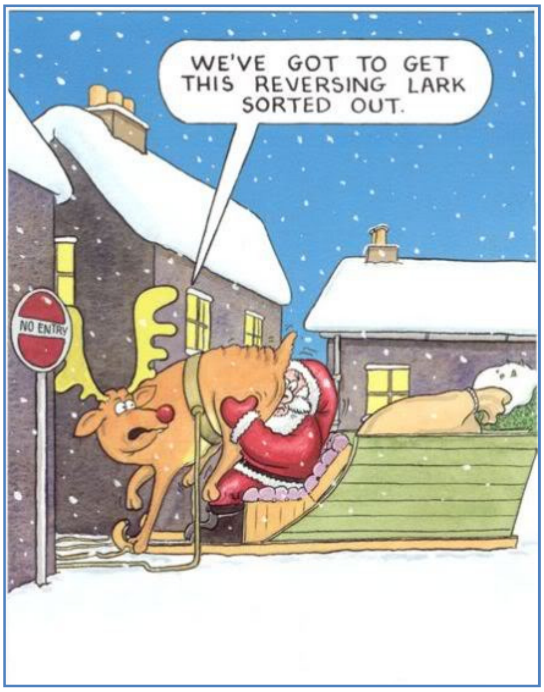
Craigs IP
Fisher & Paykel Healthcare
Fletcher Building
Meridian Energy
Mainfreight
Australian Foundation

Hamilton Hindin Greene
Metlifecare
Chorus
Steel & Tube
A2 Corp
NZX

Check out how they faired....

Security	Brkrs Pick'g	31-Dec 2013	22-Dec 2014	+/-	Security	Brkrs Pick'g	31-Dec 2013	22-Dec 2014	+/-
A2 Corp	1	$0.80	$0.56	**-30.0%**	Metlifecare	1	$3.96	$4.57	15.4%
Air New Zealand	3	$1.64	$2.63	60.4%	Nuplex	1	$3.40	$2.78	**-18.2%**
Airwork Holdings	1	$2.76	$3.29	19.2%	NZX	1	$1.24	$1.16	**-6.5%**
Australian Foundation	1	$6.80	$6.28	**-7.6%**	Opus Int. Consultants	1	$2.08	$1.48	**-28.8%**
Chorus	2	$1.44	$2.62	81.9%	Pumpkin Patch	1	$0.89	$0.21	**-76.4%**
Contact Energy	2	$5.13	$6.27	22.2%	Sky Television	1	$5.84	$6.00	2.7%
Diligent	2	$3.80	$5.00	31.6%	Steel & Tube	1	$3.05	$2.89	**-5.2%**
F&P Healthcare	2	$3.85	$6.27	62.9%	Summerset Group	1	$3.25	$2.84	**-12.6%**
Fletcher Building	1	$8.51	$8.25	**-3.1%**	Spark	1	$2.31	$3.09	33.8%
Heartland Bank	1	$0.85	$1.14	34.1%	Tower	1	$1.75	$2.17	24.0%
Hellaby Holdings	1	$3.25	$3.34	2.8%	Trade Me	1	$4.06	$3.56	**-12.3%**
Infratil	2	$2.27	$2.97	30.8%	VMob	1	$0.03	$0.011	**-66.7%**
Mainfreight	2	$11.97	$16.04	34.0%	Z Energy	1	$3.70	$4.64	25.4%
Meridian Energy	1	$1.04	$1.73	66.3%					





Local Government Reform – Where to for the Western Bay of Plenty

There is a lot of "vested interest" – but….

For me there are three possible options – with the status quo not being one (or shouldn't be!).

Central Government, under John Key and his team over the past six years, has made good inroads with at least getting government departments to think about efficiency and effectiveness. He has challenged the status quo, insisting upon a more business case (investment) focus on central government decision making.

Unfortunately local government decision making has not followed, and the "cost plus" mentality is alive and well. Local politicians talk about reducing investment in infrastructure because the City can't afford the current debt. The reality is that if we don't continue the "visionary inspiration" of some of our past Mayors (and I think of Bob Owens and Noel Pope – who organised council prefunding our motorways to ensure that the City remained "ahead of the game"), then in a very short time will be facing problem s similar to what Auckland is facing right now. Western Bay Councillors (Regional, City & District) need this same vision. And yes we can afford the infrastructure (including a new stadium) – but only if we take the gas torch to our local government administration, and get some real cost/benefit analysis of our council bureaucracy.

There is no point in looking at rationalisation of our local government structures, unless this is combined with a real emphasis on efficiency and effectiveness. Tauranga City currently employs about 550 staff, and Western Bay another 165. Add the Regional Council (apportioned by ratepayers within our region) and you have a bureaucracy totalling approximately 880 in the Western Bay alone. This amounts to one council staff member to every 182 of the population. This is just plain crazy…

Population Projections

Sub-region	2013	2016	2021	2026
Western Bay	158,481	174,900	188,000	199,900
Rotorua	65,280	66,140	66,280	66,200
Eastern Bay	47,487	50,100	49,300	48,000
Regional Total	267,741	292,040	303,580	314,120

Source: Statistics NZ - Population Projections of Territorial Authority Areas

All Bay of Plenty's future growth is expected to come from the Western Bay.

Some argue that we should just merge Western Bay District Council with Tauranga City; and yes – that would be the easiest transition… but it would also be short sighted. With the increased responsibility for environmental monitoring and compliance being delegated to the Environmental Protection Authority, there is less need for a separate Regional Council.

Others will argue for a Bay-wide Coastal Unitary Council (from Waihi Beach to east of Opotiki), but this is just a distraction, and not realistic. The Western Bay already has a population of around 160,000 and this will continue to grow – projected to reach close to 190,000 by 2021 and to 280,000 by 2051. Regional Council staff numbers currently top 290, and with 58.3% of the population residing in Western Bay, we can assume 169 of the work on Western Bay regional issues. Add the Tauranga City staff, plus those from Western Bay, and we can easily see rationalisation reducing total staff by at least one third (maybe by half) including 2 of the three CEO's (total current salaries of the CEO's alone is around $950,000). So what is the downside? I don't think there is any. Existing unitary councils are not compromising environmental standards, and the savings to ratepayers are far more comprehensive than can be achieved by just "shared services".

Staff Numbers at BOP Regional Council

Staff by Location	1999	2000	2001	2002	2003
Whakatane	120	119	126	138	145
Tauranga	12	12	12	16	18
Rotorua	7	6	8	8	9
Edgecumbe	15	15	15	11	8
Opotiki	5	5	5	5	3
Total:	**159**	**157**	**166**	**178**	**183**

Staff by Location	2004	2009	2010	2012	2014
Whakatane	158	165	155	149	
Tauranga	23	64	89	99	
Rotorua	10	24	27	25	
Edgecumbe	12	14	14	13	
Opotiki	3	2	2	2	
Total:	**206**	**269**	**287**	**288**	

One other issue is the Regional Council's shareholding in the Port of Tauranga. The 54.96% shareholding currently held can be vested on a pro rata basis, giving the new Western Bay Unitary Council a holding of around 32% (54.96% times the population ratio of 58.3%) in the Port shares. This would still be a strong cornerstone shareholding, and could be ring fenced to prevent future Councillors from liquidating the shares. The Port shareholding would shore up the currently stretched balance sheets that the individual councils will take into an amalgamation. Amalgamation really is a no-brainer, and needs to happen sooner rather than later… Let's get our local politicians off their comfortable perches, and into affirmative action – NOW.

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently." - **Warren Buffett**

NZ Daily Fixed Interest Rate Sheet

Prices at 15th December 2014

Secondary market	Code	Rating	Type	Maturity/ Reset Date	Coupon	Yield	Coupon Freq
Fonterra Co-operative Group	FCG020	A+	Snr	4/03/2016	6.83%	**3.94%**	2
Fletcher Building	FBI060	NR	Cap	15/05/2016	9.00%	**4.80%**	2
Fletcher Building	FBI070	NR	Cap	15/05/2016	7.75%	**4.80%**	2
Infratil	IFT150	NR	Convert	15/06/2016	8.50%	**5.45%**	4
Z Energy Ltd	ZEL010	NR	Snr	15/10/2016	7.35%	**4.80%**	2
Air New Zealand Limited	AIR010	NR	Snr	15/11/2016	6.90%	**4.80%**	2
Fletcher Building	FBI100	NR	Cap	15/03/2017	7.50%	**5.00%**	2
Meridian Energy	MEL020	BBB+	Snr	16/03/2017	7.55%	**4.20%**	2
Vector	VCT070	BB+	Cap	15/06/2017	7.00%	**5.10%**	2
Auckland Council	AKC050	AA	Snr	29/09/2017	6.52%	**4.00%**	2
Auckland Intl Airport	AIA110	A-	Snr	17/10/2017	5.47%	**4.25%**	2
Trustpower	TPW100	NR	Snr	15/12/2017	7.10%	**5.00%**	4
Fletcher Building	FBI110	NR	Cap	15/03/2018	7.15%	**5.25%**	2
Z Energy	ZEL020	NR	Snr	15/08/2018	7.25%	**5.00%**	4
Trans Power	TRP010	AA-	Snr	30/11/2018	5.14%	**4.30%**	2
Fletcher Building	FBI120	NR	Cap	15/03/2019	5.40%	**5.50%**	2
Fletcher Building	FBI130	NR	Cap	15/03/2019	6.45%	**5.50%**	2
Contact Energy Limited	CEN020	BBB	Snr	15/05/2019	5.80%	**4.96%**	4
Kiwibank	KCF010	BB+	Tier 2	15/07/2019	6.61%	**5.60%**	2
Infratil	IFT200	NR	Bnd	15/11/2019	6.75%	**5.70%**	4
Infratil	IFT090	NR	Convert	15/02/2020	8.50%	**5.71%**	4
Sky TV	SKT020	NR	Snr	31/03/2021	6.25%	**5.45%**	4
Infratil	IFT190	NR	Bnd	15/06/2022	6.85%	**6.00%**	4

Floating Rate / Perpetual Bonds	Code	Rating	Type	Reset Date	Coupon	Price	Coupon Freq
Credit Agricole S.A.	CASHA	BBB-	Tier 1	19/12/2017	5.04%	**$0.76**	4
CBA Capital Australia Ltd	CBAFA	A-	RPS	15/04/2015	4.39%	**$1.001**	4
Fonterra Co-operative Group	FCGHA	A	Perp	10/07/2014	4.33%	**$1.005**	4
Genesis Power Limited	GPLFA	BB-	Cap Bond	15/07/2018	6.19%	**$1.028**	4
Infratil	IFTHA	NR	Perp	15/11/2014	4.53%	**$0.77**	4
Quayside Holdings Ltd	QHLHA	NR	Perp Pref	12/03/2017	5.88%	**$1.01**	4
Rabobank Nederland	RBOHA	A-	Tier 1	8/10/2014	3.71%	**$0.95**	4
Rabobank Nederland	RCSHA	A-	Tier 1	18/06/2019	8.34%	**$1.07**	4
Works Infrastructure Finance	WKSHA	NR	RPS	15/06/2015	7.95%	**$1.025**	4

Glossary:

Senior	Snr
Subordinated	Sub
Callable Subordinated Call	Sub
Perpetual Callable Subordinated	Tier 2
Capital Note	Cap
Redeemable Preference Share	RPS
Perpetual	Perp
Perpetual Preference Share	Perp Pref
Convertable	Convert
Government Guarantee	GG

Issuer	Name of issuing entity
Credit	Standard & Poor's ratings, NR = Not Rated
Maturity	Agreed maturity date of fixed interest product
Reset Date	For floating rate bonds this is the date at which the Perpetual Non-Cumulative Callable Subordinated Tier 1 coupon is reset
Coupon	The coupon is fixed from the date the bond is issued, it will not change until maturity or until the next reset date, if applicable
Yield	Yield to maturity, indicates the overall per annum return you will receive for the remaining life of the bond
Price	The price paid per $100 of face value (includes Accrued interest)

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