Market Analysis

Subscriber Reports

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Special Report 1: Common Investment Statistics

Stockmarket Capitalisation: This is the total value of all of a company's shares and measures the value placed upon the company's operations by the stockmarket. The stockmarket capitalisation is found by multiplying the current share price by the number of *issued shares*.

Book Value and **Net Asset Backing:** The Book Value of a company's shares is found by dividing *Total Shareholders' Funds* (less any preference capital) by the number of *issued shares*. The Net Asset Backing of the shares is the *Total Shareholders' Funds* (less preference capital) less *Intangible Assets* (e.g. Goodwill, "Brand" values) divided by the number of *issued shares*.

Both of these statistics attempt to measure the value of the shares based upon the company's assets - but this is often <u>not</u> a reliable method of valuation. When inflation has been high the replacement cost (and even the market value) of assets is usually far above their depreciated book values resulting in the Book Value and Net Asset Backing understating share values. In addition, often a company's most valuable asset will be intellectual property, its competitive position in a niche market, quality of management or other intangibles that are usually <u>not</u> recorded in its balance sheet (i.e. accounting standards assess <u>no value</u> to these important intangible assets).

Book value is most relevant where a company owns assets that can be readily sold. For example, an investment company owning shares, a property investment company or a manufacturer owning factories and non-specialised machinery.

Dividends per Share: This is the total *annual dividends paid* (usually twice per year: an interim dividend and a final dividend) on each share. This figure is usually stated before the addition of any *imputation tax credits* to the dividend, or before the deduction of *Resident Withholding Tax.*

Imputation Tax Credits and **Resident Withholding Tax:** Under current NZ tax legislation, if a company pays income tax it can pass tax credits (called *imputation tax credits*) on to its shareholders along with dividend payments. The company tax rate is 33%, so for every $67 of dividend paid to shareholders the company can attach a $33 imputation

tax credit (i.e. the $33 income paid on the $100 of pre-tax profits).

Shareholders would declare their income as $100 (i.e. $67 as a cash dividend plus the $33 imputation tax credit), and claim the $33 as a tax credit. On a personal tax rate of 33% the dividend is fully tax paid, while investors on lower marginal tax rates can use excess imputation credits to offset tax payable (or already deducted) from other income.

Where a company has paid no income tax, or insufficient tax to attach full imputation tax credits (i.e. a $33 credit for every $67 of cash dividend), it is required to deduct *resident withholding tax* at the rate of 33%.

The main difference between the two tax credits is that *imputation credits* are *added* to the cash dividend while *resident withholding tax* is deducted. For example, a 10.0 cents per share dividend *with* full imputation credits will give a shareholder an income of 14.925 cents (i.e. 10.0 cents cash plus 4.925 cents tax credit), while a similar dividend *without* imputation credits gives an income of 10.0 cents (i.e. 6.7 cents in cash and 3.3 cents as a withholding tax credit).

Earnings per Share: This is the *After Tax Profit* (before one-off Abnormal gains or losses, and before extraordinary gains or losses) divided by the number of *issued shares.*

Price/Earnings Ratio: This is the *current share price* divided by the *earnings per share.*

A low P/E ratio would tend to indicate that a share is under-priced (i.e. low in relation to the company's ability to earn profits). Alternatively, it could indicate that profits are likely to fall in the future, or that future growth prospects were low.

A high P/E ratio indicates the reverse: a share is “popular”, investors expect (and the share price has anticipated) rapid growth prospects and the share is probably over-valued.

Buying and holding shares trading on low P/E ratios may seem a very simple investment strategy (P/E ratios can be found in most newspapers). It is also one that works! Numerous overseas studies have revealed that shares on low P/E ratios offer higher investment returns that the more “popular”, “growth” shares on high P/E ratios.

Gross Dividend Yield: This is the *annual dividends per share* plus *imputation tax credits* divided by the *current share price*. This yield is the rate of income earned on an investment in shares (similar to an interest rate yield on a bank deposit).

Over the *very long term*, the value of any share is based upon the

dividend income it can produce for its shareholders. Investors should therefore look at the current *gross dividend yield* plus the potential growth in dividends that will be possible from any growth in profits.

Price/Sales Ratio: This statistic is similar to the more common Price/Earnings ratio. However, where the P/E ratio compares the share price to company earnings, the P/S ratio compares the *current share price* to company sales.

The P/S ratio is particularly useful in valuing growth companies experiencing a temporary sales and earnings "glitch", unprofitable companies (i.e. where there are no profits to calculate a Price/Earnings ratio) and also cyclical companies.

While P/S ratios vary *between industries* that have different *profit margins*, some general rules are:

(1) Avoid shares with a P/S ratio greater than 1.5, and never buy a share with a P/S ratio greater than 3.0.
(2) Buy shares in good growth companies with a P/S ratio of 0.75 or less.
(3) Sell shares when their P/S ratio rises to 3.0 or 6.0.

Volatility Ratings: Volatility ratings measure how a share is likely to fluctuate *relative to the market*. A volatility rating of 1.0 shows that a share is as volatile as the market, while a share with a volatility rating of 2.0 will be around *twice* as volatile.

Volatility ratings are not reliable for *individual* shares, but are most useful in calculating your **Portfolio Volatility**.

To calculate your Portfolio Volatility, simply multiply the volatilty rating of every share you own by the current dollar value of each investment. Total these amounts, and divide this by the total value of your portfolio ("riskless" fixed interest investments have a volatility of *zero*). The Portfolio Volatility will give a very good estimate of how your porfolio will fluctuate relative to rises or falls in the general stockmarket.

<u>Holding a portfolio of high volatility shares during a Bull Market is a very simple - but extremely reliable - way to outperform the market.</u>

STATEMENT OF FINANCIAL PERFORMANCE

For the year ended 30 June 2000

		Note	GROUP 2000 $000	GROUP 1999 $000	PARENT 2000 $000	PARENT 1999 $000
Sales Revenue			38,829	37,961	-	-
Dividend Revenue			-	21	1,200	1,200
Management Fee			-	-	500	450
Rental Income			283	310	239	239
Total Revenue			39,112	38,292	1,939	1,889
Auditors' Remuneration	- Audit Fees		55	13	13	17
	- Other Services		16	20	1	2
Goodwill Amortisation			165	175	-	-
Plant Depreciation			2,161	2,149	115	50
Stock Amortisation			5,474	5,924	-	-
Directors' Fees			84	84	84	84
Donations			5	2	-	-
Doubtful Debts	- Written Off		65	51	-	-
	- Increase/(Decrease) in Provision		25	(17)	-	-
Interest	- Term Loans		321	404	321	403
Interest	- Lease		15	-	15	-
Rental Costs			1,647	1,540	-	-
Other Expenses			25,537	25,032	170	114
Gain on Sale of Fixed Assets			(13)	(8)	-	-
Loss on Sale of Fixed Assets			3	54	-	-
Total Expenses			35,560	35,426	719	670
Surplus Before Taxation			3,552	2,866	1,220	1,219
Taxation		1	(1,242)	(1,052)	(10)	(4)
Surplus After Taxation			2,310	1,814	1,210	1,215

Taylors Group share price (on January 2, 2000) was 118 cents.
Issued Capital (found in Note 2) is 24,300,294 shares.
The annual Dividend rate was 6.0 cents per share

Sharemarket Capitalisation = Share Price x Issued Shares
= \$1.18 x 24,300,294 = **\$28,674,346**

Book Value and **Net Asset Backing**

$$= \frac{\text{Shareholders' Funds}}{\text{Issued Capital}} = \frac{\$19{,}517{,}000}{24{,}300{,}294} = \mathbf{\$0.80}$$

Earnings per share

$$= \frac{\text{Profit after Tax}}{\text{Issued Shares}} = \frac{\$2{,}310{,}000}{24{,}300{,}294} = \mathbf{9.5\ cents}$$

Payout Ratio

$$= \frac{\text{Dividends per share}}{\text{Earnings per share}} = \frac{6.0}{9.5} = \mathbf{63.2\%}$$

Dividend Cover

$$= \frac{\text{Earnings per share}}{\text{Dividends per share}} = \frac{9.5}{6.0} = \mathbf{1.58}$$

Gross Dividend Yield
(full imputation credits paid)

$$= \frac{\text{(Dividends per share +Tax Credit)}}{\text{Share Price}}$$

$$= \frac{6.0 + (6.0 \times 33/67)}{118} = \frac{6.0 + 2.9552}{118} = \mathbf{7.6\%}$$

Taylors

STATEMENT OF FINANCIAL POSITION

As at 30 June 2000

	Note	GROUP 2000 $000	GROUP 1999 $000	PARENT 2000 $000	PARENT 1999 $000
Equity					
Equity Share Capital	2	13,886	13,886	13,886	13,886
Reserves	3	5,631	4,779	(1,979)	(1,731)
Total Equity		19,517	18,665	11,907	12,155
Represented by:					
Non Current Assets					
Fixed Assets	4	11,628	12,480	2,300	2,184
Goodwill	5	1,996	2,161	-	-
Investments in Subsidiaries	6	-	-	5,972	5,972
Total Non Current Assets		13,624	14,641	8,272	8,156
Current Assets					
Cash on Hand		229	122	10	4
Accounts Receivable	7	4,324	4,559	-	-
Inventory	8	9,774	8,311	-	-
Taxation Receivable		245	643	-	-
Prepayments and Other Receivables		196	147	150	-
Amounts due from Subsidiaries		-	-	11,075	13,193
Total Current Assets		14,788	13,982	11,235	13,197
Total Assets		28,392	28,623	19,507	21,353
Non Current Liabilities (Unsecured)					
Deferred Tax	9	595	151	(12)	(17)
External Loans	10	3,982	5,550	3,982	5,550
Accounts Payable	11	24	16	-	-
Finance Lease Liabilities	12	133	-	133	-
Total Non Current Liabilities		4,734	5,717	4,103	5,533
Current Liabilities					
Accounts Payable	11	3,265	3,630	135	96
Finance Lease Liabilities	12	147	-	147	-
Taxation Payable		-	-	6	19
Dividend Payable		729	611	729	611
Amounts owing to Subsidiaries		-	-	2,480	2,937
Total Current Liabilities		4,141	4,241	3,497	3,663
Total Liabilities		8,875	9,958	7,600	9,196
Net Assets		19,517	18,665	11,907	12,155

Price/Earnings Ratio $= \frac{\text{Share price}}{\text{Earnings per share}} = \frac{118}{9.5} =$ **11.2**

Return on Shareholders' Funds $= \frac{\text{Profit after Tax}}{\text{Average S/holders' Funds}}$

$= \frac{\$2,310,000}{(\$19,517,000 + \$18,665,000) / 2} =$ **12.1%**

Price/Sales Ratio $= \frac{\text{Share price}}{\text{(Sales/Issued Capital)}}$

$= \frac{\$1.18}{\$39,112,000/24,300,294} = \frac{\$1.18}{\$1.61} =$ **0.73 times**

Special Report 2: Investment Statistics and Terms used in "Market Analysis"

Bull, Bull Market, Bullish: A "Bull" is an investor who believes share prices will rise. A "Bull Market" is one where share prices are rising over the long term. Any news, event or situation that will have a *positive* or *favourable* impact and cause prices to rise can be described as "bullish".

Bear, Bear Market, Bearish: The opposite of above. A "Bear" expects prices to fall, in a "Bear Market" share prices generally trend downwards and "Bearish" events cause share prices to decline.

Share Price Trends: Stockmarket price trends are usually classified into three groups. *Long Term* (or *Primary*) trends lasting several years (a long term uptrend is a "Bull Market" and a long term downtrend a "Bear Market"), *Intermediate* (or *Secondary*) trends lasting from several weeks to several months, and *Short Term* trends lasting from several days to several weeks. Intermediate and Short Term trends are also referred to as *corrections* to the Primary market trend.

One-Year Stockmarket Forecast: Our One-Year Stockmarket Forecast is calculated using an econometric forecasting model designed by Securities Research Company to predict whether the stockmarket is in a Bull Market or Bear Market trend. Forecasts of 50% or greater indicate that a Bull Market is in progress and that share prices are likely to be higher in 6-12 months time, while readings below 50% indicate a Bear Market and that share prices are likely to decline.

The model gives a probability estimate of whether or not a bull market will exist . A forecast of 75% indicates a 75% probability that the stockmarket will rise in value over the next 6-12 months. This forecasting model is designed to detect only long term stockmarket trends and will ignore price trends shorter than approximately 6 or 12 months.

Forecasts between 40% and 60% should usually be interpreted as neutral. Forecasts above 60% are bullish and identify periods suitable for buying and holding shares. Forecasts below 40% are bearish and identify periods when shares are not an attractive investment. (Portfolios

should then be invested in short term interest earning deposits until the stockmarket outlook improves.)

One-Month Stockmarket Forecast: Our One-Month Stockmarket Forecast is another econometric forecasting model designed to identify short term (i.e. four week) stockmarket trends. This forecast gives an estimate of the probability that the stockmarket will be higher in four weeks time.

Diversification: Over the very long term the stockmarket is the best place to invest your money - but the performance of *individual* company shares can vary widely. Diversification is necessary to ensure that the value of an investment portfolio captures those attractive long term returns *and* minimises the impact of those investments that don't work out as well as expected!

The easiest and most common mistake investors can make is to hold an *under-diversified* portfolio (i.e. too few companies or too much invested in one or two holdings) or a *poorly diversified* portfolio (i.e. invested in too many *similar* companies). Fortunately, diversification is one of the easiest things to correct.

Investors with just a few thousand dollars would probably be best investing through a unit trust.

Even the smallest stockmarket investors should spread their investment over shares in *at least four different companies in different industries* (with approximately equal dollar amounts invested in each share). This simple four share portfolio will remove 72% of “unsystematic risk” (i.e. the individual “company-related” risk of stockmarket investment).

Portfolios worth over $20,000 should be invested in *8-12 different shares* (removing 85% of “unsystematic risk”) and portfolios worth over $300,000 should be invested in at least *twenty different shares* (which will remove over 95% of “unsystematic risk”).

International diversification will significantly reduce the risks associated with the performance of the *Australian and NZ economies* and the *Australian and NZ stockmarkets*. Long term NZ based investors could hold around 25-35% of their portfolio in NZ shares, 40-50% in Australian shares and 20-30% offshore (e.g. in foreign shares, investment trusts or unit trusts).

Special Report 3: Inside "Market Analysis"

Summary and Recommended Investment Strategy: This section consists of two or three concise sentences summarising the investment strategy (i.e. how much of a portfolio should be invested in shares, and which kind of shares, or which countries are most attractive). This section will clearly indicate any changes that are made to our recommended investment policy.

Investment Outlook: This section is concerned with the general stockmarket outlook in New Zealand and Australia and contains our current stockmarket forecasts in greater detail. The One-Year Forecast of the actual probability that NZ and Australian share prices will be higher in 6-12 months time, and the One-Month Forecast of the probability that share prices will rise over the next four weeks, appear in this section. Any other important economic, stockmarket, or political factors that could affect the stockmarket are discussed together with their likely impact on share prices.

Only rarely will the Investment Outlook extend to more than half or three-quarters of a page. Some publications can fill three or four pages with their market summary - but this is usually because they need room to express several opinions on where the stockmarket is going! A multitude of different opinions is a very handy thing to have in print, as in subsequent issues they can usually point out how they stated the correct opinion! But if you want it straight, half a page is usually enough room to say whether the primary stockmarket trend is up or down (i.e. whether the market is in a Bull market or Bear market phase), the main reasons for believing so, the direction of the short term trend and why, with room left over to comment on major recent events.

Also on the front page we usually publish charts of the NZ and Australian stockmarkets showing their rises and falls over the last several years. These charts provides a historical perspective to recent developments and our current forecasts.

Performance Forecasts: Performance Forecasts are predictions of the *relative future price performance of individual shares over the next three to six months*. The shares with the *highest* potential are rated "A", those with *above average* potential are rated "B", shares with *average* potential are rated "C", shares with *below average* potential are rated "D", while those shares with the *lowest* potential are rated "E".

These forecasts are short term predictions (i.e. 3-6 months), and as we are often looking to realise investment gains over several years, we may

continue to hold shares rated "C", "D" or even "E" if the long term outlook for the share remains favourable.

The Performance Forecasts are primarily designed as a general investment scan to identify potential shares to Buy or Sell, and as a guide of share traders. Shares rated "A", "B" or "C" may be suitable for further study and analysis. If a share is rated "D" or "E" it may be better to defer any planned purchase - unless there is a very strong reason to buy now. In a similar way the Forecasts can be used to help time share purchases. They are not intended as a final answer to share selection, just a very useful general rating for sorting through all of the shares listed on the stockmarket.

The Forecasts are computer generated using a ten-indicator econometric model. Rather than a simple composite rating that adds up whether these indicators are bullish or bearish, this econometric model measures each indicator's *degree* of bullishness or bearishness, and then weights each indicator according to its forecasting reliability and any correlation with similar indicators.

The exact nature, formula and weighting of the model must remain a secret - this is one "Market Analysis" feature we don't want to see copied in other newsletters (and with exaggerated claims as to their actual forecasting ability).

The ten indicators used (together with a brief comment) are:

(1)	**Price/Earnings Ratio**	"Undervalued" shares
(2)	**Dividend Yield**	"Undervalued" shares
(3)	**Relative Strength Rank**	Long Term Share Price "Trend"
(4)	**4-wk change in Strength Rating**	Trend "change" indicator
(5)	**Price/Earnings Ratio relative to its Industry Group**	Shares under-valued within Industry
(6)	**Industry Group Strength Rank**	Industry-wide share price trend
(7)	**Capitalisation**	"Small" coys perform slightly better
(8)	**Short Term Trend Indicators**	Based on "moving averages"
(9)	**Company Profitability Measure**	Proxy for Management ability?
(10)	**"Neglect"**	Widely followed = not undervalued

The model looks for under-valued shares, especially those also under-valued relative to others in their industry (although these fundamental statistics are more reliable forecasting longer term trends than three to six months). Technical factors are very important in predicting short to medium term future performance so the model favours "strong" shares in long and short term uptrends, as well as looking for confirmation of that trend across the whole industry. Finally, the model's forecasts are improved by slightly favouring smaller, neglected companies. These indicators have a sound theoretical and practical basis for inclusion in this forecasting model.

Performance Forecasts will not work all of the time, or be accurate for every share. However, over many years they have proved valuable in helping to predict the short term trend in share prices and have made a valuable contribution to timing the purchase or sale of individual shares.

Recommended Investments: This section reviews shares in our Portfolio of Recommended Investments, including any new BUY or SELL recommendations. Profit and dividend announcements, together with any other relevant developments are discussed and analysed, leading to our current projections and investment advice for many of our currently recommended shares.

While our objective is to identify and invest in shares with the potential to increase several fold in value over several years, we generally invest fairly conservatively with a widely diversified portfolio so as to achieve a fairly consistent and reasonably assured overall gain.

No effort is made to include a new share recommendation in every issue. In fact, most issues will not carry a new recommendation and the reason for this is simple. New share recommendations are only made when the time is right and when we have a share that we believe will turn out to be a profitable investment. We are selective in the shares we recommend as we invest our own money in all of the shares recommended in "Market Analysis". We believe that no-one should give advice to others unless they are prepared to follow it themselves. When we advise you to buy or sell a share, we buy or sell it ourselves. In this way you are always guaranteed our very best advice.

Portfolio of Recommended Investments: This table lists *all* of our current NZ and Australian share recommendations. We consider this list of shares a *core portfolio* around which subscribers can build their own investment portfolio.

The first column contains our *Current Advice* - which is either "Buy", "Hold+", "Hold", "Hold–" or "Sell". New investors - and investors looking to add to their portfolio - should first consider buying those shares rated "Buy" and - to achieve a wider spread of investments - shares rated "Hold+" and "Hold".

"Hold–" indicates relatively less attractive shares. Typically, we may be holding these for further gains, but wouldn't recommend new purchases.

Shares rated "Sell" should be sold and will be removed from the Portfolio. The Recommended Investments section will always contain details of our reasons for this sale.

This table also includes the date and price of our initial "buy" recommendation, several important investment statistics, each share's recent price and the total return (i.e. dividends plus capital gain or loss) since our initial recommendation.

At the bottom of this table we include a Performance Summary of ALL share recommendations ever made in "Market Analysis" . . . a truly unique feature that you won't find in other investment newsletters. We believe this track record is the best way to judge the value of an advisory service or the skill of an investment advisor. Unfortunately, most investment services

can remember a their best recommendations but have conveniently "forgotten" about unsuccessful investments and - more importantly - many have failed to get subscribers out of them! This can never happen with "Market Analysis".

How to Use the "Recommended Portfolios": All "Market Analysis" investment recommendations are added to our Recommended Portfolio and are continuously monitored until we advise the time to sell.

There are several ways to view these portfolios:
Firstly, investors could simply buy some (or all) of these recommended investments, obtaining a diversified holding in what we believe to be some of the best NZ and Australian shares, in the industry sectors we consider most attractive at any particular time. Investors following this strategy will not need to read another investment publication or newspaper nor become a financial expert or make another investment decision.

As *simple* as that investment strategy may appear, these are the very investments we hold in our own portfolios. We obtain information from many sources in Australia, NZ and around the world, apply our own analysis and consider all of that information to produce our forecasts, investment strategies and specific investment recommendations that we publish in "Market Analysis". Typically, around 85-90% of our own portfolios are invested in the NZ and Australian shares recommended in "Market Analysis" and the international investment funds we recommend through "International Investor" (with the remaining 10-15% in shares or funds that have been informally recommended).

Secondly, investors can consider the recommendations as a "core" portfolio, around which to build their own, unique investment portfolio. Most investors can pick a few shares or funds in which to invest, but that probably doesn't provide adequate *diversification*. Our Recommended Portfolio provides a range of specific investments necessary to achieve a well diversified portfolio.

Reading the *reasons* for our specific recommendations will let investors know *what* we look for in an investment - and allow them to find similar investment situations on their own or analyse developments from companies in which they own shares.

Thirdly, there are a large number of investors who "do their own thing". They read "Market Analysis" (along with many other sources of investment information) to get our views - and then make their own independent decisions. That's fine by us. Although we are independently wealthy - having built up significant personal investment portfolios by following the recommendations published in our newsletters - we are not so arrogant as to think we have all the answers!

As investment advisers usually disagree over the outlook for a particular share it is necessary to take care when following advice from two or more different sources. Either (1) consider advice from *all your sources* before

making any buy or sell decision or (2) *divide your portfolio into two or more sections* to follow the advice of two or more advisers. Some investors fall into the trap of buying a share on the advice of one advisor and then selling on the advice of another. Such a strategy will only make money for your stockbroker! If you value an advisor's recommendation enough to make an investment we suggest you continue to follow that person's advice for that particular share - and not seek conflicting advice from a third party.
“Buy”, “Hold”, “Sell” Advice: When we change our advice on any share or fund from “Buy” to “Hold” that should never be considered a sell recommendation. “Hold” means you should continue to hold that security until a “Sell” recommendation is issued.

Brokers say “Hold” when they really mean “Sell” as a “Sell” recommendation would upset companies and could lose them potential underwriting or corporate advisory business. We are completely independent and don't have corporate clients, so “Buy” means buy, “Hold” means hold and when we think you should sell we say “Sell”.

“Computer Selections of NZ and Australian Shares based upon our Comprehensive Share Selection Criteria”: The methods - and the supporting historical research - used in these sections are so important that we have prepared a separate report, “Share Selection Methods used in Market Analysis” which we suggest investors study closely.

These sections identify shares that are either attractive (and worth considering for investment) or unattractive (and which could be sold if held, or avoided). As the Australian market is so large, we publish - in alternate monthly newsletters - the attractive share selections and the unattractive selections.

Often one or two of the shares identified in these sections will be examined in-depth in a “Company Analysis” report and most of our new share recommendations will be identified by our *Comprehensive Share Selection Criteria*.

Current Issues: This is a list of all Bonus and Cash Issues, Share Splits, Re-constructions and New Issues that have been announced by NZ companies.

Bonus Issues are a way for a company to distribute additional shares to its shareholders at no cost. While this may appear an easy way to increase shareholder wealth, it is similar to cutting a cake into a larger number of smaller slices (i.e. you get more pieces, but they are smaller). If a shareholder owned 1000 shares worth $1 each in a company that announced a 1 for 10 bonus issue, the shareholder would end up with 1100 shares but the market value would probably drop to 91 cents - for a total value of this investment of $1000. Bonus Issues - by themselves - therefore have no value. However, bonus issues are *usually* announced at the same time as

bullish (i.e. favourable) news, and are often used by directors to *signal* to the market a *sustainable growth in profits*. Companies *often* maintain the same dividend rate per share after a bonus issue, so a 1:10 bonus issue often signals an effective 10% dividend increase, while a 1:5 bonus issue would suggest a 20% rise in shareholders' incomes. One final word of caution: as bonus issues are interpreted by the stockmarket as “bullish”, but cost the company nothing, they are sometimes used by directors to maintain the impression that a company is performing well when, in fact, the opposite is the case. Be wary of any company that “rewards” shareholders with a bonus issue *instead* of a regular cash dividend!

A **Cash Issue** is one of the most common ways for a company to raise additional capital funds. Existing shareholders are offered new shares in proportion to their shareholding (e.g. one new share for every five held) at a subscription price usually set somewhere below the current market value. Often the “rights” to these new shares can be traded on the stockmarket for a few weeks before the subscription date of the new shares.

A cash issue increases the number and total value of shares in a company, and this increased “supply” may lower the potential for future capital appreciation (i.e. the increase in issued capital *dilutes* future earnings per share growth). However, the important factor is why the company needed to raise new capital. Usually this is to finance growth and expansion, and in these cases the company could prove a profitable investment. Sometimes new capital is raised for “debt reduction” or “working capital”. Repaying existing debt will not generate expansion, or sales and profit growth (although will reduce interest costs), but will simply dilute existing earnings per share. “Working capital” is also unlikely to generate growth and *could* include buying new cars for senior executives or funding executive cash bonuses!

A **Share Split** is similar to a bonus issue, but divides the shares into much smaller units. A 5 for 1 share split would divide 1000 shares into 5000 shares but, of course, the market value of each would also be divided be five (so the total value of the shareholding would be unchanged).

Share splits are usually used to reduce the market value of highly priced shares. This is usually said to “improve their marketability”. The theory is that there are a number of very small investors who would rather buy 500 shares at 100 cents (a $500 investment) than 100 shares at 500 cents (also a $500 investment). In fact, both investments are identical, and the very tiny amount of money that these very small investors have to invest is too insignificant to make any difference to either the “marketability” or value of a company's shares.

If you stop to think about it, both bonus issues and share splits are used to reduce the market value of a company's shares (by dividing the capital into a larger number of smaller parts). These bonus issues and splits are therefore most likely to occur *after* a company's shares have increased

significantly in price.

A **New Issue** - or Initial Public Offering (IPO) - is where shares are first offered to the public, followed by stock exchange listing of the shares. New Issues are often attractive investments and will be analysed in "Market Analysis" together with our investment advice.

To ensure that all the shares offered in a New Issue are subscribed, the underwriter will usually ensure that it is "under-priced" relative to similar shares already trading on the stockmarket. New Issues therefore usually begin trading on the market at a premium of 10-20%. Buying shares in a New Issue and selling for a profit soon after listing is called "Stagging".

New Issues broadly fall into two categories: "New" companies seeking capital to establish or expand a business, and existing companies being sold by their current shareholders. In the first case it is the company that raises money from the new public shareholders and uses that money to finance growth. In the second case, the money subscribed by the public shareholders goes *not to the company* but to the *existing shareholders* who are selling out. Shares in New Issues where the money goes to the *company* are usually better long term investments than shares in companies where the cash goes to *existing shareholders* who are wanting to get out of the business!

Dividend$: This is a list of dividend payments announced by NZ companies but not yet paid, including the amount of the dividend (in cents per share), the date the shares trade ex-entitlement to the dividend, the payment date and amount of the imputation tax credit attached.

Total Return Index For All Listed Shares: This share index is the only one to (1) give equal "weighting" or importance to every listed NZ share, regardless of the size of the company, and (2) to include cash dividends paid. By measuring both the price returns and dividend returns for all listed shares the Total Return Index is the best guide to the average returns accruing to individual share investors.

Note: The NZX50 index is weighted towards just a handful of the very biggest shares and *overstates* dividend income by incorrectly assuming that imputation tax credits can somehow be re-invested.

Quarterly Reports in "Market Analysis"

The following features are published in every third newsletter:

"Insider" Trades in Australian and NZ Shares: This report is published in the January, April, July and October newsletters and shows the number of trades by directors buying or selling shares over the previous twelve months.

To save space "neutral" situations where there is an equal number of buyers and sellers have been eliminated from this report.

In general, shares where "insiders" are buying tend to outperform the stockmarket for up to two years, while shares where directors are selling tend to under-perform. See our booklet "Share Selection Methods used in Market Analysis" for more details of the impact of insider buying and selling on the future performance of shares.

Warrant/Option Analysis: Published every February, May, August and November, this report evaluates warrants and options listed on the NZ and Australian stockmarkets.

The most common method of valuing warrants/options is the Black-Scholes Valuation model - which is based upon the period until expiry, the level of interest rates and the volatility of the underlying share price. We calculate that value - and compare it with the market price of the warrant/option to see if it is under-valued or over-valued.

The "Warrant Leverage" column shows the leverage of the warrant relative to the share price. For example, if the warrant leverage is 3.5, then a 1.0% rise in the share price should result in a 3.5% (i.e. 3.5 x 1.0%) increase in the value of the warrant.

The final column, the "Break-Even Rate" shows the *compound annual rate of appreciation* in the share price that is necessary for the warrant investor to get his money back. A high "break-even rate" indicates high risk.

"Strongest" Shares: This report is also published in the February, May, August and November newsletters and shows the 50 NZ shares that are performing best (as measured by our long term "Relative Strength Rating").

As a group these shares are likely to outperform the market - so investors should generally "let profits run".

However, a share that has increased significantly over several years, which is now *over-valued* and *where its strength rating is declining,* is a candidate for profit-taking and sale.

Neglect Ratings of NZ and Australian Shares: This report is published every March, June, September and December.

Shares that are "Neglected" by brokers tend to be under-valued and therefore to perform better than shares which are "Widely Followed". See our booklet "Share Selection Methods used in Market Analysis" for more details.

Certainly one shouldn't buy a share simply because it is *neglected* (or sell shares because they are widely followed) but many investors hold a portfolio consisting of large, blue chip, *widely followed* shares. *Neglected* shares tend to be under-valued, so investors can lift their expected investment returns by including at least some *neglected* shares in their portfolio.