

Memorandum

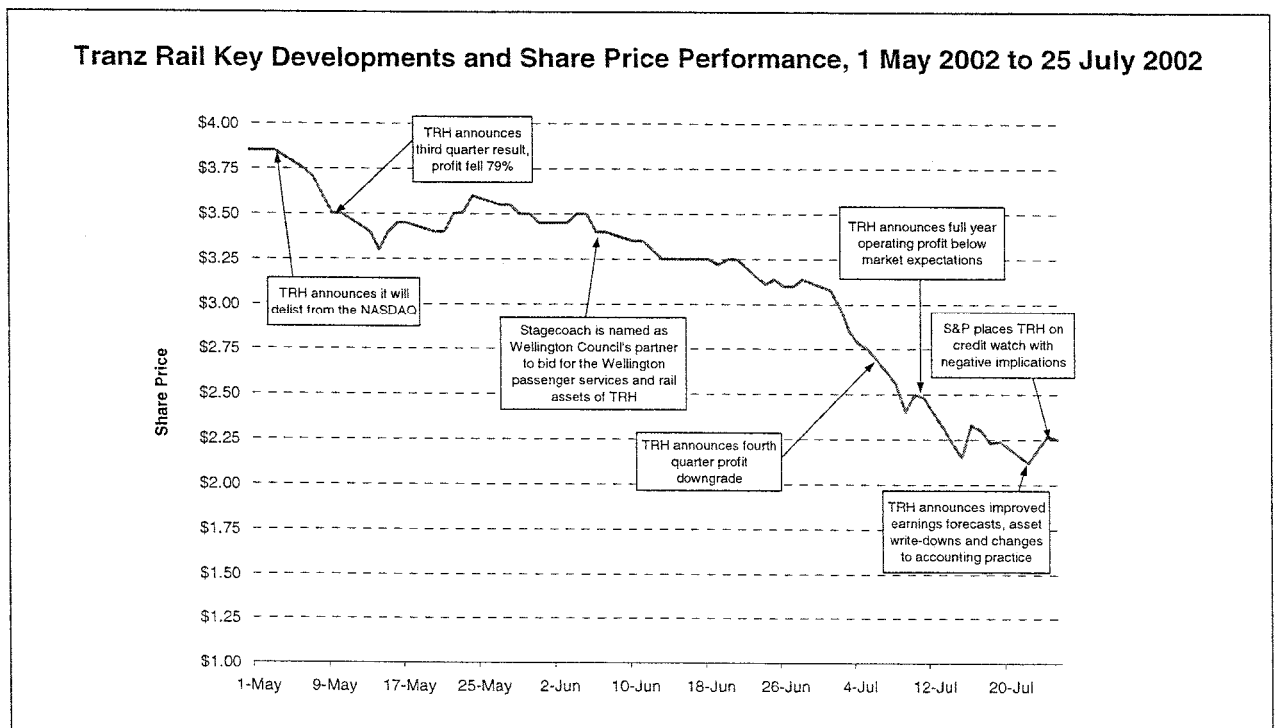
To The Treasury
 From First NZ Capital
 Date July 26, 2002
 Re Acquisition Price Update

1. Introduction

This memorandum provides an update on certain aspects of our earlier advice dated May 14, 2002 - "Overview of Transaction Options". That memorandum provided a preliminary overview of the issues that would arise for the Crown and Tranz Rail if the Crown wished to acquire either Tranz Rail's rail network infrastructure or the shares in Tranz Rail. Since that memorandum was written Tranz Rail's share price has fallen considerably. The purpose of this memorandum is to update our advice relating to an indicative price range should the Crown make an offer for 100% of Tranz Rail.

2. Acquisition of Tranz Rail

In our earlier memorandum, our preliminary view was that the Crown would have to offer a price in the range of at least \$5 to \$5.50 for an offer to be successful. At the time Tranz Rail's share price was \$3.45. Precedents in New Zealand and Australia show that a premium to the pre-offer market price in the order of 30% is required for a 100% takeover to succeed. The higher than normal premium proposed reflects the fact that the Crown would be perceived to be in a weak position to resist pressure to raise its offer price. Due to the nature and extent of Tranz Rail's recent difficulties and corresponding share price decline, investors may be willing to accept a smaller premium now, than they were two and a half months ago. It is conceivable that many investors would welcome an offer from the Crown rather than suffer continued underperformance by Tranz Rail.



The graph above summarises the key news developments and share price performance for Tranz Rail since the beginning of May. The share price has fallen from \$3.45 in the middle of May to \$2.25 on July 25. Profit warnings and a lot of media focus on Tranz Rail, including comments on Tranz Rail's accounting practices, have contributed to the share price falling by 35% in just two and half months.

The table below compares the pricing benchmarks that we used in our earlier advice with the same benchmarks, updated to reflect the most recent performance.

Pricing Benchmarks		
	May 14	July 25
Highest price over the last 12 months	\$4.50	\$4.50
Broker analysts' consensus valuation ¹	\$4.65	\$4.22
Market price	\$3.45	\$2.25
Premium on market price	45% – 60%	45% – 60%
FNZC assessed price range	\$5.00 - \$5.50	\$3.25 - \$3.60
Note:		
¹ We have not been able to access the latest research reports from all brokers yet. In addition, a number of the brokers are currently reviewing their models of Tranz Rail in light of the new information released by the company on July 23. That being said, most comment that their current models assume lower growth than that predicted by Tranz Rail in its July 23 release.		

Based on Tranz Rail's current share price of \$2.25 and current investor sentiment towards the company, our updated view is that the Crown would have to offer a price in the range of \$3.00 to \$3.40 for an offer to be successful if it were launched today. In light of Tranz Rail's recent underperformance we believe that the premium to market price paid by Crown would not have to be as high, today as it would have been two and a half months ago. Despite the share price having fallen substantially in the last two and half months, analysts' consensus valuation for Tranz Rail will still be relevant, as will be the independent appraisal report on the Crown's offer. As yet, the consensus valuation of Tranz Rail has not fallen in line with the share price. We do note that the FNZC research analyst has a 12-month target of \$3.30.

It should be noted that the steep fall in Tranz Rail's share price does not necessarily imply that Tranz Rail's long-term viability is substantially different than two and half months ago.

3. Conclusion

On the basis of developments since we provided our earlier advice in May, we believe that the premium the Crown would have to pay to successfully acquire 100% of Tranz Rail has reduced. Our revised price range is \$3.00 - \$3.40. We do note, however, that a successful offer in this price range would be dependent on the independent appraisal report supporting the offer as "fair and reasonable".