Independent Advisor's Report In Relation to Takeover Offer by Belwalsh Holdings Limited for Arthur Barnett Limited

3 September 2002

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3 September 2002

Independent Advisor's Report Pursuant to the Takeovers Code (Rule 21) in Relation to the Takeover Offer by Belwalsh Holdings Limited for all the Shares in Arthur Barnett Limited

1 Introduction

1.1 Introduction and Background

On 14 August 2002 Arthur Barnett Limited ("Arthur Barnett" or "the Company") received a Takeover Notice under the Takeovers Code ("the Code") from Belwalsh Holdings Limited ("Belwalsh" or "the Offeror"), advising of Belwalsh's intention to make a full offer to acquire all the 14,488,750 fully paid ordinary shares in Arthur Barnett.

The principal features of Belwalsh's Takeover Offer are summarised as follows:

- cash consideration for all outstanding Arthur Barnett shares of $1.40 per share;
- the offer is conditional on Belwalsh achieving a minimum 90% acceptance, although this condition may be waived by the Offeror;
- the offer closes on 1 December 2002 (the "Closing Date"); and
- payment will be made no later than seven days from the Closing Date.

Full particulars of Belwalsh's Takeover Offer are set out in its offer document to be sent to all Arthur Barnett shareholders.

Arthur Barnett is a New Zealand listed public company and is therefore a "Code Company". Accordingly, the Takeover Offer made by Belwalsh must comply with the Code.

Belwalsh presently has no direct shareholding in Arthur Barnett, however two of Arthur Barnett's Directors are also Directors of Belwalsh – Mr Trevor Scott (Arthur Barnett's Chairman) and Mr Julian Smith.

Belwalsh, in its Notice of Takeover dated 14 August 2002, identified the following connected shareholdings in Arthur Barnett, totalling approximately 53% of Arthur Barnett's issued share capital:

Name of Shareholder	Number of fully paid ordinary shares in Arthur Barnett	Percentage of total shares in Arthur Barnett
Fraser Smith Holdings Limited	6,724,770	46.41%
Trevor Donald Scott, David Houghton Wale and Alexander Philip Laing as trustees of the TD Scott No.2 Trust	989,952	6.83%
Julian Charles Stanley Smith	4,489	0.03%
Total	**7,719,211**	**53.27%**

In addition, Belwalsh, in the Notice of Takeover identified the following relationships:

- Mr Scott is a trustee of the TD Scott No.2 Trust as well as being one of the beneficiaries. He is also the trustee of certain trusts which hold shares in Fraser Smith Holdings Limited.

- Mr Smith is a director and a shareholder of Fraser Smith Holdings Limited.

  Fraser Smith Holdings holds 50% of the shares in the Offeror. The directors of Fraser Smith Holdings Limited are Messrs Julian Smith and Nicholas Smith.

  Mr Julian Smith holds 3,850,000 of Fraser Smith Holdings Limited's 11,000,000 shares in his own name and a further 2,750,000 shares in that company are held by a trust of which he is a beneficiary. The remaining shares in that company are held by Nicholas Smith (1,650,000) and a trust of which he is a beneficiary (2,750,000). Mr Scott is also a trustee of both of the abovementioned trusts.

This Report presents PricewaterhouseCoopers' *assessment of the merits* of the Belwalsh offer, for the purpose of assisting Arthur Barnett's shareholders to determine whether or not to accept the Belwalsh offer.

1.2 Requirements Under the Takeovers Code

The requirements of the Takeovers Code, which came into effect on 1 July 2001, govern the process and timetable for the making of a full takeover offer for Arthur Barnett. The Code prescribes the responsibilities and obligations of Belwalsh (as the offeror) and Arthur Barnett (as the "target") in respect of submitting a formal takeover offer, and the subsequent response to that offer by Arthur Barnett, by way of a "target company statement" ("TCS"). The TCS must be accompanied by an independent advisor's report (or a summary thereof) prepared pursuant to Rule 21 of the Code. Where only a summary report accompanies the TCS, then the full report must be available for inspection. The information to be included within the TCS is set out in the Second Schedule of the Code.

The appointment of PricewaterhouseCoopers as independent advisor to assess the merits of the Belwalsh offer was confirmed by the Takeovers Panel ("the Panel") on 19 August 2002.

1.3 Purpose of Report

The purpose of the Report is primarily to assist Arthur Barnett shareholders to evaluate the Belwalsh offer by presenting our assessment of the merits of the Belwalsh offer, and in so doing, to assist shareholders in forming their own opinions as to whether or not they should accept the Belwalsh offer for all or part of their shareholding.

We note that each shareholder's circumstances and investment objectives will be different. It is therefore not possible to prescribe or advise what action an individual shareholder should take in response to the Belwalsh offer. Our advice will necessarily be general in nature and is intended to assist each shareholder to form their own opinion as to what action they should take in the circumstances.

1.4 Overview of Approach to Assessing the Merits of the Offer

Rule 21 of the Code requires that the Report assess "*the merits of the offer*". There are no authoritative New Zealand guidelines as to how the merits of an offer should be assessed, and accordingly we believe that an offer must be assessed in light of its own features and the prevailing circumstances surrounding the offer and the target company's situation.

We have therefore undertaken our assessment in two stages. First, we have considered whether the offer price stipulated in the Belwalsh offer is "fair", and secondly we have evaluated other considerations relevant to a shareholder's assessment of the Belwalsh offer.

Our analysis of the fairness of the offer price has been undertaken by comparing our assessment of the current "fair market value" of Arthur Barnett's shares against the consideration stipulated in the Belwalsh offer. Our assessment of the current fair market value of shares in Arthur Barnett is set out in section 4 of this report.

Our evaluation of the "other considerations" relevant to the Belwalsh offer includes:

- the prospects of the Belwalsh offer becoming unconditional;
- the prospects (if any) of a competing offer for Arthur Barnett emerging;
- recent share price performance of Arthur Barnett;
- the extent to which Arthur Barnett may be viewed as undercapitalised in its current form;
- the costs and benefits of Arthur Barnett remaining listed on the New Zealand Stock Exchange;
- shareholder discounts at Arthur Barnett; and
- the likely market value of Arthur Barnett shares if the offer does not proceed.

Our analysis of these considerations is set out in section 5 of this report.

1.5 Information

The sources of information which we have had access to and relied upon are listed in Appendix 1.

1.6 Declarations, Qualifications, Disclaimer, Restrictions, and Limitation of Liability

This Report should be read in conjunction with the statements and declarations set out in Appendix 2, regarding our independence, qualifications, restrictions upon the use of this report, reliance on information, general disclaimer, and indemnity.

1.7 Note

All monetary amounts in this report are expressed in New Zealand currency and are stated exclusive of Goods and Services Tax ("GST"), unless indicated to the contrary. Arthur Barnett has a 1 August year-end. Generally, references to "year" should be taken as referring to the Company's financial year ending on 1 August. For example, references to the "2002 year" refer to the financial year ended 1 August 2002.

2 *Summary of Findings and Opinion as to the Merits of the Belwalsh Offer*

2.1 Valuation of Arthur Barnett

We have valued the Arthur Barnett retail business using a capitalisation of maintainable earnings approach; we have then added the market value of the Meridian Centre as determined by a registered valuer, deducted capitalised corporate overheads, adjusted for residual net assets and subtracted debt to derive the Company's net equity value for shareholders. Our valuation is summarised as follows:

Arthur Barnett – Valuation Summary	**Low**	**High**
Retail Business - Future Maintainable Earnings (EBITDA)	850	1,050
EBITDA Multiple	4.0	5.0
Retail Enterprise Value – ($000)	**3,400**	**5,250**
Add Other Assets		
Credit Ledger	3,802	3,802
Property under contract	240	240
Shares	75	75
	4,117	**4,117**
Add Property Investment		
Meridian Centre (market value less 1.5% disposal costs)	**57,143**	**57,143**
Deduction for Corporate Overhead		
Corporate Overheads	250	250
Multiple	9.0	9.0
Capitalised Value	**2,250**	**2,250**
Gross Enterprise Value ($000)	**62,410**	**64,260**
Less Debt		
Meridian Centre Bonds	18,000	18,000
Bank Debt	20,801	20,801
Sundry Advances	1,675	1,675
	40,476	**40,476**
Net Equity Value ($000)	**21,934**	**23,784**
No. Shares Outstanding	14,488,750	14,488,750
Value per share ($)	**$1.51**	**$1.64**

Our assessed value range for Arthur Barnett of between $1.51 and $1.64 is highly dependent upon the assessment of the market value of the Meridian Centre, which, at a valuation of $58M, is the most valuable retail property in Dunedin. If this property valuation decreased by, say, 5% our low-end assessed value would fall to $1.32 (high-end value declines to $1.44).

This valuation sensitivity is heightened by the degree of financial leverage (i.e. the substantial debt level) in Arthur Barnett, meaning that, for example, a 1% change in gross asset value (enterprise value) translates to a 2.6% movement in the equity value per share.

We cross-checked our valuation of Arthur Barnett against a comparison to Arthur Barnett's NTA, which was $1.83 at 1 August 2002. The discount in value relative to NTA can be attributed to:

- Costs that would arise if Arthur Barnett was wound up;
- Corporate overheads which depress shareholder returns;
- The lack of a steady dividend return to underpin share value;
- The Company's high level of gearing; and
- The Company's relatively small size and general lack of growth potential.

2.2 Other Considerations Relevant to Belwalsh Takeover Offer

Belwalsh's bid price of $1.40 represents a premium against Arthur Barnett's prevailing share price over the 12 month and 20 trading day periods before announcement of the offer of approximately 65% and 89% respectively. However, we believe the Company's share price has been adversely affected due to excessive debt levels which, until this year, had halted dividends.

In addition, the composition of Arthur Barnett's share register (resulting in the parties behind the Offeror already having effective control over the Company) combined with the very small "free float" of shares in the hands of the public (reflected in small trading volumes, limited liquidity and many days where no shares are traded at all) have all served to depress the share price.

In our view, it is very unlikely that an alternative takeover offer for Arthur Barnett will emerge, given the factors referred to in the preceding paragraph, especially the fact that the parties associated with Belwalsh effectively already control Arthur Barnett with a combined 53% ownership interest in the Company.

In the event that the Belwalsh takeover offer lapses, then we believe that the market price for Arthur Barnett shares is likely to fall below Belwalsh's bid price, at least until the Company can demonstrate a sustained earnings improvement, a steady dividend payout and reduced gearing.

Arthur Barnett is under capitalised in its current form, due to excessive debt arising from development of the Meridian Centre. In the absence of this takeover offer there is the real prospect that the Company would need to raise fresh equity in some manner.

Belwalsh should be in a position to extract greater benefit from an acquisition of Arthur Barnett relative to other acquirers, because $14M of accumulated tax losses should remain available as we understand that Belwalsh's takeover will not prejudice the shareholder continuity rules, so that the Company can carry forward these losses and off-set them against future assessable income. In contrast, any third party bidder for Arthur Barnett would, following a successful takeover offer (involving a transfer of more than 50% of the Company's shares), lose the ability to utilise the Company's tax losses, thereby diminishing future returns. Our valuation of the Company, as set out above, does not include any value attributable to these tax losses.

Shareholders holding over 200 shares will most probably lose their shareholder discount allowances ranging between 5% to 10% in the event that Belwalsh's offer succeeds.

The Takeovers Code stipulates a minimum acceptance condition of 50% which cannot be waived by the Offeror. In this instance Belwalsh has elected to specify a 90% acceptance condition, however, it also retains a discretion to waive this condition. This means that it can declare its offer to be unconditional and purchase shares even if it does not receive sufficient acceptances to reach the 90% threshold stipulated in its offer.

It is virtually certain that the minimum 50% threshold stipulated in the Takeovers Code will the satisfied as Belwalsh's principals already control 53% of the Company's capital. Therefore, Belwalsh will have the ability to declare its offer unconditional at any stage, even if the 90% acceptance level is not obtained.

Therefore, shareholders who do not accept the offer need to consider the prospect that the offer will nonetheless succeed, even if Belwalsh does not achieve 90% ownership, meaning that they could remain as minority shareholders in the Company. In these circumstances there would be even less prospect of an alternative bid emerging, and we believe it is likely that in this eventuality the Company's share price would fall back below the $1.40 bid price, at least for a time.

If Belwalsh achieves the 90% acceptance level specified in its offer, then it will also have the ability to compulsorily acquire the balance of outstanding shares pursuant to the provisions set-out in the Takeovers Code.

Under the Takeovers Code, Belwalsh's offer must remain open until its stipulated closing date of 1 December 2002 and Arthur Barnett shareholders have until 5.00 pm on 1 December 2002 to lodge their acceptances.

2.3 Overall Conclusions Regarding the Merits of the Belwalsh Takeover Offer

Our overall conclusions regarding the merits of the Belwalsh takeover offer for Arthur Barnett are:

- Belwalsh is offering Arthur Barnett shareholders consideration of $1.40 which is less than our assessed value range for Arthur Barnett at the present time; however, our valuation of Arthur Barnett is substantially dependent on the current valuation of the Meridian Centre of $58M;
- As Belwalsh's bid price is below our assessed value range for the Company, we therefore do not regard the Belwalsh offer as providing shareholders with "full and fair" value for their shares at the present time;
- The offer represents a substantial premium over the Company's recent share price prior to the takeover announcement;
- Shareholder benefits in the form of store discounts will most likely be lost if the offer is successful;
- Belwalsh's takeover offer is subject to reaching a minimum 90% acceptance prior to the closing date 1 December 2002 although this condition may be waived by the Offeror;
- As the principals behind Belwalsh already own or control approximately 53% of Arthur Barnett's shares they effectively already possess the ability to declare the offer unconditional;
- In the absence of the Belwalsh takeover offer, we believe it is unlikely that shareholders will be able to realise their investment in Arthur Barnett in the near future for equivalent value; and
- If the Belwalsh offer is only partially successful shareholders may continue to hold shares in Arthur Barnett (as a listed company), however, the share price is likely to decline below the bid price due to the very limited liquidity for the shares, the presence of a controlling shareholder (Belwalsh) and consequently the absence of any realistic prospect of an alternative bid, and the Company's debt level which means that a capital raising may be required and / or the Company's ability to pay dividends in the future may be constrained.

Accordingly, we believe that although the Belwalsh takeover offer for Arthur Barnett does not represent "full and fair value" it is unlikely that a better offer will be available in the near future.

This section of our Report is a summary only, and should be read in conjunction with our full Report, as set out in the remaining sections of this document. Furthermore, this Report and the opinions expressed above must be read subject to the statements set out in Appendix 2.

3 Arthur Barnett Background

3.1 History and Structure

Established in 1903, Arthur Barnett currently operates two distinct businesses:

- Retail department stores – based in Dunedin and Christchurch; and
- Property – ownership and management of the Meridian Centre, Dunedin

Arthur Barnett listed on the NZSE in 1962 and as at 6 August 2002 (before the receipt of the Takeover Offer) had a market capitalisation of $13.3M.

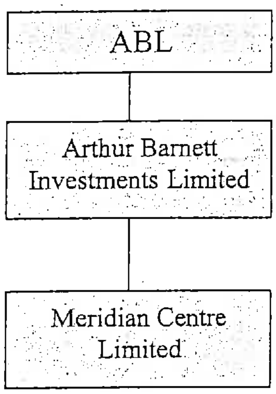
Arthur Barnett's traditional base has been the South Island of New Zealand, where it currently operates its two stores. A third store, at Balclutha was sold to H & J Smith in June 2001. The current retail business, comprising two stores, contrasts with the national chain of 19 stores the Company operated after acquisition of the DIC chain in 1987. This acquisition proved unsuccessful, and resulted in a series of losses and suspension of dividends until 1995.

Relatively poor financial performance in recent years has been the result of:

- major disruption to the Company's main Dunedin store during construction of the Meridian shopping centre;
- high debt levels arising from Meridian development;
- poor trading in the Christchurch store, due in part to the major new store fitout completed in October 1999; and
- rationalisation of product mix in all stores and redundancies resulting from restructuring including closure of its Alexandra store.

The Meridian shopping complex opened in September 1997 and has two anchor tenants, Arthur Barnett and a KMart department store, 47 specialty shops and 664 parking spaces. Dividends were suspended again in December 1999 due to the Company's high debt levels following completion of the Meridian Centre. Unsuccessful efforts to sell the Meridian led to the project being refinanced by an $18M (net) issue of capital bonds by company subsidiary, Meridian Centre Limited, in October 2001. This refinancing, along with recently improved retail trading conditions, have enabled the company to resume dividend payments in April 2002 following the 2002 interim results.

The Arthur Barnett's group trading structure is illustrated in the diagram below:



Principal trading operations are undertaken by Arthur Barnett Limited (Retail Stores) and Meridian Centre Limited (Property). Arthur Barnett Investments Limited is a holding company only and does not trade.

A summary of key historical events of Arthur Barnett is set out below:

Date	**Event**
1903	Arthur Barnett formed
1962	Listed on New Zealand Stock Exchange
1987	DIC stores acquired for $24.8M
1989	Dividends suspended due to poor trading performance
1995	Dividends recommenced (following DIC store closures during early 1990s)
September 1997	Arthur Barnett opens The Meridian Centre
July 1998	Arthur Barnett concludes a cash issue of 5,838,750 shares at $1.50 each, raising capital of $8,758,125
March 1999	Arthur Barnett unsuccessfully attempts to sell a minimum of 50% of the Meridian Centre
December 1999	Dividends again suspended due to debt burden associated with Meridian Centre
June 2001	Arthur Barnett sells its Balclutha store to Invercargill-based department store chain H.J. Smith as a going concern for an undisclosed price
October 2001	Arthur Barnett concludes an issue of NZ$18M (net) in capital bonds to refinance the Meridian Centre
April 2002	Dividends resumed following Meridian refinancing and 2002 interim results
7 August 2002	Belwalsh announces its intention to make a full offer under the Takeovers Code for all the shares in Arthur Barnett for a cash consideration of $1.40 a share

3.2 Ownership and Capital Structure

Arthur Barnett's issued share capital consists of 14,488,750 fully paid ordinary shares.

Arthur Barnett's ownership is summarised in the tables below:

Shareholders	As at 19 August 2002	
	Number of Shares	%
Fraser Smith Holdings Limited	6,724,770	46.41 [1]
Jarden Custodians	1,449,678	10.01 [1]
Alexander Philip Laing & others	918,926	6.34 [1]
Ronald Scott Gilkison & others	487,600	3.37
Essex Castle Unlimited	369,939	2.55 [2]
Earl Raymond Hagaman	301,904	2.08
Hillcrest Properties Limited	295,712	2.04
Mary Rose Cammiade	212,786	1.47
NZ Central Securities	210,300	1.45
Stuart James McLauchlan	148,156	1.02
Thomas Alan Pegler	132,500	0.92
John Andrew Nicolson	110,387	0.76
Arthur Michael Barnett & others	100,004	0.69
Anthony Peter Richards	90,374	0.62
Howard Cedric Zingel & others	87,471	0.60
Joan Frances Chisholm	83,137	0.57
Sarah Antoinette Rockefeller	82,707	0.57
David Grindell	80,000	0.55
Graeme James Marsh	71,436	0.49
Herman Christian Rockefeller	59,098	0.41
Total Top 20 Shareholders	12,016,885	82.94
Balance 1,514 shareholders	2,471,865	17.06
TOTAL	**14,488,750**	**100.00**

Source: Arthur Barnett Share Register as at 19 August 2002

Note

(1) Belwalsh Holdings Limited, in its Notice of Takeover, has identified these share holdings as being directly and indirectly related to it as Offeror (refer Section 1).

(2) We have been informed by Arthur Barnett that this is a nominee for TD Scott & Co Chartered Accountants. We understand that certain of these shares are held on behalf of the TD Scott No.2 Trust and are therefore disclosed in the total holdings of the TD Scott No.2 Trust in the Notice of Takeover.

Number of Shares Held	As at 19 August 2002		
	Number of Shareholders	Shares	% of Total Capital
1 – 1,000	914	516,574	3.56
1,001-5,000	533	969,681	6.69
5,001-10,000	40	298,939	2.06
10,001-100,000	34	1,240,894	8.56
100,001 and over	13	11,462,662	79.13
TOTAL	**1,534**	**14,488,750**	**100.00**

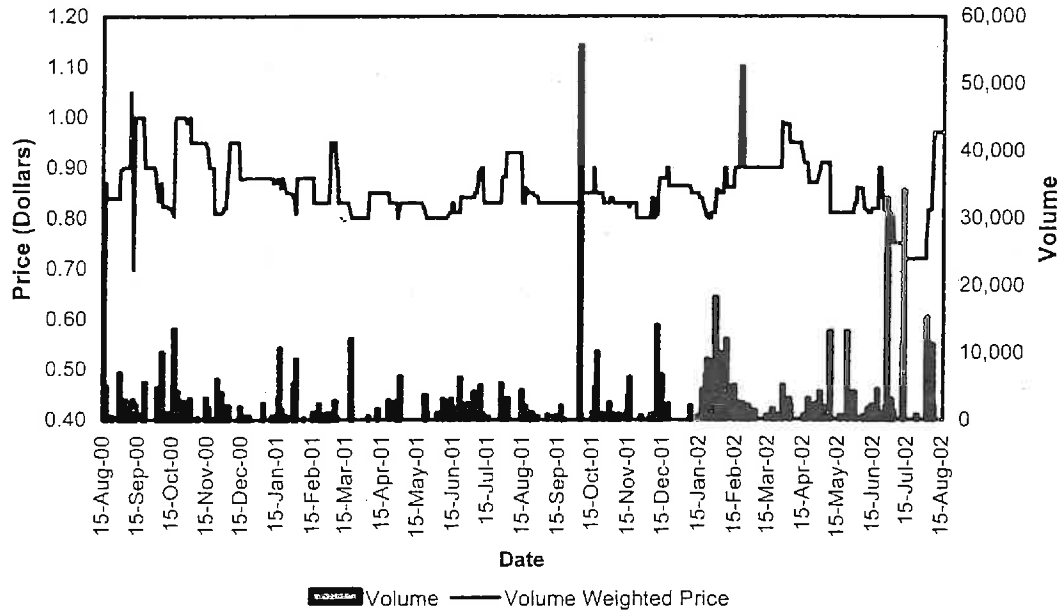
Source: Arthur Barnett Share Register as at 19 August 2002

As can be seen from the above tables, the majority of Arthur Barnett's ownership is closely held by a small number of shareholders.

3.3 Share Trading Performance

The share price performance of Arthur Barnett over the last two years is set out below:

Arthur Barnett Limited Share Price and Volume since 15 August 2000 to 15 August 2002



Source: Bloomberg

The volume weighted average price ("VWAP") of Arthur Barnett's shares over this period is $0.86 and the VWAP over the 20 trading days prior to the takeover offer being announced on 7 August is $0.74. Since the takeover offer was announced 5,098 Arthur Barnett shares have traded, 2,098 shares at $0.97 and 3,000 shares at $1.35.

During 2002 the share price peaked at $1.10 in February, but steadily declined to a low of $0.71 just prior to the Belwalsh takeover offer being announced.

The shares are infrequently traded – of a total of 14.5m shares on issue the total volume traded in the last year to date was only 270,000 shares (1.9% of the issued share capital). Trading occurred on only 97 days out of a total of 261 trading days during the last year.

3.4 Governance and Management

Board of Directors

The Board of Arthur Barnett is as follows:

Name	Role	Date Appointed
Trevor Scott [1]	Chairman	November 1987
Julian Smith [1]	Non-executive Director	November 1980
Bernice Barnett	Non-executive Director	December 1991
Stuart McLauchlan	Non-executive Director	September 2000
Michael Coburn	Managing Director	December 1991 [2]

[1] Parties to the Takeover Offer
[2] Joined January 1990

Executive Management

Arthur Barnett has a small head office executive management team lead by Mr Michael Coburn (Managing Director), together with Mark Jacombs (Financial Controller) and Sue Smaill (Retail Manager), who collectively have more than 40 years service with the Company.

3.5 Arthur Barnett's Retail Business

Background

Arthur Barnett operates retail department stores in Dunedin and Christchurch. Emphasis is placed on national and international high quality brands, particularly in cosmetic, lingerie and apparel categories. Representative brands include Estee Lauder, Elizabeth Arden, Lancome, Levis, Country Road, Monsoon, Jag, Calvin Klein, Canterbury and Elle McPherson.

The Arthur Barnett Dunedin store has been an anchor tenant of the Meridian Centre since its opening in 1997. The Meridian Centre is positioned in what is generally considered the prime retail shopping area in Dunedin at the northern end of George Street.

In October 1999, Arthur Barnett opened its refurbished Christchurch store in the new Crossing development on the corner of Cashel Mall and Colombo Street. The Crossing experiences high pedestrian flows due to it also being occupied by the Christchurch bus terminal which is entirely undercover and opens onto Lichfield Street.

Both the Dunedin and Christchurch store fitouts are virtually brand new. Arthur Barnett, through its two stores, currently employs approximately 250 people (both full time and part time).

Store Offerings

Much of Arthur Barnett's offerings in store are based on a "store within store" concept whereby a leading brand is sold in a physically separate area, with brand-approved point of sale advertising and promotional activity. Regular training sessions are held by suppliers with Arthur Barnett staff to ensure brand image is protected and sales maximised.

The Dunedin retail store occupies 4,300 square metres and offers a large range of merchandise including (in descending order of 2002 sales revenue):

- Cosmetics
- Lingerie
- Home Appliances
- Ladieswear
- Casual living
- Menswear
- Soft Furnishings
- Schoolwear
- Home Linens

By contrast, the Christchurch store occupies 1,300 square metres and focuses almost solely on Cosmetics, Lingerie, Casual Living and Home Linens. Combined, Cosmetics and Lingerie sales represent the majority of turnover in the Christchurch store.

Key to Arthur Barnett's retail sales and profitability are the cosmetics and lingerie (including hosiery) departments which together account for nearly half of the Company's retail gross profits.

3.6 Arthur Barnett's Property Business

Meridian Centre Limited Overview

The Meridian Centre was completed in 1997 on the site of the former Arthur Barnett Department Store in George Street in Dunedin. The Meridian Centre is positioned in the main retail shopping area in Dunedin at the northern end of George Street and is close to the University of Otago.

The Meridian Centre has three levels and includes 47 speciality shops (including the foodcourt), a KMart store, Arthur Barnett's own flagship store and includes a suite of offices. The Meridian Centre has a net lettable area of 15,948m^2 and provides 664 carparks. It is the largest shopping centre in Dunedin and attracts the highest number of shoppers. The mix of tenancies has been targeted to ensure a high proportion of branded national and international stores together with specialised local stores.

At the end of the 2002 financial year, Meridian had a total rental revenue income of $5.8M and a registered valuation of $58M.

Sales have increased in the Meridian Centre since its opening in 1997 from over $54M to $67.4M per annum in the year to July 2002 (an increase of 7.89% over 2001). A number of tenant rentals are based on turnover – accordingly, this growth in the Meridian Centre's annualised turnover has led to increased rental income.

The Retail Market in Dunedin

The Meridian Centre offers leading brands and retailers such as Kimberleys, Overland Footwear, Barkers, Whitcoulls, Burger King, Jeans West and Sussans. There are presently no other comparable retail shopping centres in Dunedin.

There is a diverse range of recently opened other retailing operations in Dunedin ranging from local boutique operators to the new Warehouse superstore – although this new superstore is not in the Central Business District ("CBD"). The anchor tenants within the Meridian Centre, KMart and Arthur Barnett, face competition from Farmers and The Warehouse, together with other large format retailers located around the city fringe. The Warehouse's new store, which opened in May 2002, has, to date had no noticeable effect on retail trading in the Meridian Centre.

The Directors of Arthur Barnett are not aware of any plans to construct a new shopping centre in Dunedin similar to Meridian targeting a similar customer base and the risk of a competitor affecting Meridian in the foreseeable future is therefore believed to be very low.

Lease Profile

Meridian leases fall into three general categories – the leases for the speciality shop tenancies (including the food court), the KMart lease and the Arthur Barnett lease. The first category includes the 47 speciality shops, which are typically six-year leases with various rights of renewal. The latter two leases are long-term anchor tenant leases in the usual commercial form. A summary of the features of these leases is set out in the table below:

Speciality Shop Leases	
Lessee	Various
Type of lease	Standard BOMA lease
Term of lease	Generally 6 years with no rights of renewal (some exception)
Rent review	Generally every two years. Include a rent ratchet clause.
Rent	The greater of the base rent or percentage rent.
Percentage Rent	Generally 5% to 10% of gross sales.
Operating Expenses	Proportionate share of taxes, rates, insurance, utilities and administration costs.
Marketing Fund	6% of Base Rent.
Carparking	Levy based on area of tenancy.

KMart Lease	
Lessee	Coles Myer New Zealand Holdings Limited.
Term of lease	15 years from September 1997 with a right of renewal of 10 years.
Rent review	3 yearly
Rent	Combined base rent and percentage rent.
Other	Operating expenses, marketing fund contribution and carparking costs are particular to the lease.

Arthur Barnett Lease	
Lessee	Arthur Barnett Limited
Term of lease	15 years from 5 September 1997 with a right of renewal of 4 years, 364 days
Rent review	On renewal of the lease.
Rent	Combined base rent and percentage rent.

Car Parking

In addition to its retail space, the Meridian Centre provides 664 car parks utilising its two upper levels and an adjoining purpose built building purchased from the Dunedin City Council in 1997. Customers are currently charged 70 cents for each half-hour parked except where they have a receipt from a Meridian Centre tenant, which provides for the first hour free of charge. Tenants contribute to cover the cost of providing one hour free parking to their customers as part of their lease.

3.7 Retail Property – Market Overview

Retail property generally offers investors a property exposure with attractive yields and earnings growth potential not necessarily offered to the same extent by other forms of commercial and industrial property investment. Rental income is generally linked, either directly or indirectly, to the level of retail sales generated by tenants.

The retail property sector ranges from single shops within traditional strip locations to substantial regional shopping centres. Over the past 30 years the structure of the retail property sector in New Zealand has changed dramatically, with a shift in focus from traditional strip shopping and large department stores in CBD locations to expanded suburban shopping centres, large format supermarkets, and more recently bulk retail or "power centres".

The key drivers of demand in the retail property sector include:

- trends in consumption expenditure (which are dependent on population growth, real household incomes, and other macro factors such as interest rates and taxation);
- shopping preferences and patterns amongst consumers. One of the reasons for the decline in strip shopping and the rise in demand for large shopping centres is the convenience factor and access to car parking;
- internal migration; and
- urban spread

As noted above, the trend in the sector is towards larger shopping centres rather than smaller shopping centres and strip shopping. Market evidence suggests that the key to generating value for investors is proactive ownership of large shopping centres that occupy key positions in their catchment area. These shopping centres are favoured as they tend to be able to attract the maximum number of shoppers and therefore command premium rentals from tenants. In addition, their size generally minimises the impact of competitors who may otherwise attempt to develop competing shopping centres within the existing centre's catchment area.

There are a number of barriers making entry by new competitors difficult. A key barrier in metropolitan areas is the availability of sizeable parcels of land on which to develop new retail centres in the right locations. Other barriers include:

- Town Planning and Resource Management Act issues which are costly and time consuming to address;
- availability of suitable anchor tenants such as supermarkets and department stores; and
- access to sufficient equity and debt funding

Another trend in the sector is the introduction of bulk retail or "power centres". These are groups of large freestanding stores, generally clustered around a large central carpark. Retailers tend to be large national retailers who require a large store format at low cost eg. The Warehouse, Harvey Norman, Noel Leeming, etc.

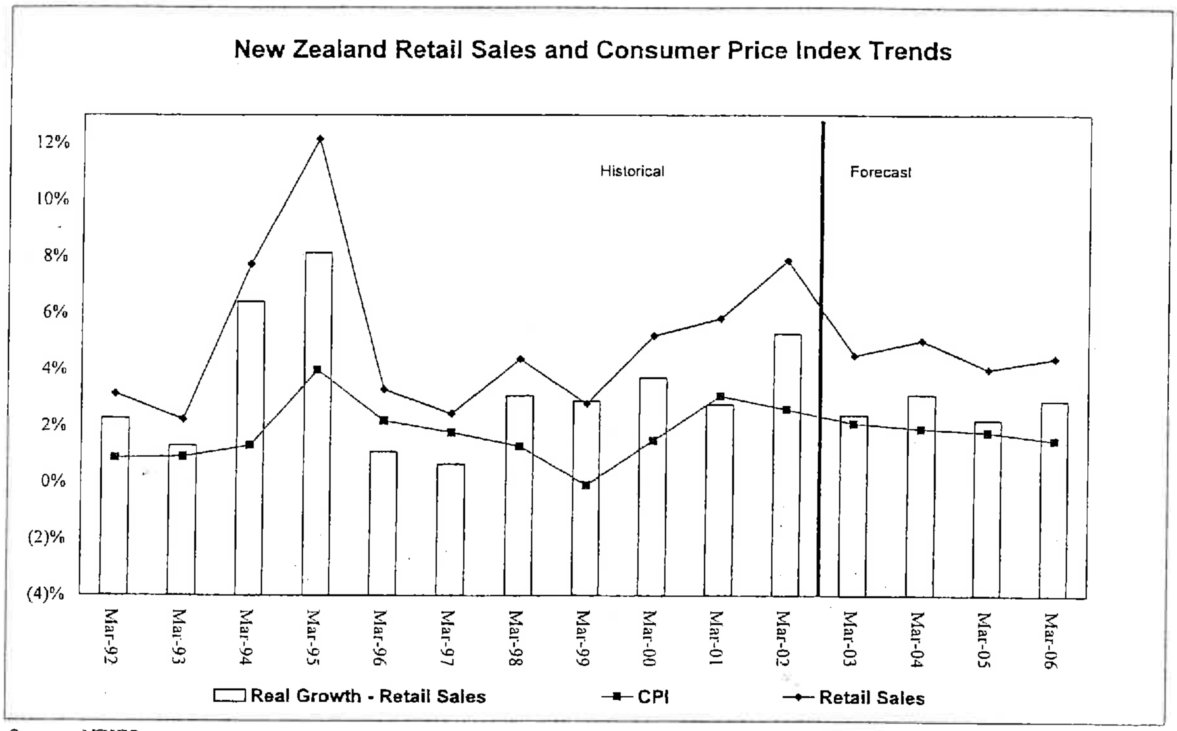
A potential threat to the retail industry is changes in consumers' buying patterns, including the increased usage of the internet for shopping. The growth of e-commerce via the internet and consequent changes in retail spending patterns is expected to change the property requirements of many retailers, with potential to impact retail property owners.

The entertainment experience and social interaction of shopping centres are becoming an increasingly important means of drawing consumers to shopping centres. Cinemas and large food courts are the main entertainment attraction for shopping centres.

Shopping centres need to be "refreshed" on a regular basis to maintain their attractiveness to consumers and tenants. If shopping centres are not modernised and instead become tired and relatively unattractive, income may decline as tenants relocate or negotiate lower rentals. For this reason capital expenditure on redevelopments and modernisations is important to protect cash flow.

The New Zealand retail sector is currently poised at a relatively mature stage of its current lifecycle, with growth highly dependent on underlying economic conditions, especially given New Zealand's relatively modest overall population growth. In the past, new product offerings, such as the introduction of suburban shopping centres, generated fresh opportunities in the market.

As discussed above, a key driver of rental growth is the trend in the growth in retail sales. With this in mind we have summarised the trends in natural retail sales growth (excluding automotive sales) and the Consumer Price Index ("CPI") over the last ten years, as illustrated in the table below. We have also included the NZIER forecasts for retail sales growth and movements in the CPI for the period 31 March 2002 to 31 March 2006.



Source: NZIER

In every year shown retail sales growth has exceeded the CPI (ie. there has been real growth in the level of retail sales). The strongest period of retail sales growth occurred in the 1994 and 1995 years, when retail sales recorded real growth of 6.4% and 8.1% respectively. Excluding these two years, retail sales (excluding automotive sales) have increased on average by 1.5% above the annual CPI between March 1992 and March 2002.

This analysis suggests that retail sales are likely to continue to grow at a rate of between 2.2% and 3.1% above the CPI. This in turn should allow retail property owners to achieve real growth in rental income.

The NZIER forecasts published in its *Quarterly Predictions June 2002* assumes there will be real growth in retail sales (excluding automotive sales) of 2.7% per annum between March 2002 and March 2006.

A key driver of the demand for retail property is internal migration. There is a distinct population growth movement towards regions with existing high urban densities. Retail projections for areas of high population growth are likely to exceed retail sales on an overall basis as this will increase the number of people in the shopping centre's catchment area. Otago's population is expected to remain flat at best. In the period 1996 – 2001 census data showed that, overall, the Otago population had shrunk by 2%.

3.8 Regional Economic Overview

Key economic trends for Canterbury and Otago (where Arthur Barnett's two stores are based) are discussed below.

Otago

The Otago economy is driven by agriculture, tourism, education and manufacturing. The region has experienced a large expansion in dairy farming which has contributed to its strong economic growth, and rural incomes over recent years. The NZIER predicts that strong income growth over the past year in the export sector, together with current high levels of consumer confidence, will continue to boost retail activity over the short term. However, weaker growth in Otago is expected at the end of 2002, as consumer spending eases and demand softens for Otago's exports.

Overall the Otago economy is expected to expand by 2.7% per year (on average) over the next five years. Whilst this is below Otago's recent growth, it is above the expected national average of 2.6%. Growth will be driven by further development of dairy manufacturing capacity to meet growing milk production. However, slow predicted population growth will put a cap on domestic driven demand.

The Otago Regional Council's "Otago Economy June 2002" notes that household spending growth has recently slowed due to softening agriculture prospects. The value of retail sales growth (excluding automotive) has decreased to an annual rate of 5% in the March 2002 quarter, down from 8% in 2001. Looking forward, it is expected that a steady recovery in tourist numbers, solid employment growth and rising house prices will ensure household spending growth remains positive.

Canterbury

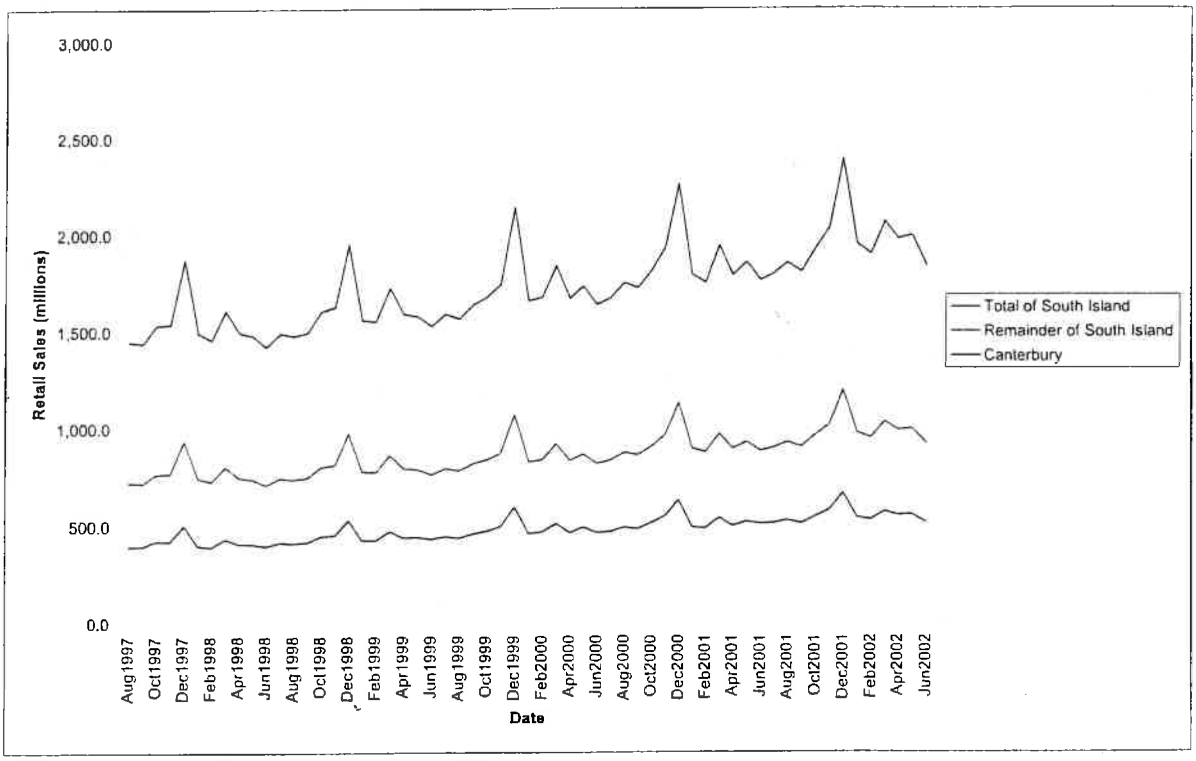
Similar to Otago, the Canterbury economy relies on agriculture as its main revenue earner and Canterbury therefore remains highly dependent on international markets. Issues impacting Canterbury's economy in that short term are:

- decreasing demand for agricultural exports as a consequence of the current decline in world growth;
- weaker demand for non commodity manufactured goods;
- weaker demand for education services; and
- an easing of tourist numbers.

Nevertheless, over the period to March 2006 NZIER expects the Canterbury economy to grow an average of 2.7% per year (the same as Otago), following lower expected growth in 2002 of 2.5%.

South Island Retail Sales

Actual retail sales for the South Island for the periods August 1997 to June 2002 are graphically depicted below.



Source: Statistics NZ

General Issues Affecting Retail Sales

The key risk to the retail sector on the demand side is that consumer confidence declines. Currently, confidence levels are high and this has been reflected in strong retail sales volume growth late in 2001 and early in 2002. The NZIER highlights the risk to this trend in the event that easing export returns erode income and spending falls.

Offsetting this, New Zealand's increased tourism profile overseas can be expected to improve visitor arrivals, with the "September 11" effect on air travel dissipating.

3.9 Financial Position

Arthur Barnett's financial position as at 1 August 2000, 1 August 2001, and 1 August 2002 is set out below:

Arthur Barnett Statement of Financial Position As at 1 August (NZ $ 000)	**2000 (Audited)**	**2001 (Audited)**	**2002 (Unaudited)**
Current Assets			
Cash	16	10	15
Account Receivables and Prepayments	4,684	4,710	4,457
Inventories	4,039	3,941	4,214
Total Current Assets	**8,739**	**8,661**	**8,686**
Current Liabilities			
Overdraft	1,014	932	201
Short Term Funding	3,500	3,500	1,600
Current Portion of Liabilities	3,027	37,951	1,675
Accounts Payable and Accruals	4,077	3,034	2,944
Total Current Liabilities	**11,618**	**45,417**	**6,420**
Working Capital	**(2,879)**	**(36,756)**	**2,266**
Non Current Assets			
Property, Plant and Equipment	67,764	62,902	61,187
Capital Bond issue costs	-	-	836
Total Non-Current Assets	**67,764**	**62,902**	**62,023**
Non-Current Liabilities			
Capital Bonds	-	-	18,000
Bank Loans	36,000	-	19,000
Total Non-Current Liabilities	**36,000**	**-**	**37,000**
Net Assets	**28,885**	**26,146**	**27,289**
Issued Capital	15,219	15,219	15,219
Revaluation Reserve	12,373	9,120	9,101
Retained Profits	1,293	1,807	2,969
Shareholders' Funds	**28,885**	**26,146**	**27,289**
Net Tangible Assets per Share	*1.99*	*1.80*	*1.83*

Source: Arthur Barnett's Annual Reports and 2002 unaudited management accounts.

Key issues to note regarding the financial position of Arthur Barnett are as follows:

- The Meridian Centre development costs were refinanced in October 2001 by the issue of capital bonds which raised $18M (net). The key terms in respect of the bonds are:
  - no scheduled repayment date (in perpetuity);
  - the bonds can be traded on the New Zealand Stock Exchange;
  - interest is fixed at 10.5% pa until the end of the first four year period, at which stage interest rates will be reset based on the Government bond rate and an agreed premium;
  - underwriting and other costs directly associated with the capital bond issue have been capitalised at $836,000 in the 1 August 2002 balance sheet; and
  - these costs are being spread over the initial four year term of the bonds.
- In October 2001 banking facilities were moved from the ANZ Banking Group (NZ) Limited to Bank of New Zealand.
- Property, plant and equipment includes the Meridian Centre which is carried at an independent valuation of $58M.
- The Company has available tax losses of $14.2M carried forward from previous years. The majority of these losses were accumulated during the period of the Company's ownership of the DIC stores. No tax asset has been recognised in the balance sheet.
- Levels of working capital as at August 2002 in the retail business (net of debt) are in line with normal trading requirements.

3.10 Financial Performance

Historical Financial Performance

Arthur Barnett's historical financial performance for the five years ending 1997 – 2001 inclusive is set out below:

Arthur Barnett Statement of Financial Performance Year ended 1 August (NZ$000)	**1997 (Audited)**	**1998 (Audited)**	**1999 (Audited)**	**2000 (Audited)**	**2001 (Audited)**
Operating Revenue					
Retail Sales	28,094	25,385	22,935	21,629	22,233
Rental Income and Management Fees	-	4,369	4,869	6,506	6,936
Other Income	474	406	756	1,019	643
Total Revenue	**28,568**	**30,160**	**28,560**	**29,154**	**29,812**
Expenses	27,131	26,931	23,041	23,975	24,467
EBITDA	**1,437**	**3,229**	**5,519**	**5,179**	**5,345**
EBITDA % of Revenue	*5.0%*	*10.7%*	*19.3%*	*17.8%*	*17.9%*
Depreciation & Amortisation	438	1,480	1,479	1,502	1,378
EBIT	**999**	**1,749**	**4,040**	**3,677**	**3,967**
EBIT % of Revenue	*3.5%*	*5.8%*	*14.1%*	*12.6%*	*13.3%*
Less Interest Expense	514	4,001	3,624	3,022	3,459
Net Profit / (Loss) Before and after Tax	**485**	**(2,252)**	**416**	**655**	**508**
Segmental Information					
Surplus/(Deficit)					
Retail	999	(1,147)	685	229	178
Property	-	2,896	3,355	3,448	3,789
Total Surplus/(Deficit)	**999**	**1,749**	**4,040**	**3,677**	**3,967**
Unallocated Expenses - Interest	514	4,001	3,624	3,022	3,459
Net Surplus/(Deficit)	**485**	**(2,252)**	**416**	**655**	**508**

Source: Arthur Barnett's Annual Reports segmental information notes

Key issues to note in respect of Arthur Barnett's historical financial performance are as follows:

- The Meridian Centre was completed in September 1997 and therefore rental income and management fees did not commence until the 1998 year.

- 1998 was impacted by three main factors:
  - restructuring expenses of $980,000, relating to provision for contractual tenancy costs for sites which were no longer occupied and for other restructuring costs;
  - severe disruption to the Christchurch operation whilst awaiting occupation of a newly fitted out store, which was eventually opened in late 1999; and
  - generally weak retail trading due to a number of factors including flow-on effects from the Asian crisis and local droughts in Otago.

- Depreciation costs increased significantly from 1997 to 1998 and thereafter due to the accounting treatment of the Meridian Centre. The Directors, in accordance with accounting standards, classified the Centre as a fixed asset on the grounds that Arthur Barnett occupied over 20% of the lettable area for its own retail operations.

- Interest expense increased in 1998 due to the significant debt levels taken on post completion of the Meridian Centre.

- Arthur Barnett results in the above table include the Balclutha retail business which was sold in July 2001.

- Rental income and management fees increased significantly from 1999 to 2000, and thereafter, due to a change in accounting policy whereby recharged operating costs within the Meridian Centre were grossed-up as income and expenses, as opposed to presentation on a net basis. This change had no effect on bottom line earnings.

- The 2001 results were stated after non- recurring items of $238,000 relating to the write down of certain plant and equipment.

A range of "normalisation adjustments" in respect of the retail business are discussed in Section 4.

Current Financial Performance

Arthur Barnett's financial performance for the current year ending 1 August 2002 (unaudited) is set out below, compared to the previous financial year:

Arthur Barnett **Statement of Financial Performance** **Year ended 1 August** **(NZ$000)**	**2001** **(Audited)**	**2002** **(Unaudited)**
Operating Revenue		
Sales	22,233	21,545
Rental Revenue and Management Fees	6,936	7,079
Other Income	643	608
Total Revenue	**29,812**	**29,232**
Expenses	24,467	23,491
EBITDA	**5,345**	**5,741**
EBITDA % of Revenue	*17.9%*	*19.6%*
Depreciation & Amortisation	1,378	533
EBIT	**3,967**	**5,208**
EBIT % of Revenue	*13.3%*	*17.8%*
Less Interest Expense	3,459	3,617
Net Profit Before and After Tax	**508**	**1,591**

Source: Arthur Barnett Annual Reports and unaudited management accounts 2002

The improvement in Earnings before interest, taxation, depreciation and amortisation ("EBITDA") has been driven by improved profitability at a gross profit level within the Dunedin and Christchurch stores. As stated in the Arthur Barnett 2002 interim results commentary, the sales mix has changed as a result of the Company putting greater emphasis on more profitable branded merchandise, particularly apparel. Conversely, sales dropped in lower margin "big ticket" items such as furniture and home appliances, where competitors continued to discount heavily to maintain market positions.

The draft 2002 accounts show depreciation (excluding amortisation of the capital bond issue costs) reduced at $313,000, because it is currently planned to change the accounting treatment for the Meridian Centre. The Directors now intend to treat the property as an "investment property", whereby no depreciation will be charged. The accounting treatment of the Meridian Centre is not relevant to our valuation of Arthur Barnett, as we have assessed the retail business on an EBITDA basis (for capitalisation of earnings) and relied on the property's valuation as provided by an independent registered valuer (refer Section 4). This change in accounting treatment has not yet been agreed with the Company's auditors.

3.11 Forecast Financial Performance and Future Outlook

The budgeted performance for Arthur Barnett is set out below, compared to the 2002 results (unaudited) and the 2001 results (audited):

Arthur Barnett Statement of Financial Performance Year ended 1 August (NZ$000)	**2001 (Audited)**	**2002 (Unaudited)**	**2003 (Budget)**
EBITDA	**5,345**	**5,741**	**5,785**
Depreciation & Amortisation	1,378	533	683
EBIT	**3,967**	**5,208**	**5,102**
Less Interest Expense	3,459	3,617	3,624
Net Profit / Before and after Tax	**508**	**1,591**	**1,478**

Source: Arthur Barnett Annual Reports, unaudited management accounts 2002 and 2003 Budget

Due to commercial sensitivity reasons we have not published the budgeted gross profit margins for Arthur Barnett, although we have reviewed the detailed budgets prepared by management.

Issues surrounding the growth in Arthur Barnett's retail business are discussed in Section 4, along with retail EBITDA to sales ratios.

Retail Business Earnings

Earnings of the retail business are set out below.

In performing this review we have isolated out exceptional items, non recurring items and non retail related sundry income and corporate overheads. A summary of this analysis which reconciles between normalised EBITDA of the retail business and the retail surplus as disclosed by Arthur Barnett for statutory segmental reporting purposes is set out below:

Arthur Barnett Limited Retail Business Year ended 1 August	**1999 Actual (Audited)**	**2000 Actual (Audited)**	**2001 Actual (Audited)**	**2002 Actual (Unaudited)**	**2003 Budget**
Retail surplus	685	228	178	334	343
Adjustments					
Closed stores [1]	(67)	1	(40)	-	12
Non Meridian Rentals [2]	(147)	(177)	(177)	(188)	-
Corporate Overheads (net) [3]	67	176	205	354	291
HP and store card business income (net) [4]	19	(72)	(199)	(169)	(144)
Retail depreciation	603	614	485	313	419
2001 exceptional writedown	-	-	238	-	-
Abnormally high advertising costs [5]	-	-	-	126	-
Rental of surplus space-Christchurch	(164)	-	-	-	-
Fitout recoveries-Christchurch	-	(250)	-	-	-
EBITDA retail business [6] (normalised)	**996**	**520**	**690**	**770**	**921**
EBITDA % of Sales	*4.7%*	*2.6%*	*3.3%*	*3.6%*	*4.0%*

Source: Arthur Barnett Annual Reports, unaudited 2002 Management Accounts and 2003 Budget

Notes:

[1] *Losses / profits attributable to closed stores are excluded.*

[2] *Represent rental income on various properties owned by Arthur Barnett. All such properties are now sold or are subject to unconditional contracts.*

[3] *Represent unallocated corporate overheads (net).*

[4] *Represents net income of HP and Arthur Barnet store card business, excluded from retail business EBITDA due to credit ledger being valued separately.*

[5] *Management inform us that advertising costs were unusually high in 2002.*

[6] *Dunedin and Christchurch only.*

4 Valuation Of Arthur Barnett Limited

4.1 Valuation Methodologies

There are four principal methodologies commonly used for valuing a business or shares in a trading enterprise:

- discounted cash flow analysis ("DCF");
- capitalisation of earnings;
- industry rules of thumb; and
- estimation of the aggregate proceeds from the orderly realisation of assets.

Each of these valuation methodologies has an application in different circumstances. A key factor in determining which methodology is most appropriate in any particular instance is the actual practice adopted by purchasers of the type of business involved.

DCF Analysis

DCF valuations involve calculating the net present value ("NPV") of projected cash flows using a discount rate, which reflects the risk associated with the projected cash flow stream.

The DCF methodology relies heavily on:

- the availability of a reliable cash flow projection covering at least a medium term duration;
- assumptions about the prospects of the business beyond the discrete forecast period;
- the capital expenditure requirements during the forecast period and beyond;
- identification of any surplus assets; and
- changes in working capital.

Considerable judgement is required to estimate future cash flows. Generally reliance is placed on the medium to long-term projections prepared by management. Typically the NPV produced by a DCF analysis is very sensitive to relatively small changes in underlying assumptions, some of which cannot be predicted with a high degree of accuracy.

Typically an enterprise's weighted average cost of capital ("WACC") is used as the discount rate. WACC represents an amalgam of the returns required by debt and equity providers to the enterprise, and incorporates both the time value of money and the particular risk profile of the subject business and its cash flows.

Capitalisation of Earnings

Capitalisation of earnings is probably the most commonly used method for valuation of companies with an operating history and an earnings trend that is sufficiently stable to be indicative of on-going earnings potential. This method involves capitalising the earnings of a business by a market-derived multiple that can be applied to either earnings before interest, tax and depreciation and amortisation (EBITDA), earnings before interest and tax (EBIT), or net profit after tax (NPAT).

EBITDA is a useful measure because, for a relatively stable business, it represents the accounting measure most likely to correlate to operating cash flow over the long term. Its use eliminates the risk of distortions between comparisons due to differing depreciation and amortisation policies.

EBIT measures earnings after non-cash items such as depreciation and amortisation, but reflects the aggregate economic earnings before payments due to any capital providers, whether they be equity or debt providers. This measure also eliminates the risk of distortions from differing tax rates and levels of borrowing.

NPAT represents earnings available before distributions to shareholders but is usually the least desirable earnings figure to apply for the capitalisation of earnings methodology. NPAT can be distorted by differences in accounting policies with respect to depreciation and amortisation, as well as differing levels of debt and therefore interest costs in comparable companies.

The application of the capitalisation of earnings methodology involves:

- The selection of the future maintainable earnings level, having regard to historical and forecast operating results, non-recurring items of income and expenditure and other factors likely to impact on future performance.

- Determination of an appropriate capitalisation multiple, having regard to the share market ratings of comparable companies, the extent and nature of competition, quality of earnings, growth prospects and relative business risk.

In practice, it is often difficult to obtain accurate forecasts of future cash flows and the capitalisation of earnings methodology is sometimes used as a surrogate for the DCF methodology.

Under both the DCF and capitalisation of earnings methodologies, any surplus assets are included at their net realisable value.

Industry Rules of Thumb

In some industries businesses are valued using well established "rules of thumb". Generally these rules of thumb are used as a cross-check against a primary valuation methodology such as capitalisation of earnings or DCF. While they are only used as a "check" in most cases, in some industries they are the primary basis on which buyers determine prices.

Notional Realisation

In the event that a company has a poor earnings record or faces an uncertain future earnings outlook its value may have to be established by assessing the results of a notional winding up. The notional realisation assumes an orderly realisation process, or the sale of the company as a going concern.

The method would typically be used if an earnings based valuation would give a lesser total value, implying that a rational owner or controlling shareholder would liquidate in order to maximise value. This approach can also be used to complement the primary valuation approach for the purpose of providing an assessment of minimum value.

This method involves valuing self sufficient businesses on a going concern basis, with remaining assets and liabilities valued at their net realisable value. Potential liquidation costs, timing issues and tax consequences are taken into account.

4.2 Preferred Valuation Approaches

Our valuation approach adopted for Arthur Barnett is set out below:

- Retail business – capitalisation of earnings (refer Section 4.3);
- Property business – market valuation of Meridian Centre net of disposal costs (Section 4.4); and
- Surplus and non-core assets – at estimated net realisable values.

We have combined the values attributed to each of the parts above to derive an aggregate enterprise value for Arthur Barnett, from which the Company's net debt is subtracted to determine the equity value, being the value attributable to shareholders in the Company.

As a cross-check on our valuation methodology, we have evaluated the net tangible asset value ("NTA") for Arthur Barnett, and compared this to the results of our earnings-based valuation for the retail business and the valuation of the Meridian Centre.

4.3 Retail Business Valuation

4.3.1 Overview of Approach

Our approach to valuing Arthur Barnett's retail business is summarised as follows:

- Identification of future maintainable EBITDA;
- Selection of an appropriate earnings multiple; and
- Capitalisation of these earnings to derive a standalone enterprise value for the retail business.

We selected EBITDA as the appropriate measure of earnings based on our understanding that both the Dunedin and Christchurch stores are virtually new and therefore do not require substantial capital expenditure, whereas the Company's actual and forecast depreciation charges reflect recent high levels of capital expenditure. Capitalisation of EBITDA rather than NPAT also avoids risk of distortions due to differing gearing levels or assumptions regarding the tax-paying profile of a company.

4.3.2 Estimated Future Maintainable Earnings of Retail Business

Future maintainable earnings can be defined as the level of earnings, which (on average) a business expects to maintain in real terms, notwithstanding the vagaries of economic cycles that will inevitably cause earnings to fluctuate from year-to-year.

To determine the future maintainable EBITDA for Arthur Barnett's retail business we made adjustments to the reported earnings in respect to the following:

- 1999 – rental income received in respect of sub-tenancies of the old Christchurch store
- Internally allocated finance charges in respect of the HP and Store Card business, as the credit ledger has been separately valued and future maintainable earnings have been assessed on a EBITDA basis; and
- 2002 – unusually high advertising costs, particularly aimed at promoting the Christchurch store. Management do not anticipate the need for similar levels of expenditure in 2003.

Our calculation of Arthur Barnett's EBITDA from its retail business, after making these adjustments for the 1999 to 2003 years, is set out below:

Arthur Barnett Retail Business Year ended 1 August (NZ$000)	**1999 Actual (Audited)**	**2000 Actual (Audited)**	**2001 Actual (Audited)**	**2002 Actual (Unaudited)**	**2003 Budget**
Retail EBITDA (Dunedin and Christchurch only)	**931**	**300**	**490**	**439**	**737**
Adjustments					
Add back extra advertising in Dunedin and Christchurch	-	-	-	126	-
Rental of surplus ChCh space	(164)	-	-	-	-
Add back internal finance charges	229	220	200	205	184
Normalised EBITDA	**996**	**520**	**690**	**770**	**921**
Normalised EBITDA % of Sales	*4.7%*	*2.6%*	*3.3%*	*3.6%*	*4.0%*

Source: Arthur Barnett Annual Reports, unaudited 2002 management accounts and 2003 Budget

As can been seen from the above table, the adjusted EBITDA ranges between $520,000 and $996,000 over the 1999 to 2003 years.

We have taken the following factors into account when estimating future maintainable earnings for Arthur Barnett's retail business:

- We consider that the EBITDA achieved in 2000 was unusually low due to the problems surrounding the new Christchurch store in late 1999;

- There is a trend of steady improvement in EBITDA from 2000 to the budgeted result for 2003;

- Gross profit in the retail business has continued to improve year on year since 2000, although improvements achieved in 2002 (based on unaudited year end results) are not assumed to continue in the 2003 budget; margins are assumed to fall back to just above those attained in 2001. However, the Company expects to increase the EBITDA margin due to tight control of retail overheads combined with a more aggressive percentage growth in retail sales (6.5%) in 2003 than was achieved in 2002 (4.5%); and

- The improvement in gross profit percentage achieved in 2002 is largely offset by a significant increase in rental costs payable by Arthur Barnett in respect of its Meridian Centre store. The rationale for this increase was driven by a sale and lease back of the fixed store fit out (in line with the approach that has been taken with Kmart as the other "anchor tenant" in the Meridian Centre). We have not adjusted for this increase in occupancy costs when valuing the retail business, as the property valuation incorporates these higher rentals.

We have adopted $850,000 as an estimate of future maintainable earnings EBITDA for Arthur Barnett's retail business which is the mid-point between 2002 actual results (unaudited) and 2003 budget.

In the event that gross profit levels achieved in 2002 can be maintained, then the budgeted retail EBITDA would increase to approximately $1,050,000 in 2003. We have included this potential as a "high range" valuation scenario, meaning that for the purpose of our valuation of Arthur Barnett's retail business, we estimate future maintainable EBITDA to be in the range between $850,000 and $1,050,000.

4.3.3 Selection of Earnings Multiples – Retail Business

We have undertaken a comparable company ("CompCo") analysis to assist in the determination of an appropriate EBITDA multiple with which to capitalise our estimate of future maintainable earnings for Arthur Barnett's retail business.

CompCo analysis is only possible in respect of listed companies, given the need for public data on market value and earnings. The New Zealand listed retail companies set out below are exposed to varying degrees to similar business drivers to those that will influence the performance of Arthur Barnett.

Selected Comparable Listed Companies	Turnover ($M)	Market Cap ($M)	Actual EBITDA Multiple	Forecast EBITDA Multiple	Actual PE Ratio
New Zealand					
Briscoes Group		521	16.1	13.4	29.7
Hallenstein Glasson Holdings		158	7.0	7.0	13.8
Michael Hill International		193	10.2	8.9	19.2
Pacific Retail Group		154	4.7	5.7	8.8
The Warehouse Group		2,191	15.4	12.1	36.3
Kirkcaldie & Stains		31	12.1	n/a	14.5
Simple Average (excl Briscoes and Warehouse)			8.5	7.2	14.1
Weighted Average (excluding Briscoes and Warehouse)[1]			**7.8**	**6.9**	**14.4**

Source: Bloomberg and Datex
Note: (1) Weighted average based on market capitalisation.

Brief explanatory notes on each of the above retail companies are set out below:

Briscoes Group Limited	Briscoes Group Limited owns and operates the Briscoes Homeware chain of retail stores and the Rebel Sport chain of retail sporting goods stores throughout New Zealand under a limited franchise agreement with Australian company Rebel Sport Limited.
Pacific Retail Group Limited	Pacific Retail Group Limited is a retailer of home appliances and related products throughout New Zealand. The Company sells whiteware, audio and visual equipment, home office products, computers and home comfort products such as heaters, air conditioners and dehumidifiers. The Company also provides financing services for its products.
The Warehouse Group Limited	The Warehouse Group Limited operates general merchandise retail stores throughout New Zealand under the name "The Warehouse". The Company operates approximately 77 stores. The Company also operates "Warehouse Stationery" stores which sell office supplies.
Hallenstein Glasson Holdings Limited	Hallenstein Glasson Holdings owns and operates retail stores that sell men's and boy's clothing, sportswear and footwear. The stores operate under the "Hallensteins" name and are located in shopping malls throughout New Zealand. The Company also operates "Glassons" stores, which retail women's discount fashion apparel.
Michael Hill International Limited	Michael Hill Limited owns and operates approximately 43 retail jewellery stores in New Zealand and approximately 78 retail jewellery stores throughout Queensland, New South Wales, Victoria and Canberra, Australia.
Kirkcaldie & Stains Limited	Kirkcaldie & Stains Limited listed on the NZSE in May 2001. The company operates a single department store in Wellington, encompassing a wide range of merchandise with a total leased floor area of 6,600 square metres, focusing on quality of product and service. Up until this year, Kirkcaldies owned no property, making its business closest in operations and size to Arthur Barnett's retail businesses in Dunedin and Christchurch (excluding the Meridian Centre property). In March 2002 a 1:2 rights issue of 2,500,000 shares at $3.50 was completed, for the principal purposes of acquiring the Harbour City Centre in Lampton Quay, Wellington.

We have excluded from our overall weighted averages the multiples for Briscoes Group Limited and The Warehouse Group Limited as we do not consider these companies to be comparable to Arthur Barnett. Both companies operate major nationwide chains of retail stores on an entirely different scale and with different growth prospects.

In terms of direct comparisons, we consider that Kirkcaldie & Stains Limited ("Kirkcaldies") represents the best comparison to Arthur Barnett. Kirkcaldies is a single department store, based in Wellington. In 2001 Kirkcaldies reported retail revenues of $35.4M. Although Kirkcaldies acquired a property interest this year its most recent published audited financial results (for the year ending 31 August 2001) include no property interest and these reported financial results relate purely to the departmental store retailing operation in Wellington. In our view, the nature of Kirkcaldies' retail operations are therefore most closely aligned to those of Arthur Barnett, albeit they are more than 50% larger in terms of turnover.

We also considered Australian retailers, however we have not included these in our CompCo analysis as the majority of these businesses operate on an entirely different scale from Arthur Barnett or are specialty retailers.

The CompCo EBITDA multiples are extracted from share market transactions involving relatively small parcels of shares. An appropriate allowance therefore needs to be made for the premium attributable to a controlling or 100% shareholding. Such a shareholding is worth more on a per share basis than a minority holding as it can control the appointment of directors, management policy and shareholder benefits, amongst other things. New Zealand takeover evidence indicates that this premium is typically between 15% and 40%, but can be higher or lower depending on the circumstances.

However we have more than offset this premium by discounting the multiple applicable to Arthur Barnett's retail business, to recognise its small size, lack of diversification, and more limited growth opportunities when compared with other listed retailers such as Kirkcaldies.

In summary, to determine an appropriate EBITDA multiple for Arthur Barnett we have had regard to the following factors:

- Historical and forecast EBITDA multiples for the CompCos summarised above;
- Our knowledge of multiples which other buyers have been prepared to pay for other retail businesses in the past (some of which are confidential or incapable of being directly referenced);
- The limited nature and range of Arthur Barnett's activities and the specific risks surrounding its retail business;
- The stability and quality of Arthur Barnett's earnings;
- Future prospects for Arthur Barnett's retail business including growth potential, the nature of the industry, the strength of other competitors and barriers to entry; and
- Control premia and appropriate discounts for lack of size and lack of negotiability.

Taking all of these factors into account we consider that an appropriate multiple with which to capitalise estimated future maintainable EBITDA for Arthur Barnett's retail business is between 4 and 5.

4.4 Valuation of Meridian Centre

The Meridian Centre has been valued as at 31 July 2002 by registered valuers Colliers International New Zealand Limited ("Colliers"). The Director of Colliers responsible for the valuation was Mr RW Macdonald (FRICS, ANZIV, SNZPI). Mr Macdonald was also responsible for the Meridian Centre valuation prepared by Jones Lang LaSalle as at 31 July 2001, a copy of which was published in the September 2001 Meridian Centre Limited Investment Statement and Prospectus for the Capital Bonds issue. Mr Macdonald and Colliers have confirmed to us that they are independent of Arthur Barnett and the Meridian Centre and have no direct or indirect interest in the Meridian Centre.

Colliers defines market value as the highest price which might reasonably be expected to be obtained for the property at the date of valuation. This definition is consistent with the formal definition approved by The International Asset Valuation Standards Committee and the New Zealand Institute of Valuers:

> *"The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion."*

In Colliers' opinion, the market value of the Meridian Centre as at 31 July 2002 is $58M. We have estimated disposal costs, principally comprising real estate commission and legal fees, at approximately 1.5%. This produces a net market value for this property of $57.1M.

In arriving at the Meridian Centre valuation Colliers considered two principal valuation approaches. First the direct capitalisation approach, which involves the capitalisation of actual net rental income, together with potential reversionary increases resulting from the let up of vacant shops and periodic rent reviews. Secondly, Colliers carried out a discounted cashflow analysis incorporating an explicit forecast of the major variables affecting value over a ten year timeframe with cash flows and terminal value discounted at an appropriate discount rate. The value of the property at the end of the 10 year discrete forecast period was determined based on a capitalisation of its future projected rentals using a capitalisation rate of 10%.

Colliers' valuation reflects an initial yield (after let up of two vacant shops) of 9.56% and an internal rate of return of 11.06% at the adopted value of $58M.

We note that the Colliers' valuation of $58M (before disposal costs) is unchanged from the valuation incorporated in the Company's 2001 financial statements.

The valuation report notes the following:

> *"The Meridian Centre is located in a prime central city location bounded by George Filleul and Hanover Streets. George Street provides the main retail focus and enjoys significant passing of pedestrian traffic. Filleul and Hanover Streets also enjoy significant prominence but do not have the same level of pedestrian traffic. It is noted that the Dunedin City Council has consistently endeavoured to preserve the central city retail focus rather than encourage suburban shopping as has happened in most other New Zealand cities."*

We understand that the Meridian Centre, at a valuation of $58M, would be the highest valued retail property in Dunedin. We asked the valuer to consider comparable transactions in the South Island, which are as follows:

- Riccarton Mall – by far the largest shopping centre in the South Island, at the date of sale this centre possessed four major anchor tenants (KMart, Pak n Save, Farmers and Deka) with approximately 92 speciality tenants in an area in excess of 29,000 square metres. The valuer believes that the sale occurred in December 1996 at $113M, effectively reflecting an implied yield of 8.9% on the then contracted income.

- The Palms – this centre is located east of the Christchurch CBD in the suburb of Shirley, and is a large and relatively modern centre with KMart and a Big Fresh Supermarket as the anchor tenants together with 84 speciality stores. Then total area exceeds 22,000 square metres. A 50% interest was purchased by a local Christchurch investor who has a considerable involvement in the retail sector. The sale is understood to have occurred in February 2000 at a price of $74.5M, implying an initial yield of 9.4%.

We discussed the valuation with Mr Macdonald of Colliers, who confirmed to us that in his opinion, it is realistic to expect that the Meridian Centre could be sold at the stipulated valuation, given current market conditions. Mr Macdonald indicated that he believes there are several parties that would seriously consider purchasing this asset.

We have accepted the Colliers' market valuation for the Meridian Centre for the purpose of our valuation as being the best professional estimate of value for this key asset. We have also recognised the sensitivity of the overall Arthur Barnett valuation to the value of the Meridian Centre within our sensitivity analysis set-out in Section 4.6.

4.5 Summary of Arthur Barnett Valuation

Having assessed the value of Arthur Barnett's retail business, we then aggregated this with the valuation of the Meridian Centre, included other non-core/surplus assets, and adjusted for unallocated corporate overheads and debt to derive an overall equity value for Arthur Barnett, which is then used to calculate the value per share. This is summarised as follows:

Arthur Barnett – Valuation Summary	**Low**	**High**
Retail Business - Future Maintainable Earnings (EBITDA)	850	1,050
EBITDA Multiple	4.0	5.0
Retail Enterprise Value – ($000)	**3,400**	**5,250**
Add Other Assets		
Credit Ledger	3,802	3,802
Property under contract	240	240
Shares	75	75
	4,117	**4,117**
Add Property Investment		
Meridian Centre (market value less 1.5% disposal costs)	**57,143**	**57,143**
Deduction for Corporate Overhead		
Corporate Overheads	250	250
Multiple	9.0	9.0
Capitalised Value	**2,250**	**2,250**
Gross Enterprise Value ($000)	**62,410**	**64,260**
Less Debt		
Meridian Centre Bonds	18,000	18,000
Bank Debt	20,801	20,801
Sundry Advances	1,675	1,675
	40,476	**40,476**
Net Equity Value ($000)	**21,934**	**23,784**
No. Shares Outstanding	14,488,750	14,488,750
Value per Share ($)	**$1.51**	**$1.64**

Non-core / Surplus Assets

A small surplus property in Dunedin is subject to an unconditional sale contract which management expect will be settled in early September 2002. We have included the disposal proceeds in our valuation summary above. In addition, since balance date proceeds totalling $65,000 have been received relating to a capital distribution from Otago Power (in liquidation) in which Arthur Barnett held shares through electricity rebates. We have included these proceeds as a surplus asset, including a small residual holding based on the estimated final distribution amount.

Arthur Barnett operates a store card credit ledger in conjunction with JCB International. We have excluded the net income from this business from our retail enterprise value, but included the expected realisable proceeds from the credit ledger as a surplus asset for the purpose of our valuation approach. The attributed value of $3.8M is the book value recorded in the Company's draft 2002 accounts. Management would expect to realise these amounts (including HP arrangements) in full, as the carrying value of the credit ledger is recorded net of an allowance for doubtful debts.

Corporate Overhead

We have excluded unallocated corporate overheads from our estimate of future maintainable earnings for Arthur Barnett's retail business. These overheads relate to costs which are presently being incurred by Arthur Barnett, and which are not clearly attributable to either its retail business or the operation of the Meridian Centre (in which case the costs are recovered from tenants and reflected in the Meridian Centre's property valuation). Some of these costs are incurred as a consequence of the Company's status as a listed entity, which results in higher administrative, governance, compliance, and financial reporting costs than would otherwise be incurred.

We have estimated these unallocated corporate overheads to be $250,000, based on the budgeted 2003 costs. We have capitalised these costs at a multiple of 9, which represents a blend of the retail business EBITDA multiple and the implied earnings multiple reflected by the Meridian Centre valuation.

The capitalised corporate overhead is deducted in arriving at our valuation of the Company, reflecting the ongoing effect of these costs on shareholder value.

Debt

We have subtracted the debt due to Meridian Centre capital bond holders, bank debt and sundry advances from shareholders, employees and related parties at face value. Although the capital bonds are publicly listed, trading occurs only very infrequently and it is therefore difficult to derive a meaningful market yield, from which a market value for this debt can be determined. We have therefore included this debt at its nominal or face value rather than attempting to assess its current market value.

4.6 Valuation Sensitivities

Our valuation of Arthur Barnett is sensitive to a number of key variables, including:

- Market valuation of the Meridian Centre;
- Consumer confidence levels, which impact retail demand;
- Direct retail competition and the risk that new retail outlets will be developed;
- Procurement terms, which influence gross margins for the retail business; and
- Other non-controllable macro-economic factors such as interest rates and inflation.

Our valuation of Arthur Barnett does not assume any significant earnings growth from its retail business in the short to medium term. It is also conceivable that the retail business may suffer some earnings decline given the current cyclical peak of the rural economy in Otago which has boosted retail trade in Dunedin in recent times. Nevertheless, positive economic growth is expected over the medium term which should underpin future retail sales levels.

The following table demonstrates the sensitivity of our overall valuation of Arthur Barnett's shares to changes in the future maintainable EBITDA for the retail business of Arthur Barnett and a range of EBITDA multiples:

Arthur Barnett Share Valuation – Sensitivity to Earnings and Earnings Multiple					
	EBITDA Multiple				
Retail EBITDA ($000)	**3**	**4**	**5**	**6**	**7**
750	$1.43	$1.49	$1.54	$1.59	$1.64
850	$1.46	$1.51	$1.57	$1.63	$1.69
950	$1.48	$1.54	$1.61	$1.67	$1.74
1050	$1.50	$1.57	$1.64	$1.71	$1.79
1150	$1.52	$1.60	$1.68	$1.76	$1.83

The above table demonstrates that if future EBITDA for the retail businesses did not improve upon the actual 2002 result (EBITDA of just over $750,000), combined with using an EBITDA multiple of 4, this would result in a decrease in our low end valuation to $1.49 per share. Conversely, in the event that the high end EBITDA discussed above was achieved, in conjunction with a higher EBITDA multiple of, say, 6 this would increase our overall valuation to $1.71 per share.

Our assessment of Arthur Barnett's net equity value is most significantly influenced by changes in the market value of the Meridian Centre. The sensitivity of the valuation to changes in the Meridian Centre valuation are summarised below:

Arthur Barnett Share Valuation – Sensitivity to Meridian Centre Valuation							
Movement in market valuation	-5%	-3%	-1%	0%	+1%	+3%	+5%
Resulting market value ($000)	54,286	55,429	56,572	57,143	57,714	58,857	60,000
Arthur Barnett share valuation (using low end base)	$1.32	$1.39	$1.47	$1.51	$1.55	$1.63	$1.71
Arthur Barnett share valuation (using high end base)	$1.44	$1.52	$1.60	$1.64	$1.68	$1.76	$1.84

In the event that market valuation fell 5% below current estimates of $58M, to $54.3M (net of 1.5% disposal costs), this would result in a decrease of approximately $0.20 per share in our overall valuation for Arthur Barnett, reducing the low-end retail business valuation for Arthur Barnett to $1.32 per share (or $1.44 using the high-end retail business valuation).

Whilst, as indicated above, we are comfortable relying on the Colliers' valuation for the Meridian Centre, it is also readily apparent that this value is the major driver of the value of the shares in Arthur Barnett. Moreover, the value attributed to the Meridian Centre of $58M is virtually without precedent in Dunedin, as there has not been a sale of a commercial or retail property in Dunedin with a value approaching this order of magnitude previously.

4.7 Other Valuation Considerations

Dividends

Arthur Barnett paid a three cent per share dividend in April 2002 following announcement of its 2002 interim results after not paying any dividends since 1999. Arthur Barnett's ability to pay dividends is constrained by the Company's debt servicing requirements. Arthur Barnett has suspended dividends twice in the 1990s, and consequently we do not believe it is appropriate to perform a capitalisation of dividends valuation for the Company.

We believe that Arthur Barnett's history of suspending dividend payments due to poor trading performance and excessive debt levels is reflected in its share price Given our conclusions regarding the undercapitalisation of the Company (Section 5.7) and the uncertainty surrounding how this situation will be alleviated, we believe that there is only a limited prospect that Arthur Barnett will continue dividend payments in the short – medium term.

Asset Backing

As a cross check of our valuation we have compared our valuation range against the Company's historic and projected NTA.

Our valuation range for Arthur Barnett lies below the Company's NTA which was $1.83 as at 1 August 2002 (based on the unaudited 2002 accounts).

We have not attributed any value to the "Arthur Barnett" brand as there is no clear evidence that the retail business is able to generate a superior return as a result of its long-established and well known name. We have also not attributed any value to the tax losses in the Company although if Belwalsh's takeover offer is successful, these losses should continue to be available to carry forward within Arthur Barnett and therefore have value to the Offeror.

The carrying values for Arthur Barnett's operating assets do not reflect closure costs and redundancies, meaning that the net realisable value of the Company's assets would be reduced in this eventuality.

Another factor partially explaining why our value range falls below the Company's NTA is the effect of the unallocated corporate overhead (equating to $0.15 per share), which on an ongoing basis will depress shareholder returns and is therefore reflected in our valuation of the Company but is not incorporated within the NTA calculation.

Overall, we are comfortable with a value range for Arthur Barnett below its reported NTA, in view of:

- Costs not reflected on the balance sheet that would arise if Arthur Barnett was wound up;
- Corporate overheads which depress shareholder returns;
- The lack of a steady dividend return to underpin share value;
- The Company's high level of gearing, meaning that any fluctuation in gross asset values will have a much more pronounced affect on equity value (for example, a 5% decrease in the Meridian Centre market valuation translates to a 13% decrease in value per share); and
- The Company's relatively small size and general lack of growth potential.

5 *Other Considerations*

5.1 Prospects of an Alternative Takeover Offer for Arthur Barnett

The principals of Belwalsh, through their related shareholdings, currently control 53% of Arthur Barnett. We believe it is therefore unlikely that an alternative takeover offer for Arthur Barnett will emerge. In reality, Arthur Barnett represents two quite distinct investment "opportunities", comprising on the one hand a relatively small retail business, and on the other a very substantial Dunedin property investment.

Since parties connected to Belwalsh already are controlling shareholders in Arthur Barnett, we consider it is unlikely that other retailers and/or property investors would invest to take a minority non-controlling interest.

Belwalsh should be in a position to extract the greatest benefits from an acquisition of Arthur Barnett, principally due to the $14M of accumulated tax losses which should remain available as we understand that Belwalsh's takeover will not prejudice the shareholder continuity rules, so that the Company can carry forward these losses and use them to off-set future assessable income. In contrast, any third party bidder for Arthur Barnett would, following a successful takeover offer (involving a transfer of more than 50% of the Company's shares), lose the ability to utilise the Company's tax losses, thereby diminishing future returns.

Consequently, whilst the prospect of an alternative offer cannot be discounted, we believe this is very unlikely given all the circumstances.

5.2 Prospect of Belwalsh Takeover Offer Becoming Unconditional

The Takeovers Code stipulates a minimum acceptance condition of 50% which cannot be waived by the Offeror. In this instance Belwalsh has elected to specify a 90% acceptance condition, however, it also retains a discretion to waive this condition. This means that it can declare its offer to be unconditional and purchase shares even if it does not receive sufficient acceptances to reach the 90% threshold stipulated in its offer.

Arthur Barnett has approximately 1,500 shareholders, with its top 20 shareholders accounting for 83% of the Company's issued capital. The Company's capital base is therefore narrowly held amongst a small number of relatively large shareholders. There would appear to be no significant shareholdings that could block the Belwalsh Takeover Offer and therefore it would require a concerted effort by small shareholders in order for the Takeover Offer to not succeed.

The other critical issue which could impact the prospects of Belwalsh's offer succeeding is, of course, any competing bid. However, as indicated above, we view this prospect as fairly remote.

Given the structure of the acceptance conditions within Belwalsh's offer, it is virtually certain that the minimum 50% threshold stipulated in the Takeovers Code will be satisfied (as Belwalsh's principals already control 53% of the Company's capital). Therefore, Belwalsh will have the ability to declare its offer unconditional at any stage, even if the 90% acceptance level is not obtained.

Therefore, shareholders who do not accept the offer need to consider the prospect that the offer will nonetheless succeed, even if Belwalsh does not achieve 90% ownership, meaning that they could remain as minority shareholders in the Company. In these circumstances there would be even less prospect of an alternative bid emerging, and we address the likely consequences for Arthur Barnett's share price under these circumstances in the next section.

If Belwalsh does achieve the 90% acceptance level specified in its offer, then it will also have the ability to compulsorily acquire the balance of outstanding shares pursuant to the provisions set-out in the Takeovers Code.

5.3 Market Value of Arthur Barnett Shares if Belwalsh Offer Lapses

Arthur Barnett shares are listed on the NZSE but are only traded on a relatively infrequent basis. Previous trading in the shares over the last two years has generally taken place at a price of under $1.00, well below the consideration offered by Belwalsh of $1.40. Trading occurred on only 97 days during the last year.

The VWAP over the 12 months prior to Belwalsh's takeover offer being announced was 85 cents and over the 20 trading days prior to the announcement date 74 cents. Belwalsh's offer therefore represents a substantial premium of between 65% and 89% relative to the quoted market price for Arthur Barnett's shares prior to the takeover offer being announced. This level of premium exceeds the typical premia evident in New Zealand takeover transactions, which usually range between 15% and 40% above the quoted market price pre-bid (although in some instances the premium can be considerably higher, reflecting the specific circumstances of the bidder and the target company).

In our view, shareholders in Arthur Barnett may have difficulty in finding buyers for their shares at a price approaching the total consideration being offered by Belwalsh, in the event that the Belwalsh offer lapses. We therefore believe that the "sharemarket value" for Arthur Barnett shares is likely to fall below the $1.40 price being offered by Belwalsh under its takeover offer if its takeover offer lapses. A contributing factor to this is that the prospects of ongoing dividends could be limited given the Company's gearing. In these circumstances Arthur Barnett shareholders may have to wait some time before they are able to sell their shareholdings for an equivalent value.

It is possible that a revised, and possibly improved, offer may be forthcoming from Belwalsh at a future date, however, there is absolutely no certainty that this would occur. Any such offer would reflect trading conditions and financial performance at that time. It would be presumptive to assume any future offer would necessarily match or better the current Belwalsh takeover offer terms.

5.4 Costs and Benefits of NZSE Listing of Arthur Barnett

We believe that the aggregate cost savings available to Arthur Barnett as a consequence of no longer being a listed company would approximate $100,000 per annum. Assuming an earnings multiple of approximately 9 means these benefits translate into an aggregate value gain in the order of $900,000 (or 6 cents per share) for Arthur Barnett's owners (Belwalsh in the event that the Takeover Offer succeeds).

5.5 Implications of Takeovers Code Regime

The Takeovers Code regime, which took effect from 1 July 2001, introduces significant changes to the manner in which a takeover offer can be progressed. In particular shareholders should note:

- shareholders can no longer be treated on a "first come – first served" basis;
- shareholders have until the specified offer closing date to decide whether to accept the offer, and will be notified whether the offer will proceed based on satisfaction of the offer conditions;
- the Takeovers Code stipulates a minimum acceptance condition of 50% which cannot be waived by the Offeror. In this instance it is virtually certain that this condition will be satisfied as the principals of Belwalsh control more than 53% of Arthur Barnett's capital; and
- whilst the Offeror has stipulated a 90% acceptance condition (thereby allowing it to proceed with compulsory acquisition), it is able to waive this condition at its discretion and proceed with the takeover offer in respect of those shares for which acceptances have been received (ie. the offer may partially succeed, resulting in Belwalsh owning somewhere between 53% and 90% of Arthur Barnett's issued capital).

Belwalsh has stipulated that its offer will remain open until 1 December 2002. If the conditions are satisfied prior to that date, then Belwalsh is obliged to notify Arthur Barnett and the Panel of this, so that shareholders will then be informed that the offer has become unconditional. In the absence of these conditions being satisfied, shareholders accepting the offer will not necessarily know whether or not the offer will be declared unconditional. Importantly however, the closing date cannot be accelerated, and shareholders will always have until the specified closing date to lodge acceptances.

5.6 Shareholder Discounts

Shareholders in Arthur Barnett are entitled to shareholder discounts in respect of their retail purchases with Arthur Barnett as follows;

Shareholding size	Discount received
200 to 499 shares	5%
greater than 500 shares	7.5%

A shareholder deposit scheme also exists, although this is now closed to new participants. The 400 existing participants receive an additional 2.5% discount on purchases. Shareholders with both shareholder deposits and over 500 shares are therefore entitled to a total discount of 10% on their purchases.

If the takeover succeeds then these benefits would most likely cease. The estimated saving to Belwalsh would be in the region of $50,000 per annum. Capitalised at a minimum of 9 times, this equates to a value gain of approximately $450,000 (or 3 cents per share) for the Offeror in the event that the Takeover Offer is successful. Off-setting this is the prospect that some shareholders will change their shopping patterns once the discount scheme is terminated.

5.7 Undercapitalisation of Arthur Barnett

The Notice of Takeover submitted by Belwalsh notes that "for a long time Arthur Barnett has been undercapitalised which has been reflected in a continuing low share price".

We note that the Capital Bonds raised in 2001 to refinance the Meridian Centre may be viewed as having some qualities of equity, in that they exist in perpetuity, being only repayable upon the disposal of the Meridian Centre. Nevertheless these Bonds, which are in fact debt, add to the financial gearing of the Company. Moreover, the bondholder's interest must be paid ahead of any dividend distributions to shareholders.

We consider that the $40M of debt (including Capital Bonds) carried by the Company relative to its gross assets totalling $70.7M is excessive. We believe that the Company's retail business is unable to sustain any significant level of debt, given its level of earnings and our view on the value of the business. Therefore, any debt must be borne by the Meridian Centre. We consider that an appropriate debt level consistent with industry norms would be around one-third to half of the gross asset value, implying a debt level of approximately $20M-$29M.

Given the Company's existing debt level is approximately $40M, this means then that Arthur Barnett has excess debt of approximately $11M-$20M.

The reality of the Company's financial position means that the prospect of some form of capital raising will overhang the Company, with a risk that shareholders will perceive that any such capital raising will be value dilutive at worst, and at best will not result in any enhanced return for shareholders in terms of additional dividends.

Yours faithfully
PricewaterhouseCoopers

David Bridgman
Partner

Maurice Noone
Partner

Appendix 1

Sources of Information

1. Notice of Takeover Offer issued by Belwalsh
2. Draft Target Company Statement prepared for Arthur Barnett
3. Arthur Barnett Constitution
4. Last five years Statutory Accounts and Annual Reports for Arthur Barnett
5. Draft management accounts to 1 August 2002 for Arthur Barnett
6. 2003 operating budgets for Arthur Barnett
7. Details of Arthur Barnett funding arrangements
8. Arthur Barnett shareholder statistics
9. Discussions with Arthur Barnett's Independent Directors (M Coburn, S McLauchlan and B Barnett) and its Financial Controller (M Jacombs)
10. Comparable company data sourced from Bloomberg and other sources
11. Industry forecasts macro-economic data and other information prepared by NZIER and Statistics NZ
12. Meridian Centre Valuation Report (as at 31 July 2002) prepared by Mr RW Macdonald, Director Valuation Services, Colliers International New Zealand Limited MERINZ, dated 27 August 2002
13. Other publicly available information

Appendix 2

Declarations

This Report dated 3 September 2002 and accompanying summary letter of the same date have been prepared by PricewaterhouseCoopers at the request of the Independent Directors of Arthur Barnett Limited, to fulfil the reporting requirements under the Takeovers Code (Rule 21) in relation to a Notice of Takeover issued by Belwalsh on 14 August 2002. This Report should not be used for any other purpose.

This Report is provided for the benefit of the shareholders of Arthur Barnett, and PricewaterhouseCoopers consents to the distribution of this Report to the shareholders of Arthur Barnett.

Qualifications

This Report has been prepared by the Corporate Finance division of PricewaterhouseCoopers, which provides advice on mergers, acquisitions and divestments, valuations, independent experts reports and appraisals, financial investigations and strategic corporate advice. The partners responsible for this Report are David Bridgman (MCom, LLB, CA), who has considerable experience in corporate advisory matters, valuations, and the preparation of independent appraisal reports, and Maurice Noone (BCom, CA) who has considerable experience as an advisor to a number of South Island businesses.

Independence

We consider ourselves to be independent in terms of the Takeovers Panel's policy for the appointment of independent advisors. Our appointment has been approved by the Takeovers Panel.

As at the date of issuing this Report neither PricewaterhouseCoopers nor any personnel involved in the preparation of this Report:

(a) have had, or will have, any relationship with the parties to the proposed transaction except as disclosed below;

(b) will receive any fees for the preparation of this Report contingent on the success or implementation of the proposed transaction; and

(c) have had any involvement in the formulation of the proposed transaction.

PricewaterhouseCoopers confirms that it has no conflict of interest that could affect our ability to provide an unbiased report.

Disclaimer and Restrictions on Scope of Our Work

The statements and opinions expressed in this Report are based on information available as at the date of the Report. In forming our opinion, we have relied on forecasts and assumptions prepared by Arthur Barnett management, about future events which by their nature, are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

The statements and opinions expressed in this Report have been made in good faith and on the basis that all relevant information for the purposes of preparing this Report has been provided by Arthur Barnett management and that all such information is true and accurate in all material aspects and not misleading by reason of omission or otherwise. Accordingly, neither PricewaterhouseCoopers not its partners, employees or agents, accept any responsibility or liability for any such information being inaccurate, incomplete, unreliable or not soundly based or for any errors in the analysis, statements and opinions provided in this Report resulting directly or indirectly from any such circumstances or from any assumptions upon which this Report is based proving unjustified.

Our opinion has been arrived at based on economic, market and other conditions prevailing at the date of this Report. Such conditions may change significantly over relatively short periods of time.

We reserve the right, but will be under no obligation, to review or amend our Report, if any additional information, which was in existence on the date of this Report was not brought to our attention, or subsequently comes to light.

Advance drafts of this Report were provided to management at Arthur Barnett, solely for the purpose of verifying factual matters contained in the Report. Minor changes were made to the drafting of the Report as a result of the circulation of the draft Report. However, there was no alteration to any part of the substance of this Report, including the methodology, valuations or conclusions as a result of issuing these drafts.

Indemnity

Arthur Barnett has agreed that to the extent permitted by law, it will indemnify PricewaterhouseCoopers and its partners, employees and consultants in respect of any liability suffered or incurred as a result of or in connection with the preparation of the Report. This indemnity will not apply in respect of any negligence, wilful misconduct or breach of law. Arthur Barnett has also agreed to indemnify PricewaterhouseCoopers and its partners and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where PricewaterhouseCoopers or its employees and officers are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, PricewaterhouseCoopers shall reimburse such costs.