



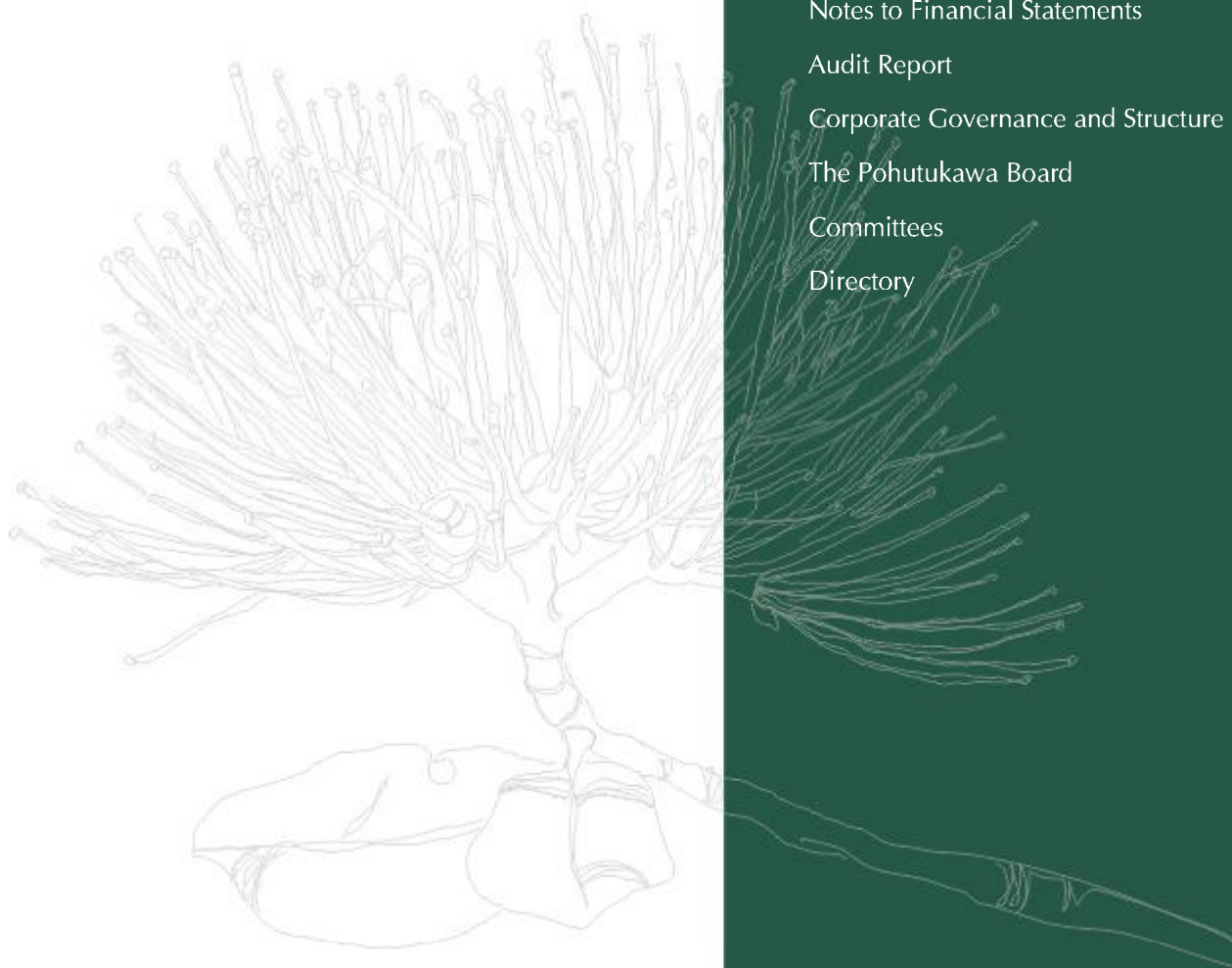
Annual Report  
For the Year Ended 31 December 2010

**Pohutukawa**  
PRIVATE EQUITY II LIMITED



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## Report to Shareholders

14 April 2011

Dear Shareholder

I am pleased to present the second Pohutukawa II Annual Report. The report includes the financial statements for the year ended 31 December 2010 with commentary on our portfolio companies and investment prospects for 2011.

The year proved to be yet another stressful one for many small to medium sized businesses in our target market in New Zealand, testing management resolve in terms of financial management and growth plans generally. Although there are many investment opportunities arising, our investment manager Direct Capital adhered to its proven investment model of investing alongside owners in already profitable, well-managed companies. This has resulted in Pohutukawa II making two further investments during the year, in Bayley Corporation Ltd and Cavalier Wool Holdings Ltd.

Pohutukawa II's three investments at 31 December 2010 represent an investment outlay of \$12.6 million.

### Pohutukawa II

The Pohutukawa II offer raised \$82.5 million in February 2009.

Pohutukawa II coinvests with the Direct Capital IV fund (\$243 million capital raised from a number of NZ institutions and from management coinvestment) in all investments it makes.

Table 1 shows a summary of the Pohutukawa II investments at cost.

Companies	Date of Investment	Industry	Stage	Total Investment at Cost (NZ\$)	PPE Shareholding %
Transaction Services Ltd	Jan 2010	Financial services	Secondary	\$ 5,700,507	11.80
Bayley Corporation Ltd	June 2010	Real estate	Expansion	\$ 3,574,666	7.50
Cavalier Wool Holdings Ltd	Dec 2010	Wool scouring	Secondary	\$ 3,336,366	6.00
<b>Total Cost of Current Pohutukawa II Investments</b>				<b>\$ 12,611,539</b>	

### Portfolio Investments in 2010

Of the 20 cents per share called, Pohutukawa II has invested 15.3 cents per share, or \$12.6 million in the following companies:

#### *Transaction Services Limited*

In January 2010 Direct Capital, through its Direct Capital IV and Pohutukawa II funds, invested \$24 million to acquire a 49% interest in Transaction Services Limited (TSL), Australasia's largest third party recurring payment-processing company.

Pohutukawa's stake in Transaction Services is \$5.7 million, or 11.8% of the company. This investment represents 7 cents per share of Pohutukawa II shareholders' capital.

#### *Bayley Corporation Limited*

In June 2010 Direct Capital, through its Direct Capital IV and Pohutukawa II funds, acquired a 31.5% stake in well-known national real estate firm Bayleys. Pohutukawa has a minority shareholding of 7.5%. This investment of \$3.57 million represents 4.3 cents per share of Pohutukawa II shareholders' capital.

#### *Cavalier Wool Holdings Limited*

In December 2010 Direct Capital, through its Direct Capital IV and Pohutukawa II funds, acquired a 25% stake in Cavalier Wool Holdings (CWH) a wool scourer servicing the local wool industry. Pohutukawa II has a minority shareholding of 6%. The \$3.34 million investment represents 4.0 cents per share of Pohutukawa II shareholders' capital.

## Report to Shareholders

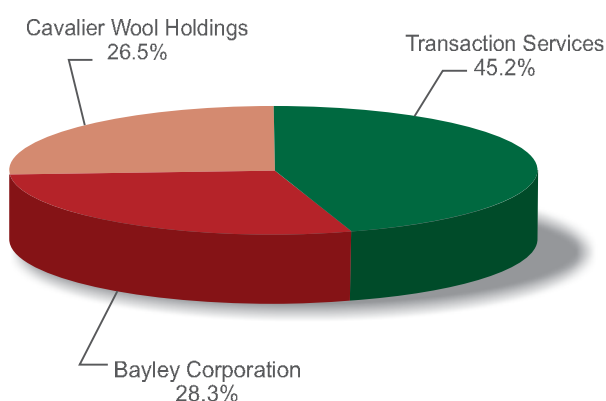
### Portfolio Weightings

At this early stage in the investment cycle the portfolio weightings are skewed with Transaction Services representing 45% of the total investment cost, with Bayleys and CWH representing 28% and 27% respectively. See *Chart 1*.

The three investments are across three different industries so the industry exposure percentages are the same as the investment weightings at this point in time.

**Chart 1** - The following chart shows each investment as a percentage of the total investment portfolio (at investment cost):

Pohutukawa II Investments as at 31 December 2010



### Investment Revaluations

The Manager revalues the portfolio investments each quarter using valuation guidelines issued by AVCAL (The Australian Private Equity & Venture Capital Association). These quarterly revaluations are completed for all portfolio company investments unless the investment has only been recently completed, in which case they are reported at cost (as is the case with Cavalier Wool Holdings at year end).

The portfolio was valued at \$13.5 million as at 31 December 2010 comparing favourably to the investment cost of \$12.6 million.

### Annual Financial Statements 31 December 2010

Our financial statements for the year ended 31 December 2010, Directors' Report and KPMG Audit Report are included in this annual report.

As at 31 December 2010 Pohutukawa II had 82.5 million stapled securities on issue, \$1 shares paid to 20 cents.

At balance date shareholders' funds were \$13.5 million.

Assets comprised:

- Investments           \$13.53 million
- Receivables           \$0.42 million
- Cash                   \$0.13 million

The receivables figure includes an accumulated GST refund of \$404,000. The Inland Revenue Department is currently reviewing Pohutukawa II's GST reporting and withholding refunds whilst this review is underway. Pohutukawa II directors and our advisers believe our position is correct in the treatment of GST and discussions are continuing with the Inland Revenue Department.

Trade payables total \$556,000 of which \$533,000 is deferred management fees, which we expect to pay at the time of the next call.

Income was derived from interest of \$54,000 from short-term deposits with the National Bank of New Zealand and Craigs Investment Partners Cash Management Account.

Other income of \$54,000 was derived from advisory fee income received from portfolio companies.

Operating expenses were \$2.02 million, plus finance (interest) expenses of \$77,000. Of the total operating expenses management fees were \$1.85 million and director fees \$26,000.

The loss for the period was \$1.07 million dollars.

## Report to Shareholders

Table 2 below shows the Pohutukawa II Performance Summary

**Table 2**

**Pohutukawa II Financial Performance Summary**  
For the year ended 31 December 2010

	2010	2009
	\$000	\$000
<i>Operating Results</i>		
Interest income	55	224
Other income	54	-
Change in fair value of investments	922	-
Operating expenses	(2,099)	(2,120)
Loss after tax	(1,068)	(1,897)
<i>Share performance</i>		
Stapled Securities on issue	\$1.00 82,500,000	82,500,000
Earnings per share	nil	nil
Net asset backing-cents per share	\$ 0.16	\$ 0.08

### The Manager

One of the roles of the Pohutukawa II Board is to review the Manager's performance. This review was undertaken at the end of 2010. The Board considered the services and activities of the Manager including: all aspects of the investment management process and portfolio management; the fund's administration; investor communications; statutory reporting and governance support for the Board. The Board believes the Manager is performing to the expected standards in all respects.

### Secondary Market

Craigs Investment Partners facilitates a secondary market for your Pohutukawa II shares, details of which are available on the Pohutukawa website [www.pohutukawafund.co.nz](http://www.pohutukawafund.co.nz).

The last sale price on 31 March 2011 was 24 cents per share which compares with net asset backing at 31 December 2010 of 16 cents per share.

### Investment Prospects

The Direct Capital investment team have been busy reviewing a number of investment opportunities.

Due diligence has recently been completed on a large investment and a final bid submitted. If successful this will necessitate a further call on shareholders in the short-term.

The investment team also has a number of other investments under active review and several at the bid stage.

### Annual Shareholders Meeting

The details for the Annual Shareholders Meeting for Pohutukawa Private Equity II are:

**Date:** Tuesday, 17 May 2011

**Time:** 2.45pm

**Place:** Craigs Investment Partners Limited, Level 32, Vero Centre, 48 Shortland Street, Auckland

**RSVP:** Contact Peter Lalor on 07 5774 727 or [enquiries@pohutukawafund.co.nz](mailto:enquiries@pohutukawafund.co.nz) by 6 May 2011.

We extend an invitation to you to attend this meeting and look forward to seeing you there.

Thank you for your ongoing support of Pohutukawa II and please note that any further investments will require a further capital call. We will provide you with the required 30 days notice in this regard.

If you have any queries regarding your investment in Pohutukawa II, please call your Investment Advisor or Peter Lalor at Pohutukawa II Management on 07 5774 727.

Yours sincerely,

**POHUTUKAWA PRIVATE EQUITY II LIMITED**



John McDonald  
Chairman

## Manager's Report

Three investments have been made during this first full financial year. We have a number of opportunities under active review and several at the bid stage. The Manager is pleased with the performance and composition of the portfolio which spans a diverse mix of industries. We have invested 15.3% of the fund and are satisfied with the early performance of the portfolio companies despite the economic climate and, to a lesser extent, the natural disasters afflicting Christchurch. Individual performance and prospects are highlighted in each of the portfolio company summaries that follow.

Table 3 below illustrates the composition of the portfolio at 31 December 2010 market values:

**Table 3**

Company Ranking by Value 31 December 2010	As a % of Portfolio at Current Values
<b>Direct Investments</b>	
Transaction Services	51.0%
Cavalier Wool Holdings	24.7%
Bayley Corporation	24.3%
<b>Total Pohutukawa II Investments</b>	<b>100%</b>

As at 31 December the net asset value represents 15.9 cents per share compares favourably to the 15.3 cents invested in portfolio companies to date.

Damage caused by the September Christchurch earthquake did not materially impact the portfolio. Bayley's is the only portfolio company with direct business in Christchurch and they were up and running immediately after the earthquake. The first earthquake caused a slow-down in real estate activity in the latter part of 2010. The second earthquake in February 2011 will similarly impact growth in this market. The Christchurch operation is a small part of Bayley's nationwide business activities.

In the current economic environment there continues to be opportunity for Pohutukawa II and Direct Capital IV to make meaningful investments in proven, profitable companies that require further investment capital to meet their growth strategies.

The investment appraisal and analysis process is proven and robust, and builds on Direct Capital's many years of experience in investing in private companies. With the experience of having invested in more than 65 companies, our belief in partnering with business owners and managers to continue creating growth and value is stronger than ever. Providing an investment into successful businesses to provide succession solutions to business owners is also a key offering within the private company market in New Zealand and Australia.

For us there is no better investment than investing alongside owners and managers of a well-run private company. They know their own business, their industry, the risks and opportunities better than anyone. They know where the right investment will make the biggest difference. With our capital and experience we can help owners achieve their goals.

### Portfolio Companies Performance and Outlook

Each of the portfolio companies are well positioned for future growth strategies, which may include acquisitions.

Whilst the second Christchurch earthquake will impact on Bayley's, as the longer-term real estate market in Christchurch takes time to recover and rebuild, overall we see 2011 as an interesting year for our portfolio companies.

The companies are actively considering acquisition opportunities and expanding through new business initiatives.

We look forward to providing an update on our investments at the annual meeting.

## Manager's Report

### TRANSACTION SERVICES LIMITED

[www.debitsuccess.co.nz](http://www.debitsuccess.co.nz)



Date of Investment	Description	Stage	Total Investment Cost \$000	Shareholding %
January 2010	Third party processing	Secondary	\$5,701 - equity	11.8

Total shareholding managed by Direct Capital 49%

#### Background

Transaction Services Limited (TSL) is Australasia's largest third party recurring payment processing company.

Transaction Services was established in 1994 and annually processes more than 20 million transactions on behalf of over 2,500 clients, from their 600,000 customers in New Zealand and Australia. TSL operates under the brands Debitsuccess and FFA Paysmart, and manages the payment processing function for clients in a wide range of industries..

Direct Capital's investment in TSL was completed in January 2010.

#### Performance

TSL's performance in 2010 was pleasing with the business again achieving significant growth over the previous year, with management securing new clients across a broad range of target sectors where regular instalment billing is required including health and fitness facilities, sports clubs, property management companies, childcare operators and retailers.

#### Outlook

The market environment remains positive in both countries with companies increasingly looking to outsource their payment processing functions. With their ability to offer the full breadth of payment services to businesses of all sizes, Transaction Services is well positioned to continue its impressive historical growth. Acquisition opportunities are also expected to be considered where these compliment TSL's existing service offering.

## Manager's Report

### BAYLEY CORPORATION LIMITED

[www.bayleys.co.nz](http://www.bayleys.co.nz)



Date of Investment	Description	Stage	Total Investment Cost \$000	Shareholding %
June 2010	Real Estate	Expansion	\$3,575 - equity	7.5

Total shareholding managed by Direct Capital 31.5%

#### Background

Bayleys is a full-service property services company operating nationally from 54 corporate owned and franchise branches, and has a dominant position in marketing commercial, industrial, and rural properties, and a leading position in high-value residential and lifestyle property sales. In addition to real estate agency, Bayleys offers facilities and asset management, valuation, leasing, research and advisory services.

#### Performance

The investment in Bayleys was completed in June 2010.

Bayleys revenue eased over the period compared with last year, with the impact from the first Christchurch earthquake and lower consumer confidence in general having a negative impact on the residential market. Positively, Bayleys continues to gain marketshare with its own residential volumes declining less than half that of the broader market and its closest competitors.

The downturn in residential market activity continued into the latter part of 2010 before staging a modest recovery late in 2010 with an improvement in activity observed across all geographies.

Activity across all agency segments are showing signs of increased activity. The corporate C&I division contributed significantly to Bayleys result, with its gross commissions up year-on-year, driven by an increase in large investment transactions. Rural

transactions are also well up on last year, with Bayleys continuing to gain substantial market share in this sector.

The property services and valuation division continued to trade in line with expectations.

#### Outlook

The second Christchurch earthquake is likely to have an impact on activity in the local market (Bayleys second largest franchise) and as well impact prospects nationally.

Bayleys management remain focused on their strategic aims of increasing the scale of operations and the proportionate contribution from commercial and industrial property services, particularly property and asset management, valuation, consultancy, financial services and funds management.



## Manager's Report

### CAVALIER WOOL HOLDINGS LIMITED



Date of Investment	Description	Stage	Total Investment Cost \$000	Shareholding %
December 2010	Wool scouring	Expansion	\$3,336 - equity	6.0

Total shareholding managed by Direct Capital 25.0%

#### Background

Cavalier Wool Holdings Limited (CWH) is a wool scouring business in New Zealand servicing the NZ sheep industry.

Operating from two sites in Napier and Timaru, CWH processes 'greasy' wool on behalf of wool exporters and carpet makers and converts it to 'clean' wool (removing grease and contaminants) and then dense packs it for either local conversion into carpet, or for export shipment.

As a by-product, wool grease is extracted and exported to global customers who further refine it and convert it to lanolin for use in cosmetic and pharmaceutical end products.

#### Performance

The CWH shareholding was acquired in December 2010.

The investment is based on sheep numbers in New Zealand remaining at current levels (following a long period of decline). There are opportunities to service more specialised wool clip varieties, service offshore wool growers and exporters as part of an international supply chain. Also CWH expect to improve wool grease recovery and marketing of what is a highly valued intermediary product.

CWH is owned 50% by listed carpet maker, Cavalier Corporation, 25% by Accident Compensation Corporation and 25% by Direct Capital IV/Pohutukawa II. The company operates to a high standard of governance.

#### Outlook

The industry has been in a long-term, 20-year consolidation phase which is now substantially complete. Higher commodity prices for lamb and wool support stabilising sheep numbers at current levels. There are significant industry initiatives underway that are also supportive of generating efficiencies in the market and CWH is well-placed to contribute to these activities and to benefit from them.

## Directors' Report

For the year ended 31 December 2010

The following table shows Directors holding office during the year, their remuneration rate and the amount of director fees paid during the year.

	*Remuneration Rate \$	Date of appointment
J McDonald	15,000	04-Nov-08
M Prendergast	11,250	19-Nov-08
N J Craig	6,250	19-Nov-08
F M Aldridge	6,250	19-Nov-08

\*Note Directors agreed to a 50% remuneration rate in 2010 while investment activity was low

### Entries recorded in the interests register

The entries shown in the table below were recorded in the interests register of the company during the year.

### *Directors' shareholdings and dealings in Pohutukawa II as at 31 December 2010.*

The directors of Pohutukawa II also have co-investment rights in the investments that are undertaken by Pohutukawa II. Holdings (including relevant interests) are as follows:

Pohutukawa II Director Investment Disclosure 31 December 2010 (Directors holding office as at 31 December 2010)				
Investment Holding	J McDonald	M Prendergast	N J Craig	F Aldridge
	No. Securities	No. Securities	No. Securities	No. Securities
Pohutukawa II	100,000	25,000	100,000	
Transaction Services Ltd	23,874	51,240	25,075	
Bayley Corporation Ltd	5,015	5,015	3,115	
Cavalier Wool Holdings Ltd	3,963	3,963		



Director

4 April 2011

Date



Director

4 April 2011

Date

## Statement of comprehensive income

For the year ended 31 December 2010

	Note	Consolidated		Parent	
		2010	2009	2010	2009
Interest income		54,835	223,641	54,835	223,641
Change in fair value of investments		921,884	-	-	-
Other operating income		53,629	-	389,476	-
Administrative expenses	5	(2,021,960)	(2,120,359)	(2,021,960)	(2,120,359)
<b>Operating (loss)/profit</b>		(991,612)	(1,896,718)	(1,577,649)	(1,896,718)
Finance expenses - interest		76,599	-	76,599	-
<b>(Loss)/profit before tax</b>		(1,068,211)	(1,896,718)	(1,654,248)	(1,896,718)
Income tax expense	6	-	-	-	-
<b>(Loss)/profit for the period</b>		(1,068,211)	(1,896,718)	(1,654,248)	(1,896,718)
Other comprehensive income for the period		-	-	-	-
<b>Total comprehensive income for the period</b>		(1,068,211)	(1,896,718)	(1,654,248)	(1,896,718)
<b>Attributable to:</b>					
Equity holders of the parent		(1,654,248)	(1,896,718)	(1,654,248)	(1,896,718)
Non-controlling interest	3a(iv)	586,037	-	-	-
<b>(Loss)/profit for the period attributable to the equity holders of stapled securities</b>		(1,068,211)	(1,896,718)	(1,654,248)	(1,896,718)

## Statement of changes in equity

For the year ended 31 December 2010

Consolidated	Attributable to equity holders of the parent			Non-controlling interest	Total equity
	Share capital	Retained losses	Total		
Balance at 1 January 2010	8,241,895	(1,896,718)	6,345,177	-	6,345,177
Total comprehensive income for the year	-	(1,654,248)	(1,654,248)	586,037	(1,068,211)
Issue of share capital	8,250,000	-	8,250,000	-	8,250,000
Balance at 31 December 2010	16,491,895	(3,550,966)	12,940,929	586,037	13,526,966
Balance at 4 November 2008	-	-	-	-	-
Total comprehensive income for the period	-	(1,896,718)	(1,896,718)	-	(1,896,718)
Issue of share capital	8,241,895	-	8,241,895	-	8,241,895
Balance at 31 December 2009	8,241,895	(1,896,718)	6,345,177	-	6,345,177
<b>Parent</b>	<b>Share capital</b>	<b>Retained losses</b>	<b>Total equity</b>		
Balance at 1 January 2010	8,241,895	(1,896,718)	6,345,177		
Total comprehensive income for the year	-	(1,654,248)	(1,654,248)		
Issue of share capital	8,250,000	-	8,250,000		
Balance at 31 December 2010	16,491,895	(3,550,966)	12,940,929		
Balance at 4 November 2008	-	-	-		
Total comprehensive income for the period	-	(1,896,718)	(1,896,718)		
Issue of share capital	8,241,895	-	8,241,895		
Balance at 31 December 2009	8,241,895	(1,896,718)	6,345,177		

## Statement of financial position

For the year ended 31 December 2010

	Note	Consolidated		Parent	
		2010	2009	2010	2009
<b>Assets</b>					
Loans to investment companies		-	-	12,611,539	-
Investments – equity securities	7	13,533,423	-	-	-
Total non-current assets		13,533,423	-	12,611,539	-
Receivables and prepayments	8	424,506	236,042	760,353	236,042
Cash and cash equivalents	11	125,293	6,136,931	125,293	6,136,931
Total current assets		549,799	6,372,973	885,646	6,372,973
Total assets		14,083,222	6,372,973	13,497,185	6,372,973
<b>Equity</b>					
Issued capital	12	16,491,895	8,241,895	16,491,895	8,241,895
Retained losses		(3,550,966)	(1,896,718)	(3,550,966)	(1,896,718)
Total equity attributable to equity holders of the parent		12,940,929	6,345,177	12,940,929	6,345,177
Non-controlling interest	3a(iv)	586,037	-	-	-
Total equity attributable to equity holders of stapled securities	12	13,526,966	6,345,177	12,940,929	6,345,177
<b>Liabilities</b>					
Trade and other payables	13	22,584	27,796	22,584	27,796
Trade payable to Manager	9	533,672	-	533,672	-
Total current liabilities		556,256	27,796	556,256	27,796
Total liabilities		556,256	27,796	556,256	27,796
Total equity and liabilities		14,083,222	6,372,973	13,497,185	6,372,973

For and on behalf of the Board



Director

4 April 2011

Date



Director

4 April 2011

Date

## Statement of cash flows

For the year ended 31 December 2010

	Note	Consolidated		Parent	
		2010	2009	2010	2009
<b>Cash flows from operating activities</b>					
Cash receipts from fees		60,333	-	60,333	-
Interest received		68,407	209,236	68,407	209,236
Income taxes paid		-	(8,841)	-	(8,841)
Interest paid		(75,847)	-	(75,847)	-
Cash paid to suppliers		(2,236,664)	(2,305,359)	(2,236,664)	(2,305,359)
<b>Net cash from operating activities</b>	14	<b>(2,183,771)</b>	<b>(2,104,964)</b>	<b>(2,183,771)</b>	<b>(2,104,964)</b>
<b>Cash flows from investing activities</b>					
Acquisition of investments		(12,611,539)	-	-	-
Loans to investment companies		-	-	(12,611,539)	-
<b>Net cash from investing activities</b>		<b>(12,611,539)</b>	<b>-</b>	<b>(12,611,539)</b>	<b>-</b>
<b>Cash flows from financing activities</b>					
Proceeds from share calls		8,250,000	8,250,000	8,250,000	8,250,000
Transaction costs		-	(8,105)	-	(8,105)
Loans advanced by related parties		533,672	-	533,672	-
Loans advanced by external parties		5,100,000	-	5,100,000	-
Loans repaid to external parties		(5,100,000)	-	(5,100,000)	-
<b>Net cash from financing activities</b>		<b>8,783,672</b>	<b>8,241,895</b>	<b>8,783,672</b>	<b>8,241,895</b>
Net movement in cash and cash equivalents		(6,011,638)	6,136,931	(6,011,638)	6,136,931
Cash and cash equivalents at 1 January (2009: 4 November 2008)		6,136,931	-	6,136,931	-
<b>Cash and cash equivalents at 31 December</b>	7	<b>125,293</b>	<b>6,136,931</b>	<b>125,293</b>	<b>6,136,931</b>

## Notes to the consolidated financial statements

### 1. Reporting entity

Pohutukawa Private Equity II Limited (the "Company") is a company incorporated and domiciled in New Zealand. Pohutukawa Private Equity II and the 25 Investment Companies are registered under the Companies Act 1993 and are issuers and reporting entities for the purposes of the Financial Reporting Act 1993. The consolidated financial statements of the Company for the year ended 31 December 2010 comprise the Company and 25 Investment Companies (together referred to as the "Group").

Pohutukawa Private Equity II Limited is primarily involved in private equity investment made through the Investment Companies.

The financial statements were approved by the Directors on 4 April 2011.

### 2. Basis of preparation

#### (a) Statement of compliance

These financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice ("NZ GAAP"). They comply with New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS"), and other applicable Financial Reporting Standards, as appropriate for profit-oriented entities. Compliance with NZ IFRS ensures that the financial statements also comply with International Financial Reporting Standards ("IFRS").

#### (b) Basis of measurement

The financial statements are prepared on the historical cost basis except that certain financial instruments are stated at their fair value.

These financial statements are for the year ended 31 December 2010. The comparative figures are for the period from incorporation on 4 November 2008 until the Company's balance date, being 31 December 2009 (14 month period).

#### (c) Functional and presentation currency

The financial statements are presented in New Zealand dollars, which is the Company's functional currency and rounded to the nearest dollar.

#### d) Use of estimates and judgements

The preparation of financial statements in conformity with NZ IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:

- Note 7 – Investments – equity securities
- Note 8 – GST receivable
- Note 15 – Financial risk management

### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements. The accounting policies have been applied consistently by Group entities.

#### (a) Basis of consolidation

##### (i) Stapled securities

For every ordinary share held in Pohutukawa Private Equity II Limited, investors also hold 100 preference shares in Pohutukawa Private Equity II Limited as well as one preference share in each of the 25 (2009: 25) Investment Companies. All of these shares are stapled securities. This stapling arrangement creates a business combination by contract alone without any individual entity obtaining an ownership interest. The Group has designated Pohutukawa

## Notes to the consolidated financial statements

### 3. Significant accounting policies (continued)

Private Equity II Limited as the acquirer and the parent entity for the purpose of preparing consolidated financial statements. The 25 (2009: 25) companies combining under the stapling arrangement are designated as the Investment Companies who invest in Portfolio Companies.

#### (ii) Associates

Investments in equity securities, which would normally be classified as investments in associates, are carried at fair value in both the parent and consolidated financial statements and are not equity accounted (see accounting policy 3 b). This is due to the fact that the parent and group are private equity investors.

#### (iii) Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions are eliminated in preparing the consolidated financial statements.

#### (iv) Non-controlling interest

Non-controlling interest refers to the equity of the Investment Companies, as this is owned directly by shareholders of the parent and the Manager, and not by the parent company itself. These non-controlling interests are attributable to the parent company shareholders as a result of their direct investment in the preference shares of the Investment Companies and to the Manager as a result of its ownership of the ordinary shares in the Investment Companies.

#### (b) Investments in equity securities

The Group's investments in unlisted equity securities are classified as fair value through profit or loss financial assets, as they are managed by the Group on a fair value basis. They are presented as non-current assets in the statement of financial position and are stated at fair value, with any resultant change in fair value recognised in the statement of comprehensive income.

Regular purchases and sales of investments are recognised on a trade-date basis. That is the date on which the Group commits to purchase or sell the asset.

Investments in unlisted equity securities, which would normally be classified as investments in associates, are carried at fair value and are not equity accounted. This is due to the fact that the Investment Companies are private equity investors.

#### (c) Trade and other receivables

Trade and other receivables are initially recognised at fair value and subsequently measured at amortised cost less impairment losses (see accounting policy g).  
Notes to the consolidated financial statements

#### (d) Loans receivable

Loans receivable are recognised initially at fair value plus any directly attributable transaction costs (if any). Subsequent to initial recognition they are stated at their cost less impairment losses (see accounting policy g).

#### (e) Finance expense - interest

Finance expense comprises interest expense on borrowings. All borrowing costs are recognised in the statement of comprehensive income using the effective interest method.

#### (f) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits, and are recognised and measured at cost. Cash excludes short-term deposits that are not used as part of the Group's day-to-day cash management.

#### (g) Impairment

The carrying amounts of the Group's assets, other than investments in unlisted equity securities (see accounting policy b), and deferred tax assets (see accounting policy l), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated based on the present value of estimated future cash flows, discounted at the original effective interest rate.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the statement of comprehensive income.

Impairment losses are recognised in the statement of comprehensive income. An impairment loss is reversed in

## Notes to the consolidated financial statements

### 3. Significant accounting policies (continued)

the statement of comprehensive income if there has been a change in the estimates used to determine the recoverable amount.

#### (h) Share capital

##### (i) Share capital

Share capital is recognised as paid in capital when a call has been made to shareholders. Calls are made in tranches and will be for a minimum of \$0.10 per share.

##### (ii) Preference share capital

Preference share capital is classified as equity if it is non-redeemable and any dividends are discretionary, or is redeemable but only at the Company's option. Dividends on preference share capital classified as equity are recognised as distributions within equity.

##### (iii) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity.

##### (iv) Dividends

All dividends are recognised as a liability in the period in which they are declared. Notes to the consolidated financial statements

#### (i) Loans and borrowings

Loans and borrowings are recognised initially at fair value net of attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the statement of comprehensive income over the period of the borrowings on an effective interest rate basis.

#### (j) Trade and other payables

Trade and other payables are stated at cost.

#### (k) Revenue

##### (i) Services rendered

Revenue from services rendered (e.g. transaction fees and management fees) is recognised in the statement of

comprehensive income as earned and is recorded as other operating income.

##### (ii) Equity investments

Movements in the fair value of the Group's investments in equity instruments are recognised in the statement of comprehensive income. Dividend income is recognised in the statement of comprehensive income on the date the entity's right to receive payments is established.

##### (iii) Interest income

Interest income is recognised in the statement of comprehensive income as it accrues, using the effective interest rate method.

#### (l) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Notes to the consolidated financial statements



## Notes to the consolidated financial statements

### 3. Significant accounting policies (continued)

#### (m) New standards and pronouncements relevant to the Group

##### New standards adopted

There have been no new standards and amendments to standards adopted by the Company in the current period.

##### New standards not yet adopted

A number of new standards are not yet effective for the year ended 31 December 2010 and have not been applied in preparing these financial statements. The standards that will be of relevance to the Company are:

NZ IFRS 7 - Financial Instruments: Disclosures – effective for periods beginning on or after 1 January 2011. The amendments add an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments.

NZ IAS 1 – Presentation of Financial Statements - effective for periods beginning on or after 1 January 2011. The amendments clarify that disaggregation of changes in each component of equity arising from transactions recognised in other comprehensive income also is required to be presented, but may be presented either in the statement of changes in equity or in the notes.

NZ IAS 24 - Related Party Disclosures (revised 2009) - effective for periods beginning on or after 1 January 2011. The revised NZ IAS 24 amends the definition of a related party.

NZ IFRS 9 - Financial Instruments (2010) - effective for periods beginning on or after 1 January 2013. NZ IFRS 9 is the standard issued as part of a wider project to replace NZ IAS 39. NZ IFRS 9 (2009) retained but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortised cost and fair value. NZ IFRS 9 (2010) retained the requirements with respect to the classification and measurement of financial liabilities with the exception of fair value option and certain derivatives linked to unquoted equity instruments. Additionally, NZ IFRS 9 (2010) also retained the recognition requirements of NZ IAS 39. Application

of transitional provisions depends on an entity's adoption date of NZ IFRS 9 (2009) and NZ IFRS 9 (2010).

The Group has not yet determined the potential effect of the standards.

#### (n) Goods and services tax (GST)

All amounts are shown exclusive of GST, except for receivables and payables that are stated inclusive of GST.

### 4. Determination of fair values

Investments in unlisted equity securities are valued at Directors' valuation in the year of acquisition and subsequently by annual valuations carried out in accordance with the valuation principles set out by The Australian Private Equity and Venture Capital Association Limited (AVCAL). Valuations are performed by Direct Capital Management Limited (see Note 17).

## Notes to the consolidated financial statements

### 5. Administrative expenses

	Consolidated		Parent	
	2010	2009	2010	2009
Management fees	1,856,250	1,949,063	1,856,250	1,949,063
Advisory fees	37,613	31,644	37,613	31,644
Directors' fees	26,719	96,348	26,719	96,348
Other administrative expenses	101,378	43,304	101,378	43,304
	<u>2,021,960</u>	<u>2,120,359</u>	<u>2,021,960</u>	<u>2,120,359</u>

The following items of expenditure are included in administrative expenses:

Auditor's remuneration to KPMG comprises:

Audit of financial statements	17,916	6,822	17,916	6,822
Other audit-related services	6,600	-	6,600	-

Other audit related services include review of interim financial statements.

### 6. Income tax expense

	Note	Consolidated		Parent	
		2010	2009	2010	2009
Income tax expense in statement of comprehensive income		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Reconciliation of effective tax rate</b>					
(Loss)/Profit before tax		<u>(1,068,211)</u>	<u>(1,896,718)</u>	<u>(1,654,248)</u>	<u>(1,896,718)</u>
Income tax expense at 30% tax rate		(320,463)	(569,015)	(496,274)	(569,015)
Non-deductible expenses		-	6,530	-	6,530
Tax exempt income		(276,565)	-	-	-
Tax losses not recognised in the statement of comprehensive income	10	597,028	562,485	496,274	562,485
Total income tax expense in statement of comprehensive income		<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

## Notes to the consolidated financial statements

### 6. Income tax expense (continued)

#### Imputation credits

	Consolidated		Parent	
	2010	2009	2010	2009
Balance at beginning of period	8,841	-	8,841	-
Income tax paid	-	8,841	-	8,841
Balance at end of period	<u>8,841</u>	<u>8,841</u>	<u>8,841</u>	<u>8,841</u>
Imputation credits available to shareholders of the parent company:				
Through the parent company	8,841	8,841	8,841	8,841
Through investment companies	-	-	-	-
	<u>8,841</u>	<u>8,841</u>	<u>8,841</u>	<u>8,841</u>

### 7. Investments – equity securities

#### Non-current investments

The Group has a number of investments in unlisted equity securities. Group policy is to carry these investments at fair value with subsequent movements in fair value recognised in the statement of comprehensive income. As there is no quoted market price for these securities, valuation techniques must be utilised to determine fair value. The valuations are carried out by Direct Capital IV Management Limited (see Note 17) using AVCAL guidelines.

The valuation techniques utilised include the use of market based earnings multiples and an adjustment factor of up to 20% for privately owned investments.

#### Sensitivity Analysis

A movement of 0.2 in the earnings multiples applied to the investments carried at fair value changes the value of the investments by \$305,049 (2009: \$nil).

A movement in the adjustment factor of 5% changes the value of the investments by \$818,581 (2009: \$nil).

The following table lists the investments held at the end of the reporting period and the underlying cost of the initial acquisition.

The difference between the cost and the carrying value in the statement of financial position is shown as a fair value movement through the statement of comprehensive income. The cost of each acquisition is shown in the tables below and the total agrees to the amount showing as loans and receivables in the Parent Company's statement of financial position:

2010					
Entity name	Activities	Acquisition date	Voting interest	Cost of acquisition	
Transaction Services Limited	3rd Party Payment Processing	Jan 2010	11.8%	5,700,507	
Bayley Corporation Limited	Real Estate	Jun 2010	7.5%	3,574,666	
Cavalier Wool Holdings Limited	Wool Scourer	Dec 2010	6.0%	3,336,366	
					<u>12,611,539</u>

## Notes to the consolidated financial statements

### 7. Investments – equity securities (continued)

#### Non-current investments (continued)

As investments in equity securities are carried at fair value in the Group, the results and net assets of the Portfolio Companies are not recognised in these financial statements. The fair value of the total investment portfolio as at 31 December 2010 was \$13,533,423 (2009: \$nil).

### 8. Receivables and prepayments

	Consolidated		Parent	
	2010	2009	2010	2009
GST receivable	404,039	203,852	358,774	203,852
Taxation receivable	8,841	8,841	8,841	8,841
Other receivables due from related parties	4,660	19,065	385,772	19,065
Prepayments	6,966	4,284	6,966	4,284
	<u>424,506</u>	<u>236,042</u>	<u>760,353</u>	<u>236,042</u>

As a result of an Inland Revenue Department (IRD) review into the background structure of Pohutukawa Private Equity II Limited, GST refunds owing to the Company are currently in dispute. The Company believes it is correct in its treatment of GST. The matter is being pursued.

As at 31 December 2010, no trade and other receivables are considered past due (2009: \$nil).

### 9. Trade payable to manager

As at 31 December 2010 the Company owes \$533,672 to Pohutukawa II Management Limited (refer Note 17). The trade payable is subject to interest at variable bank rates and is expected to be repaid at the time of the next capital call.

## Notes to the consolidated financial statements

### 10. Deferred tax assets and liabilities

#### Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	Note	Consolidated		Parent	
		2010	2009	2010	2009
Opening balance 1 January 2010		562,485	-	562,485	-
Tax losses not recognised in the statement of comprehensive income					
	6	597,028	562,485	496,274	562,485
Closing balance 31 December 2010		<u>1,159,513</u>	<u>562,485</u>	<u>1,058,759</u>	<u>562,485</u>

Due to the nature of the stapled securities, and the fact that ordinary shares in the Investment Companies are owned by Pohutukawa II Investments Limited, there is no ability to offset losses between the Parent (Pohutukawa Private Equity II Limited) and the Investment Companies.

Tax losses do not expire, subject to shareholder continuity rules being met. Deferred tax assets have not been recognised in respect of these items because it is not certain that future taxable profit will be available against which the Group can utilise the benefit.

### 11. Cash and cash equivalents

	Consolidated		Parent	
	2010	2009	2010	2009
Call deposits	125,293	51,994	125,293	51,994
Short-term deposits	-	6,084,937	-	6,084,937
Cash and cash equivalents in the statement of cash flows	<u>125,293</u>	<u>6,136,931</u>	<u>125,293</u>	<u>6,136,931</u>

Call deposits are held with the National Bank of New Zealand via CIP Cash Management Nominees Limited. The weighted average interest rate for 2010 on call deposits was 2.89% (2009: 3.22% CIP Cash Management Trust Limited).

Short-term deposits are held with the National Bank of New Zealand via CIP Cash Management Nominees Limited (2009: CIP Cash Management Trust Limited). The weighted average interest rate on short-term deposits was 3.65% (2009: 4.02%).

## Notes to the consolidated financial statements

### 12. Share capital

Consolidated <i>In millions of shares</i>	Investment Co's Preference shares		PPE II Ordinary shares		PPE II Preference shares	
	2010	2009	2010	2009	2010	2009
On issue at 1 January	2,062.5	-	82.5	-	8,250	-
Issue of shares	-	2,062.5	-	82.5	-	8,250
On issue at 31 December	2,062.5	2,062.5	82.5	82.5	8,250	8,250

### Parent

<i>In millions of shares</i>	Ordinary shares		Preference shares	
	2010	2009	2010	2009
On issue at 1 January	82.5	-	8,250	-
Issue of shares	-	82.5	-	8,250
On issue at 31 December	82.5	82.5	8,250	8,250

Preference shares are only redeemable at the option of the issuer.

At 31 December 2010, the share capital of the Company comprised 82,500,000 ordinary shares (2009: 82,500,000), and 8,250,000,000 preference shares (2009: 8,250,000,000). In addition, there are 2,062,500,000 (2009: 2,062,500,000) preference shares in the 25 (2009: 25) Investment Companies (82,500,000 in each).

No class of share has a par value. Ordinary shares and Investment Company preference shares have been allotted at nil value. The Pohutukawa Private Equity II shares have been issued at \$1.00 per share, paid to \$0.20, of which \$0.10 was paid on allotment, and a further \$0.10 paid on a call dated 9 August 2010. Subsequent calls will be in tranches, for a minimum of \$0.10 per share and subject to 30 days advance notice. Subject to the Boards discretion, any residual balance will be payable in full on the fifth anniversary of allotment. Issue costs of \$8,105 were offset against the share capital received in 2009.

As at 31 December 2010, shareholders have a commitment to fund a further \$0.80 per share totalling \$66 million (2009: \$0.90 per share totalling \$74.25 million) in subsequent calls, subject to Board approval. Calls will not be made unless the proceeds of all previous calls have been invested or committed in full.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets. Holders of the Company preference shares do not have an entitlement to vote, and are not entitled to participate in distribution of income, but are entitled to \$0.01 per preference share upon redemption by the Company at the Company's option. Preference shareholders in the Investment Companies do not have an entitlement to vote, but are entitled to receive distributions of capital and/or income as prescribed in the Investment Companies' constitutions.

## Notes to the consolidated financial statements

### 13. Trade and other payables

	Consolidated		Parent	
	2010	2009	2010	2009
Trade payables and accrued expenses	22,584	27,796	22,584	27,796
	<u>22,584</u>	<u>27,796</u>	<u>22,584</u>	<u>27,796</u>

### 14. Reconciliation of (loss)/profit after taxation to the net cash flow from operating activities

	Note	Consolidated		Parent	
		2010	2009	2010	2009
Profit / (loss) for the year		(1,068,211)	(1,896,718)	(1,654,248)	(1,896,718)
Adjustments for:					
Change in fair value of investments		(921,884)	-	-	-
Change in trade and other receivables		(188,464)	(227,201)	(524,311)	(227,201)
Change in income tax receivable		-	(8,841)	-	(8,841)
Change in trade payables and accruals		(5,212)	27,796	(5,212)	27,796
Net cash flow to/(from) operating activities		<u>(2,183,771)</u>	<u>(2,104,964)</u>	<u>(2,183,771)</u>	<u>(2,104,964)</u>

### 15. Financial risk management

#### Introduction and overview

The Group has exposure to the following risks from its use of financial instruments:

- equity price risk
- credit risk
- interest rate risk
- liquidity risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

#### Equity price risk

The Group has policies in place to mitigate equity price risk, particularly in its investments. This includes detailed analysis of prospective equity investments. Investments in unlisted equity securities are, by their nature, less liquid and subject to greater equity price risk than listed securities.

## Notes to the consolidated financial statements

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### 15. *Financial risk management (continued)*

#### **Credit risk**

Exposure to credit risk arises in the normal course of the Group's business from its loans and receivables and bank balances. The Group does not require collateral in respect of financial assets. At the end of the reporting period there were no significant concentrations of credit risk.

The Group invests its surplus funds in short-term deposits with the National Bank of New Zealand via CIP Cash Management Nominees Limited (refer Note 17). The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the statement of financial position.

#### **Interest rate risk**

Exposure to interest rate risk arises in the normal course of the Group's business from bank accounts, short-term deposits and loans and borrowings. The Group earns interest on bank accounts and short-term deposits. Management invest excess funds in short-term deposits to maximise interest revenue whilst ensuring funds are available if required. The Group may also borrow short-term funds at floating rates due to the short-term nature of these borrowings.

Loans between the parent and investment companies are interest free and due on demand.

#### **Effective interest rates and repricing**

The only interest bearing financial assets in the Group are bank balances, short-term deposits and loans and borrowings. At the end of the reporting period the effective interest rates for bank balances for 2010 is 3.00% (2009: 2.50%), short-term deposits for 2010 is 3.50% (2009: 3.38%) and loans and borrowings for 2010 is 5.14% (2009: nil).

Bank balances reprice daily and short-term deposits reprice within 6 months.

#### **Liquidity risk**

Liquidity risk represents the Group's ability to meet its contractual obligations. The Group evaluates its liquidity requirements on an ongoing basis, and maintains sufficient cash to meet all obligations. Investments in unlisted equity securities are, by their nature, less liquid.



## Notes to the consolidated financial statements

### 15. Financial risk management (continued)

#### Interest rate risk – repricing analysis

	<i>Note</i>	Total	Non interest bearing	6 months or less
<b>Consolidated 2010</b>				
Cash and cash equivalents	11	125,293	-	125,293
<b>Total</b>		<b>125,293</b>	<b>-</b>	<b>125,293</b>
<b>Consolidated 2009</b>				
Cash and cash equivalents	11	6,136,931	-	6,136,931
<b>Total</b>		<b>6,136,931</b>	<b>-</b>	<b>6,136,931</b>
<b>Parent 2010</b>				
Cash and cash equivalents	11	125,293	-	125,293
<b>Total</b>		<b>125,293</b>	<b>-</b>	<b>125,293</b>
<b>Parent 2009</b>				
Cash and cash equivalents	11	6,136,931	-	6,136,931
<b>Total</b>		<b>6,136,931</b>	<b>-</b>	<b>6,136,931</b>

Loans to investment companies as disclosed in the Statement of Financial Position are non interest bearing and therefore have not been included in the above table.

The trade payable from the manager is expected to be repaid when the next capital call is made, and therefore will not reprice.

#### Sensitivity analysis

In managing interest rate risk the Group aims to reduce the impact of short-term fluctuations on the Group's earnings. Over the longer-term, however, changes in interest rates will have an impact on profit.

At 31 December 2010 it is estimated that a general increase of 1.0% in interest rates on its cash and cash equivalents would increase the Group's profit before income tax by approximately \$14,096 (2009: \$59,638) over a one-year period.

#### Capital management

The Group's capital includes share capital and retained earnings.

The Group's policy is to maintain its capital structure in terms of the prospectus and repay capital as investments are realised. As disclosed in note 12, \$0.20 per share has been paid on the \$1.00 share capital (2009: \$0.10 per share). The remaining \$0.80 (2009: \$0.90) will be called as required in accordance with the terms of the original prospectus.

The Group has the power to borrow only with the prior written approval of the Board, other than in respect of borrowings with a maturity date not in excess of ninety days (provided that in no case shall such borrowings exceed called but unpaid capital commitments).

The Group is not subject to any externally imposed capital requirements.

The Group's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

There have been no material changes in the Group's management of capital during the period.

## Notes to the consolidated financial statements

### 15. Financial risk management (continued)

#### Classification and fair values

	<i>Note</i>	Designated at fair value	Loans and receivables	Other amortised cost	Total carrying amount	Fair value
<b>Consolidated 2010</b>						
<b>Assets</b>						
Cash and cash equivalents	11	-	125,293	-	125,293	125,293
Receivables	8	-	424,506	-	424,506	424,506
Investments – unlisted equity securities	7	13,533,423	-	-	13,533,423	13,533,423
<b>Total assets</b>		<b>13,533,423</b>	<b>549,799</b>	<b>-</b>	<b>14,083,222</b>	<b>14,083,222</b>

#### Liabilities

Trade and other payables	13	-	-	22,584	22,584	22,584
Loans payable to manager	9	-	-	533,672	533,672	533,672
<b>Total liabilities</b>		<b>-</b>	<b>-</b>	<b>556,256</b>	<b>556,256</b>	<b>556,256</b>

	<i>Note</i>	Designated at fair value	Loans and receivables	Other amortised cost	Total carrying amount	Fair value
<b>Consolidated 2009</b>						
<b>Assets</b>						
Cash and cash equivalents	11	-	6,136,931	-	6,136,931	6,136,931
Receivables	8	-	236,042	-	236,042	236,042
<b>Total assets</b>		<b>-</b>	<b>6,372,973</b>	<b>-</b>	<b>6,372,973</b>	<b>6,372,973</b>

#### Liabilities

Trade and other payables	13	-	-	27,796	27,796	27,796
<b>Total liabilities</b>		<b>-</b>	<b>-</b>	<b>27,796</b>	<b>27,796</b>	<b>27,796</b>

## Notes to the consolidated financial statements

### 15. Financial risk management (continued)

#### Classification and fair values

	<i>Note</i>	Designated at fair value	Loans and receivables	Other amortised cost	Total carrying amount	Fair value
<b>Parent 2010</b>						
<b>Assets</b>						
Cash and cash equivalents	11	-	125,293	-	125,293	125,293
Loans to investment companies	17	-	12,611,539	-	12,611,539	12,611,539
Receivables	8	-	760,353	-	760,353	760,353
<b>Total assets</b>		-	<b>13,497,185</b>	-	<b>13,497,185</b>	<b>13,497,185</b>

#### Liabilities

Trade and other payables	13	-	-	22,584	22,584	22,584
Loan payable to manager	9	-	-	533,672	533,672	533,672
<b>Total liabilities</b>		-	-	<b>556,256</b>	<b>556,256</b>	<b>556,256</b>

	<i>Note</i>	Designated at fair value	Loans and receivables	Other amortised cost	Total carrying amount	Fair value
<b>Parent 2009</b>						
<b>Assets</b>						
Cash and cash equivalents	11	-	6,136,931	-	6,136,931	6,136,931
Receivables	8	-	236,042	-	236,042	236,042
<b>Total assets</b>		-	<b>6,372,973</b>	-	<b>6,372,973</b>	<b>6,372,973</b>

#### Liabilities

Trade and other payables	13	-	-	27,796	27,796	117,324
<b>Total liabilities</b>		-	-	<b>27,796</b>	<b>27,796</b>	<b>117,324</b>

## Notes to the consolidated financial statements

### 15. Financial risk management (continued)

#### Fair value hierarchy

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31 December 2010	Level 1	Level 2	Level 3	Total
Investments in unlisted equity securities	-	-	13,533,423	13,533,423

31 December 2009	Level 1	Level 2	Level 3	Total
Investments in unlisted equity securities	-	-	-	-

There have been no transfers between levels in either direction during the year.

The following table shows reconciliation from the beginning balance to the ending balance for fair value measurements in Level 3 of the fair value hierarchy:

Investments	2010	2009
Opening balance	-	-
Total gains or losses:		
In profit or loss	921,884	-
In other comprehensive income	-	-
Investments at cost	12,611,539	-
Closing balance	13,533,423	-

Total gains or losses included in profit or loss for the year in the above table are presented in the statement of comprehensive income as follows:

Investments	2010	2009
Total gains or losses included in profit or loss for the year	921,884	-
Total gains or losses for the year included in profit or loss for assets held at the end of the reporting period	921,884	-

Although the Group believes that its estimates of fair value are appropriate, the use of different methodologies or assumptions could lead to different measurements of fair value. Refer Note 7 for sensitivity analysis with regards to the earnings multiple or adjustment factor.

### 16. Capital commitments and contingencies

An earnout payment, based on performance, may be due and payable to the Manager at a future date.

## Notes to the consolidated financial statements

### 17. Related parties

#### a) Identity of related parties

The Company has a related party relationship with its Investment Companies (see note 19).

Craigs Investment Partners Limited and Direct Capital IV Management Limited own 50% each of Pohutukawa II Management Limited, the Manager of Pohutukawa Private Equity II Limited and 50% each of Pohutukawa II Investments Limited, the holder of the ordinary shares in the Investment Companies. Certain directors of the Company are also directors of Craigs Investment Partners Limited. Certain directors of the Investment Companies are also directors of Direct Capital IV Management Limited.

Direct Capital IV Management Limited employees are responsible for preparing valuations of investments.

#### b) Transactions with related parties

During the period, Pohutukawa Private Equity II Limited entered into the following transactions with related parties:

Management fees paid to Pohutukawa II Management Limited totalled \$1,856,250 (2009: \$1,536,563).

Legal and accounting expenses incurred in relation to investment activity by Direct Capital IV Management Limited of \$18,837 (2009: \$nil) were reimbursed by Pohutukawa Private Equity II Limited.

Surplus cash of \$nil (2009: \$4,551,984) has been invested with the National Bank of New Zealand via CIP Cash Management Nominees Limited, a subsidiary of Craigs Investment Partners Limited (2009: CIP Cash Management Trust Limited).

Loans advanced to Investment Companies (see below).

Trade payable to Pohutukawa II Management Limited (see below).

The terms and conditions of the transactions with key management personnel and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-key management personnel related entities on an arm's length basis.

Loans were advanced to Investment Companies totalling \$12,611,539 (2009: \$nil) during the year. Total loans outstanding as at 31 December 2010 were \$12,611,539 (2009: \$nil). Loans to Investment Companies are non-interest bearing, and are used to acquire long-term equity investments. Loans are repayable on demand.

Additionally, in December 2010 a trade payable of \$533,672 was due to Pohutukawa II Management Limited. The trade payable is subject to variable bank interest rates and is expected to be repaid at the time of the next capital call.

#### c) Transactions with key management personnel

	Consolidated		Parent	
	2010	2009	2010	2009
Directors fees (total remuneration)	26,719	96,348	26,719	96,348

The balance owing to key management personnel at 31 December 2010 is \$nil (2009: \$22,031).

### 18. Subsequent events

The February 22, 2011 earthquake in Christchurch, has materially affected the local economy. Any portfolio companies with business activity in Christchurch are affected by this event. The Manager has not received any information to indicate that the carrying value of any of the investments has been impaired as a result. None of the businesses have incurred significant loss of earnings.

## Notes to the consolidated financial statements

### 19. Group entities

Investment Companies	Country of incorporation	Ownership interest*	
		2010	2009
Pohutukawa Alpha Limited ("Alpha")	New Zealand	0%	0%
Pohutukawa Beta Limited ("Beta")	New Zealand	0%	0%
Pohutukawa Gamma Limited ("Gamma")	New Zealand	0%	0%
Pohutukawa Delta Limited ("Delta")	New Zealand	0%	0%
Pohutukawa Epsilon Limited ("Epsilon")	New Zealand	0%	0%
Pohutukawa Zeta Limited ("Zeta")	New Zealand	0%	0%
Pohutukawa Eta Limited ("Eta")	New Zealand	0%	0%
Pohutukawa Theta Limited ("Theta")	New Zealand	0%	0%
Pohutukawa Iota Limited ("Iota")	New Zealand	0%	0%
Pohutukawa Kappa Limited ("Kappa")	New Zealand	0%	0%
Pohutukawa Lambda Limited ("Lambda")	New Zealand	0%	0%
Pohutukawa Mu Limited ("Mu")	New Zealand	0%	0%
Pohutukawa Nu Limited ("Nu")	New Zealand	0%	0%
Pohutukawa Xi Limited ("Xi")	New Zealand	0%	0%
Pohutukawa Omicron Limited ("Omicron")	New Zealand	0%	0%
Pohutukawa Pi Limited ("Pi")	New Zealand	0%	0%
Pohutukawa Rho Limited ("Rho")	New Zealand	0%	0%
Pohutukawa Sigma Limited ("Sigma")	New Zealand	0%	0%
Pohutukawa Tau Limited ("Tau")	New Zealand	0%	0%
Pohutukawa Upsilon Limited ("Upsilon")	New Zealand	0%	0%
Pohutukawa Phi Limited ("Phi")	New Zealand	0%	0%
Pohutukawa Chi Limited ("Chi")	New Zealand	0%	0%
Pohutukawa Psi Limited ("Psi")	New Zealand	0%	0%
Pohutukawa Omega Limited ("Omega")	New Zealand	0%	0%
Pohutukawa Alpha-Pi Limited ("Alpha-Pi")	New Zealand	0%	0%

\*As stated in note 3(a)(i), the preference shares in the Investment Companies are owned by the individual shareholders of Pohutukawa Private Equity II Limited but are consolidated into the Group as they are stapled securities.

## Audit Report



### To the Shareholders of Pohutukawa Private Equity II Limited Report on the Company and Group Financial Statements

We have audited the accompanying financial statements of Pohutukawa Private Equity II Limited ("the company") and the group, comprising the company and its investment companies, on pages 10 to 29. The financial statements comprise the statement of financial position of the company and the consolidated statement of financial position of the group as at 31 December 2010, the statements of comprehensive income, changes in equity and cash flows of the company and the consolidated statements of comprehensive income, changes in equity and cash flows of the group for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### *Directors' Responsibility for the Company and Group Financial Statements*

The directors are responsible for the preparation of company and group financial statements in accordance with generally accepted accounting practice in New Zealand and International Financial Reporting Standards that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of company and group financial statements that are free from material misstatement whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these company and group financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the company and group financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the company and group financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company and group's preparation of the financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company and group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Our firm has also provided other services to the company and group in relation to other assurance services (review of interim financial statements). Partners and employees of our firm may also deal with the company and group on normal terms within the ordinary course of trading activities of the business of the company and group. There are however certain restrictions on dealings which partners and employees of our firm have with the company and group. These matters have not impaired our independence as auditors of the company and group. The firm has no other relationship with, or interest in, the company and group.

#### *Opinion*

In our opinion the financial statements of Pohutukawa Private Equity II Limited and its investment companies ("the company and group") on pages 10 to 29:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of the company and the consolidated financial position of the group as at 31 December 2010 and of the financial performance and cash flows of the company and the consolidated financial performance and consolidated cash flows of the group for the year ended on that date.

#### **Report on Other Legal and Regulatory Requirements**

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, we report that:

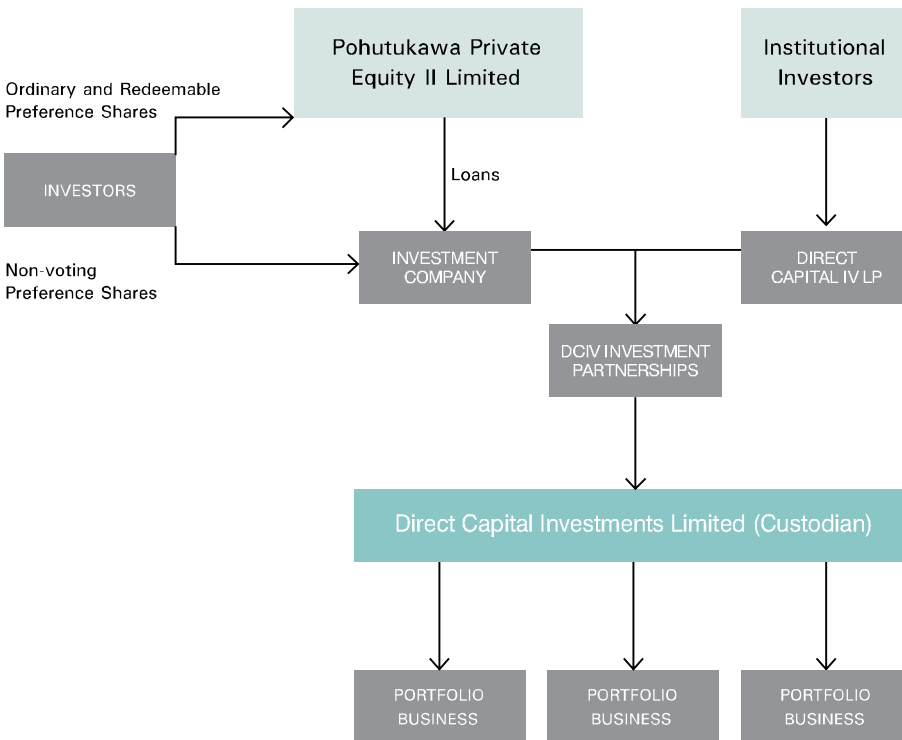
- we have obtained all the information and explanations that we have required; and
- in our opinion, proper accounting records have been kept by Pohutukawa Private Equity II Limited and its investment companies as far as appears from our examination of those records.

Tauranga  
4 April 2011

## Corporate Governance & Structure

Pohutukawa Private Equity II Limited (Pohutukawa II) is the Fund. Investors hold both ordinary and redeemable preference shares in Pohutukawa II. Investors also hold redeemable preference shares in each of the 25 special purpose vehicles (investment companies), which invest in the portfolio companies. These are called stapled securities. There are 82.5 million ordinary \$1 shares on issue. The number of ordinary shares on issue remains constant while the ratio of preference shares reduces as investments are realised and preference shares are redeemed.

Pohutukawa II intends to coinvest with Direct Capital IV in each investment in proportion to the level of Committed Capital of each of Pohutukawa II and Direct Capital IV. The structure is shown below:



Ordinary shares held by investors in Pohutukawa II confer normal voting rights on investors. The preference shares held by investors in both Pohutukawa II and the Investment Companies confer no voting rights. The Manager, through Pohutukawa II Investments Limited holds all the ordinary voting shares in each of the Investment Companies and exercises these rights in accordance with the Pohutukawa II investment policy and the investment criteria.

The Pohutukawa II Board is proposing a change to the structure to allow the owners of the Manager, Direct Capital and Craigs Investment Partners, to enter a limited partnership arrangement and it will be the limited partnership that holds the ordinary (voting) shares in the Investment Companies.

Pohutukawa II has a separate Board to ensure best-practice corporate governance and to ensure that the shareholders' interests are held paramount. The Board has two independent directors.

For so long as it holds at least 50% of the issued shares in the Manager, Craigs Investment Partners is entitled to appoint up to 50% of the directors of Pohutukawa II. All other directors of Pohutukawa II can be appointed by

directors or removed by ordinary resolution of the investors. The Board sets the investment policy and criteria, and reviews the performance of the Manager from time to time and reports to the shareholders on the content of this review. It reviews the capital adequacy of Pohutukawa II and is responsible for continuous disclosure and timely shareholder meetings of Pohutukawa II. The Directors of each Investment Company can be appointed or removed only by the Manager (being the holder of the ordinary shares in the Investment Company).

The Manager is a 50/50 joint venture between Direct Capital and Craigs Investment Partners, both of whom provide services to the Manager on a contract basis. Direct Capital provides investment management services. Craigs Investment Partners provides fundraising, cash management, administration, investor communication, and investment sourcing and divestment assistance. The Investment Committee of the Manager is responsible for all investment decisions, subject to compliance with the investment policy set by the Board.



## The Pohutukawa II Board

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The Board of Pohutukawa Private Equity II Limited (whose profiles follow) comprises four directors, two from Craigs Investment Partners and two independents, one of whom is Chairman. The Board is responsible for appointing, and then monitoring the performance of the Manager, reviewing Pohutukawa II's investment policy and criteria, and managing conflicts of interest between the Manager and Pohutukawa.



**JOHN MCDONALD**  
*(Chairman and Independent Director)*

John is a Company director and trustee who has more than 30 years experience in executive and management positions with the former Fletcher Challenge group of companies through to his retirement in 2001. He has considerable international experience in management, finance, corporate governance best practice and as a director and audit committee member of private and publicly listed companies. John is currently a director of Solid Energy New Zealand Limited and Horizon Energy Distribution Limited. John has recently retired after over 9 years as a director of Air New Zealand. He is also Chairman of Pohutukawa Private Equity Limited.



**MAURICE JOHN PRENDERGAST**  
*(Independent Director)*

Maurice is currently Chief Executive Officer for Pumpkin Patch Limited and has held this position since 1993. During this time, the Pumpkin Patch Group has grown extensively throughout the world under Maurice's leadership. Maurice brings international business experience with him along with a wealth of knowledge in logistics, technology, retail and global expansion. Maurice has held executive positions in accounting, distribution and property development in both New Zealand and Australia. He is also a director of Comvita Limited, Pohutukawa Private Equity Limited and a number of other private companies.

## The Pohutukawa II Board

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**NEIL JOHN CRAIG**  
*(Non-Executive Director)*

Neil is the founding principal and Executive Chairman of Craigs Investment Partners, a leading full service NZX Participant Firm. Craigs Investment Partners has approximately 310 staff with 17 branches throughout New Zealand. Neil has a broad experience in private equity transactions, stock exchange listings, capital raisings and corporate activity for a wide range of companies. In a personal capacity Neil has been an active private equity investor for many years.

Neil is also a director of Pohutukawa Private Equity Limited, the New Zealand Social Infrastructure Fund Limited, as well as being Chairman of NZX Listed Comvita Limited and a director of a number of privately held companies.



**FRANK MAURICE ALDRIDGE**  
*(Non Executive Director)*

Frank is Managing Director of Craigs Investment Partners, having been appointed in 2005, previously working for some eight years in various roles at Craigs Investment Partners. During this time, Frank has been involved in all facets of private wealth management as well as a number of NZX listings and capital raisings. Prior to joining Craigs Investment Partners, Frank worked at the New Zealand Stock Exchange.

Frank is a director of Pohutukawa Private Equity Limited and is on the board of a number of Craigs Investment Partners subsidiaries and is also Chairman of Priority One Limited, the Tauranga and Western Bay Economic Development Agency, Chairman of the Securities Industry Association, and a member of the Bay of Plenty Regional Governance Group.

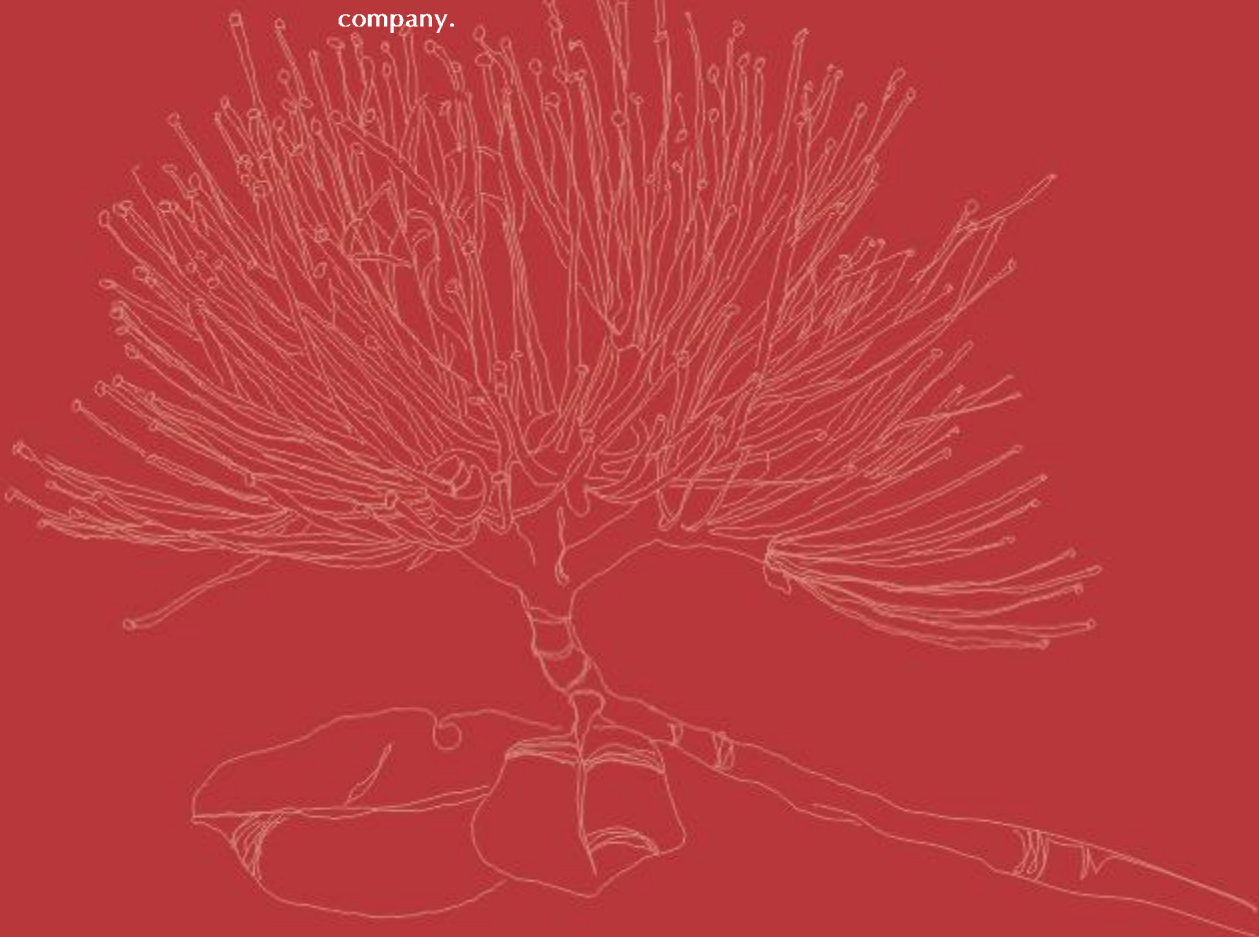
## Committees

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The Board has one committee, an Audit Committee, comprising all board members. The Audit Committee meets as required. The Audit Committee has full powers to require the Manager to provide any information or documents relating to the Fund, which it requires to enable it to meet the obligations of an Audit Committee; The Directors of Pohutukawa Private Equity II Limited and Pohutukawa II Management Limited must respond to any recommendations made to their Boards from the Audit Committee.

There is no remuneration committee because Pohutukawa II and the Manager have no employees. The Chairman and Directors of Pohutukawa II receive director's fees from Pohutukawa II. The Manager is entitled to remuneration in respect of management of the funds. Information about the remuneration received by the Manager for this reporting period can be found in the financial statements set out in this report. The Manager does not pay director's fees.

To the extent applicable and possible, the Board intends to adopt the governance structures and principles of a listed company.



## Directory

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### BOARD OF DIRECTORS OF POHUTUKAWA PRIVATE EQUITY II LIMITED

John McDonald  
Neil Craig  
Maurice Prendergast  
Frank Aldridge

The Directors can be contacted at Pohutukawa's registered office address set out below.

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#### OFFICES OF POHUTUKAWA

Pohutukawa Private Equity II Limited  
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PO Box 13155  
Tauranga 3141  
Phone: (07) 577 4727  
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#### AUDITORS

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35 Grey Street  
Tauranga 3141  
Phone: (07) 578 5179  
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#### MANAGER

Pohutukawa II Management Limited  
Craigs Investment Partners House  
158 Cameron Road  
PO Box 13155  
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#### INVESTMENT MANAGER

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#### SHARE REGISTRY

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