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Our ref TWL/Long term incentive plan/R006 LH

5 October 2004

Dear Sirs

Appraisal Report in respect of The Warehouse Group Limited giving of financial assistance in relation to the proposed executive share scheme

The directors of The Warehouse Group Limited (“The Warehouse” or “the Company”) propose to seek shareholders’ approval, by way of an ordinary resolution to be passed at the Annual Meeting to be held on 26 November 2004 to establish The Warehouse Group Limited Executive Share Scheme (“Scheme”) for selected eligible Executive Employees. We understand the Scheme will replace The Warehouse Staff Options Plan for those eligible Executive Employees who will participate in this Scheme.

Under the Scheme eligible Executive Employees will be offered a right to be allocated and transferred ordinary shares in The Warehouse, upon the satisfaction of certain conditions (which include remaining continuously employed by the Company or its subsidiaries for a specified time), in recognition of the contribution by those eligible Executive Employees to the performance and success of the Company.

To implement the Scheme, The Warehouse Management Trustee Company No. 2 Limited (“Trustee”) will be established to hold shares in The Warehouse, which subject to certain conditions, may be allocated and transferred to eligible Executive Employees. The shareholders and directors of the Trustee will be Keith Smith, Glen Inger and Luke Bunt.

The terms of the Scheme are set out in a Deed in Respect of The Warehouse Group Limited Executive Share Scheme (the “Deed”). The Trustee will act as a trustee of the Scheme in accordance with this Deed. The Deed governs the participation criteria and the offer of Award and Performance shares in The Warehouse to eligible Executive Employees.



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The Warehouse Directors' Remuneration, Talent and Nomination Committee ("Committee") will administer the Scheme. Membership of the Committee is restricted to non-executive members, and the majority of directors on the Committee must be independent directors. The Committee will nominate those Executive Employees who will be eligible to participate in offers under the Scheme. An eligible Executive Employee shall agree to become a participant in the Scheme by entering into a participation deed ("Participation Deed"). This will set out the terms of participation as determined by the Committee. The Participation Deed will state the number of Award and Performance shares that an eligible Executive Employee will be offered the conditional right to be allocated and transferred in any one year.

The Trustee, as directed by the Committee, will purchase the aggregate of the maximum number of Award and Performance shares that eligible Executive Employees could, subject to certain conditions, be allocated and transferred under the Scheme. To enable the Trustee to purchase such Award and Performance shares in The Warehouse, the Trustee will receive financial assistance from The Warehouse.

Stock Exchange Regulations

Under the New Zealand Exchange Limited ("NZX") Listing Rule 7.6.4 an issuer shall not give financial assistance for the purpose of, or in connection with, the acquisition of shares issued by the issuer unless the giving of that assistance complies with Listing Rule 7.6.5 or is approved in accordance with Listing Rule 7.6.6. Under Listing Rule 7.6.6, a company must obtain prior approval of the precise terms and conditions of the giving of financial assistance by separate resolutions of the holders of each separate group of each class of quoted equity securities of the issuer whose rights or entitlements are materially affected in a similar way by the proposal.

Under Listing Rule 6.2.1 the text of any resolution under Listing Rule 7.6.6 to be put to a meeting of a company must be set out in a notice of meeting. In accordance with Listing Rule 6.2.2(c), an Appraisal Report ("Report") must accompany a notice of meeting to consider a resolution to approve the giving of financial assistance, if it is intended or likely that more than 50% of the total financial assistance to be given, will be given to Directors or Associated Persons of Directors of the issuer. The requirement for a Report arises in this instance, as two Directors of the issuer, Keith Smith and Glen Inger, will be Directors of the Trustee, established under the Scheme, which will be given financial assistance by The Warehouse. Under Listing Rule 1.3.3, the Trustee is deemed to be an "Associated Persons" of such Directors. It is also arguable that, under Listing Rule 1.3.3, the Trustee is deemed to be an "Associated Person" of all other Directors of the issuer as they may be considered to be acting jointly or in concert with the Trustee.

Listing Rule 1.2.1 requires that an independent appropriately qualified person, approved as such by the NZX, prepare such a Report. KPMG Corporate Finance ("KPMG") has obtained the requisite approval from the NZX.

Under Listing Rule 1.2.2, the Report must inter-alia:

- a. Be addressed to the Directors of the Company not associated with any relevant Associated Persons (the term "relevant Associated Persons" is defined in Listing Rule 1.2.2 (a) and, for the purposes of this Report, means the Trustee), or if there are no such Directors, to the NZX. Our Report is therefore addressed to the NZX;
- b. Be expressed to be for the benefit of shareholders of The Warehouse not associated with any relevant Associated Persons (Refer Appendix);
- c. State, providing reasons, whether or not in the opinion of KPMG the consideration and terms and conditions of the proposed transaction are fair to shareholders, other than those associated with the relevant Associated Persons (Refer pages 3-12);

- d. State, providing reasons, whether or not in the opinion of KPMG the information to be provided by The Warehouse to shareholders is sufficient for shareholders to understand all the relevant factors and reach an informed decision as to the fairness of the proposed transaction (Refer page 11);
- e. State whether KPMG, in preparing the Report, has obtained all information it believes desirable for the purposes of preparing the Report, including all material information which is known or should have been known to any Director of the Company and has been made available to the Directors (Refer page 11);
- f. State any material assumptions on which KPMG's opinion is based (Refer pages 3-12);
- g. State any terms of reference that may have materially restricted the scope of the Report; and
- h. If it contains a disclaimer of liability, not purport to absolve the reporter from liability for an opinion expressed recklessly or in bad faith.

Our statement of independence, declarations, use of our Report and disclaimer are set out in the Appendix to the Report.

Information relied upon

In completing our opinion we have received and relied upon the following information supplied by The Warehouse:

- Copy of the Deed relating to the Scheme and all schedules to the Deed including the Loan, Reimbursement and Security Agreement ("Loan Agreement") in relation to the Deed;
- Copy of the excerpts, resolutions and explanatory notes to accompany the Notice of Annual Meeting in relation to the establishment and background information in respect of the Deed and the Scheme; and
- Discussions and various miscellaneous correspondence with senior employees of The Warehouse and their legal advisors to the Scheme.

Structure of our report

In forming an opinion on whether or not the provision of financial assistance by The Warehouse to the Trustee is fair and reasonable to shareholders of The Warehouse it is also necessary to consider the purpose of the financial assistance, namely the Scheme and its associated rules outlined in the Deed. The operation of the Scheme, and impact on The Warehouse, is integral to determining if the financial assistance given by The Warehouse to the Trustee is fair and reasonable to shareholders. We therefore consider:

- Whether or not in our opinion the terms and conditions attaching to the financial assistance that The Warehouse may provide to the Trustee are fair to the shareholders of The Warehouse (other than persons associated with the relevant Associated Persons and eligible Executive Employees); and
- Whether or not in our opinion the terms and conditions that apply to the potential offer of a conditional right to be allocated and transferred Award and Performance shares in the Company (to eligible Executive Employees nominated by the Committee to participate in the Scheme), which is facilitated by the giving of financial assistance, are fair to the shareholders of The Warehouse (other than persons associated with the relevant Associated Persons and eligible Executive Employees).

Background

Currently eligible Executive Employees receive a fixed base salary paid in cash and a variable cash payment under an annual short-term incentive plan. Executive Employees also receive share options issued under The Warehouse Staff Options Plan last approved by The Warehouse shareholders' at an extraordinary general meeting held on 31 March 03.

The ability to exercise the share options under The Warehouse Staff Options Plan is conditional upon growth in The Warehouse share price exceeding the Company's cost of equity capital, adjusted for any assumed annual cash dividends paid. Over recent years this hurdle target has not been achieved and no options have been exercised under this Staff Options Plan.

Purpose of the proposed Scheme

The Warehouse Board recognizes that the performance of The Warehouse is dependent on the quality of its people. To achieve the goals of the Company in an increasingly complex business environment and to maximise shareholder wealth it is essential that The Warehouse have remuneration policies that are market competitive and that attract, retain and appropriately motivate and reward its skilled Executive Employees.

The Scheme for eligible Executive Employees is designed to:

- Provide greater emphasis on linking actual remuneration to Company and individual performance targets;
- Provide greater incentives for skilled Executive Employees to remain in the employment of the Company; and
- Enhance the concept of share ownership and better align the interests of shareholders to the interests of the eligible Executive Employees.

Our understanding is that the total remuneration package for each eligible Executive Employee is determined in accordance with the Executive Employee's skills and responsibilities. The total remuneration package is also based on market data and other appropriate benchmark information on remuneration ranges for executives with similar qualifications, skills, job responsibilities and working experience.

The Scheme will potentially provide eligible Executive Employees on an annual basis with:

- *Award shares*. This is a medium-term incentive plan that, subsequent to the achievement of certain criteria as approved by the Board, offers eligible Executive Employees a conditional right to be allocated and transferred shares in The Warehouse.
- *Performance shares*. The Performance share aspect of the Scheme is designed to reward eligible Executive Employees based on out-performance of the Company share price over the medium to long-term.

Linking rewards to performance: The Award share aspect of the Scheme

The criteria for determining the maximum number of Award Shares that eligible Executive Employees may be offered a conditional right to be allocated and transferred under the Scheme will, in respect of each financial year, be determined with reference to a combination of:

- i. The Net Profit After Tax performance of the Company;
 - ii. The Operating Profit of the business unit in which the eligible Executive Employee is employed (if applicable); and
 - iii. The individual performance of the eligible Executive Employee
- for the immediately preceding financial year.

“Net profit After Tax” (“NPAT”) is defined under the Deed as “the net surplus after minority interests attributable to shareholders, adjusted for the after taxation effects of non-recurring items.” “Operating Profit” is defined as “earnings before interest, tax, goodwill amortisation and non-recurring items”. We hereafter refer to target NPAT and target Operating Profit as “Profit Targets”.

Prior to the commencement of each financial year Profit Targets for the Company and its key business units are set via a comprehensive strategy review and budgeting process. This process involves rigorous review and approval by The Warehouse Board, taking into account both the long-term plans and financial objectives for the Company.

We understand the Board will approve the minimum Profit Targets and hurdle criteria, together with approving individual performance criteria that eligible Executive Employees must meet prior to being offered the conditional right to be allocated any Award shares.

At the start of each financial year the base level remuneration, or the monetary value of the Award shares, that Executive Employees may be offered (the conditional right to be allocated and transferred under the Award share aspect of the Scheme) if target performance is achieved is determined, for each eligible Executive Employee. This sets the base entitlement to the value of the Award shares that may be conditionally offered to Executive Employees. These conditional offers will be made shortly after the end of the financial year when actual performance is measured relative to target performance.

No Award shares will be offered to an eligible Executive Employee, in respect of the immediately preceding financial year, unless:

- The actual Profit Targets exceed minimum specified Profit Targets approved by The Warehouse Board; and
- The individual Executive Employee achieves his or her individual performance targets.

Subject to achieving these minimum performance hurdles, a sliding scale then applies according to actual achievement relative to the targets. The scale approved by the Board for the 2005 year is currently a two for one multiplier that is applied to under or over-performance relative to the Profit Targets.

Shortly after the end of each financial year the actual Award share value is determined and eligible Executive Employees would be offered the conditional right to be allocated and transferred shares in The Warehouse of equal value to their Award entitlement. Prior to satisfaction of the conditions, the shares, representing the Award shares that an Executive Employee has the conditional right to be allocated and transferred, would be held by the Trustee.

Then, subject to the eligible Executive Employee remaining in the employment of The Warehouse or its subsidiaries, one third of such shares would transfer to the Executive Employee after a period of one year, with the remaining two-thirds of the shares transferring to the Executive Employee in equal tranches at the end of years two and three. The number of shares that may be transferred to the Executive Employee may also be adjusted for capital changes such as bonus issues, rights issues or a share consolidation.

Linking rewards to performance: The Performance share aspect of the Scheme

Under the Performance share aspect of the Scheme a base level remuneration, or the monetary value of the Performance shares, is set as part of the eligible Executive Employee's total remuneration package. At the beginning of each financial year of the Company the eligible Executive Employee will be offered a conditional right to be allocated and transferred shares in The Warehouse to a value equal to the level of their pre-set base performance remuneration. The Trustee will hold these Performance shares for the potential benefit of the Executive Employees for a period of three years.

At the end of the three year period the shares will transfer from the Trustee to the eligible Executive Employee subject to the Executive Employee still being employed by The Warehouse and conditional upon the share price in the Company increasing in value by an amount in excess of the annual cost of equity capital less an adjustment for assumed annual cash dividends paid.¹

Under the Deed the term "Assumed Annual Cash Dividend" is defined as the assumed dividend², which is calculated in accordance with the Company's dividend policy.³

If the increase in the value of shares in The Warehouse does not out-perform the assessed cost of equity capital (less any adjustment for assumed annual cash dividends) the Executive Employee will not be allocated and transferred any Performance shares.

Mechanism for the purchase of Award and Performance shares by Trustee and transfer to the eligible Executive Employee

Under the Award and Performance share aspects of the Scheme the Trustee will receive an interest free loan from The Warehouse. The loan will enable the Trustee to purchase shares in The Warehouse to meet the potential obligation to allocate and transfer shares to eligible Executive Employees.

The Trustee (through its Directors) will be the legal and beneficial owner of the Award and Performance shares until transferred to the eligible Executive Employee. The shares will be acquired by the Trustee by way of on-market purchases on the New Zealand or Australian Stock Exchanges.

Subject to the eligible Executive Employee remaining employed by The Warehouse or its subsidiaries and, in respect of the Performance shares, meeting the performance criteria, the Award and/or the Performance shares will be transferred at the appropriate date to the Executive Employee in accordance with the terms of the Scheme set out in the Deed. In the event that any Award and Performance shares are transferred to eligible Executive Employees, under the terms of the Loan Agreement contained within the Deed, The Warehouse will reimburse the Trustee an amount equal to the original cost of the shares transferred to the eligible Executive Employee. This reimbursement will enable the Trustee to then repay the loan, in respect of these shares transferred to the Executive Employee, to The Warehouse.

¹ In calculating the hurdle or adjusted share price that must be achieved before any Performance shares will transfer to the Executive Employee, the price will also be adjusted for any capital changes such as bonus issues, rights issues or a share consolidation.

² This is unless the Committee in its absolute discretion decides otherwise. We assume the Committee will not use its discretion in a manner that would be materially detrimental to the shareholders.

³ We understand the dividend policy of The Warehouse is to distribute by way of dividends 50% of its net profit after tax in respect of each financial year.

Any Award and Performance shares that do not transfer with an eligible Executive Employee (due to the resignation of the Executive Employee and/or, in the case of Performance shares, the performance criteria not being met) will continue to be held by the Trustee. The Trustee will have the discretion to:

- Continue to hold these shares in The Warehouse for future transfer to eligible Executive Employees (thereby reducing the need for future funding by The Warehouse); or
- Sell the shares and repay part of the loan owing to The Warehouse.

In respect of both Performance shares and Award shares, the Trustee will have the discretion to pay to eligible Executive Employees as a trust distribution, the after-tax proceeds of any rights issue sale proceeds or share buy-back proceeds that it has received while holding the shares. Bonus shares, attaching to these shares, that the Trustee has received may also be transferred to eligible Executive Employees. The Trustee will retain the benefit of any dividends paid on the shares. These funds will be used by the Trustee to assist in payment of its administration costs.

Our approach

To assess if the provision of financial assistance by The Warehouse to the Trustee, and the related proposed Scheme, is fair to the shareholders of The Warehouse (other than persons associated with the relevant Associated Persons and eligible Executive Employees) we have considered:

- The Executive Employees' fixed versus variable components of their remuneration;
- The reasonableness of the performance targets under the Award and Performance share aspects of the Scheme;
- The benefits of the Scheme to The Warehouse's shareholders (other than eligible Executive Employees);
- The total likely cost of the Scheme to The Warehouse's shareholders in the first year of the Scheme;
- The cost of financial assistance by The Warehouse to the Trustee; and
- The cap on the number of Award and Performance shares.

Fixed versus variable remuneration component

We understand the base remuneration, approved by the Board, and allocated to the Award and the Performance share aspects of the Scheme will represent a meaningful proportion of the eligible Executive Employee's fixed base cash remuneration. This allocation has been set in accordance with market data and other appropriate benchmark data on remuneration ranges for executives with similar qualifications, skills, job responsibilities and working experience.

A meaningful proportion of the eligible Executive Employee's remuneration that is variable, and linked to Company performance, enhances the incentives of the Executive Employee to act in the best interests of The Warehouse. This provides significant potential benefits to shareholders.

The reasonableness of the performance targets: Award Share aspect of the Scheme

As already noted eligible Executive Employees may receive a base entitlement under the Award share aspect of the Scheme (by way of the offer of conditional rights to be allocated and transferred shares in The Warehouse initially held by the Trustee) based on:

- The actual Company or business unit profit compared to Profit Targets for the immediately preceding financial year; and
- Subject to meeting individual performance criteria for the immediately preceding financial year.

Our understanding is that The Warehouse Board will approve Profit Targets. In addition the Board will approve minimum hurdle criteria in respect of both Profits Targets and personal performance targets that must be achieved before eligible Executive Employees will be offered any Award shares under the Scheme. The minimum Profit Targets and performance criteria approved by the Board will be documented at the beginning of each financial year and will be consistent with the objective of maximizing shareholder wealth.

The requirement that individual performance targets must be achieved before any Award shares are offered to eligible Executive Employees will ensure underperforming Executive Employees are not offered any Award shares, notwithstanding the Company, or business unit, may still achieve minimum Profit Targets approved by the Board.

So long as the Board approves fair and reasonable Profit Targets, minimum hurdle criteria and individual performance targets that are consistent with the shareholders' interests, in our opinion, the Award share aspect of the Scheme will provide a significant direct link between the eligible Executive Employee's remuneration and both Company and individual performance. The shareholders of the Warehouse will benefit from greater alignment of the Executive Employees' interests to the interests of shareholders and the focus on maximization of shareholder wealth.

The reasonableness of the performance targets: Performance Share aspect of the Scheme

Under the Performance share aspect of the Scheme eligible Executive Employees are offered conditional rights to be allocated and transferred shares with a value equal to the pre-set base Performance share remuneration. The shares are held by the Trustee and will only be transferred to the Executive Employee at the end of three years. This transfer is conditional upon The Warehouse share price increasing by more than the Company's cost of equity capital (adjusted for assumed annual cash dividends paid) and the relevant Executive Employee remaining continuously employed by the Company or its subsidiaries.

The Deed provides for the cost of equity capital to be calculated in accordance with a tax-adjusted capital asset pricing model after taking independent advice. This model to estimate a company cost of equity capital is commonly used by participants in the New Zealand capital market at the present time. We understand The Warehouse Board will take independent advice in determining the cost of equity to be used in the calculating the Performance share hurdle.

In our opinion a hurdle rate linked to the Company's cost of equity capital is a reasonable benchmark that must be achieved for eligible Executive Employees before the Performance shares are transferred under the Scheme.

Benefits of the Scheme to The Warehouse's shareholders (other than eligible Executive Employees)

An important objective of any incentive or variable remuneration plan is to attract, retain, motivate and reward key executives of a company. Many public listed companies adopt incentive remuneration plans to reward out-performance.

The precise value of the benefits of the Scheme to The Warehouse's shareholders is difficult to quantify. In our opinion, however, the potential benefits of the Scheme to the shareholders of The Warehouse are significant.

The provision of shares in The Warehouse under the Award and Performance aspects of the Scheme provides incentives to Executive Employees to increase shareholder value and for skilled Executive Employees to remain with the Company. The Scheme also ensures that the interests of eligible Executive Employees are more closely aligned to the interests of shareholders due to:

- The payout under the Award and Performance aspects of the Scheme are directly linked to Company performance. The potential for greater rewards if there is out-performance encourages and motivates eligible Executive Employees to work in the best interests of the Company; and
- Under the Performance share aspect of the Scheme, Executive Employees are only rewarded if The Warehouse's share price (adjusted for assumed annual cash dividends) generates a total return to shareholders in excess of the Company's cost of equity capital and they remain employed by the Company.

Unlike a share option plan where a company issues new shares in the event that the options are "in the money" and exercised, the Trustee will purchase the required number of shares on market to meet The Warehouse's obligations under the Award and the Performance aspects of the Scheme. Thus, there is no potential dilution of existing shareholders' interests in the ordinary shares of the Company.

Likely total cost of the Scheme over the next year: Award share aspect of the Scheme

The following table sets out our estimated cost of the Award share aspect of the Scheme at various different percentages of achievement of actual versus Profit Targets for the 2005 financial year⁴. For simplicity this estimate is based on an assumption that all Profit Targets are referenced to NPAT targets and that approximately 57 eligible Executive Employees would be invited to participate in the Scheme in 2005. We also assume, based on our understanding of the current hurdle criteria approved by the Board, that:

- A two for one multiplier is applied to under or over-performance relative to the Profit Targets; and
- The value of any Award shares that can be offered to eligible Executive Employees is capped at 140% of the on target performance base Award component of the Executive Employee's remuneration.

| Actual NPAT | Estimated cost of Award Scheme⁵ | Award as % of 2004 Net Profit Before Tax |
|--------------------|---|---|
| @ 95% target | \$1.9 million | 2% |
| @ 100% target | \$2.1 million | 2% |
| @ 105% target | \$2.3 million | 3% |
| @ 120% target | \$2.9 million | 3% |

Source: KPMG analysis

⁴ While the actual cost of the Award aspect of the Scheme will be determined shortly after the 2005 financial year end, we assume the expense would be recognized in the 2005 financial year.

⁵ The estimated cost calculation ignores any impact of a cap on the maximum number of shares that may be offered across both the Award and Performance shares in any one year.

The current cap of 140%, approved by The Warehouse Board, will apply once actual profit exceeds Profit Targets by 20% due to the two for one multiplier. Thus we estimate the maximum pre-tax cost of the Award aspect of the Scheme for the 2005 financial year is approximately \$2.9 million. This assumes all eligible Executive Employees meet or exceed their individual performance criteria and actual profits at the Company, and business unit, level is at least 20% in excess of Profit Targets approved by the Board. In addition, all eligible Executive Employees are assumed to remain with the Company for at least three years following the offer of Award shares and thereby receive their maximum entitlement to the Award shares.⁶

Based on the calculations above we consider that in comparison to the benefits to The Warehouse's shareholders from any overachievement in Profit Targets for the Company, the benefits under the Award aspect of the Scheme, to eligible Executive Employees, are reasonable.

Likely total cost of the Scheme over the next year: Performance share aspect of the Scheme

We understand the base Performance share remuneration for the current 57 eligible Executive Employees who may be invited to participate in the Scheme in 2005 is approximately \$2.1 million. This will mean that the Trustee must hold or purchase on market shares in The Warehouse with a value equal to approximately \$2.1 million to meet the potential payout to eligible Executive Employees under this aspect of the Scheme. A pre-tax cost of \$2.1 million is approximately 2% of the Net Profit Before Tax for the 2004 financial year.

The expected opportunity cost of the Performance aspect of the Scheme to The Warehouse will, however, be less than the value of the base Performance share remuneration. This is because the Performance shares may not transfer to eligible Executive Employees in the event the performance hurdle, or requisite growth in The Warehouse share price, is not achieved (being the requirement that The Warehouse share price must grow in value by more than the Company's cost of equity capital less an adjustment for assumed annual cash dividends paid). To receive the Performance shares the eligible Executive Employee must also remain employed by The Warehouse for a period of three years following their offer date.

The "value" of the Performance shares at their offer date is "equivalent" to the value of a call option on a share with a zero exercise price (ignoring the possibility that the Executive Employee may leave the Company prior to the transfer date and any non-negotiability discounts). The right to exercise the "option" is, however, conditional upon the out performance of The Warehouse share price over the hurdle target.

To derive an indicative expected cost of the Performance share obligation to The Warehouse in 2005 we construct an options pricing model with the payoff dependent on the share price at the end of the period when shares may be transferred to eligible Executive Employees. Based on our assumptions and inputs into the model we estimate the opportunity cost to The Warehouse of the Performance share aspect of the Scheme is between circa \$0.63 million and \$1.26 million or 30%-60% of the expected base Performance share remuneration of approximately \$2.1 million in 2005.

This calculation takes into account the possibility that the growth in The Warehouse share price will not meet the hurdle target and the Performance shares will then not be transferred to the eligible Executive Employee.

⁶ The Award shares transfer in equal tranches over a three year period. To receive all the Award shares that are offered to the Executive Employee in any one year, the Executive Employee must remain employed by the Company for a further three years.

Based on our calculations above we consider that, in comparison to the benefits to The Warehouse shareholders' from any growth in the Company share price, the benefits under the Scheme to eligible Executive Employees are reasonable.

Cost of the financial assistance by The Warehouse to the Trustee

Under the Deed the financial assistance given by The Warehouse to the Trustee shall be provided by way of a loan, which shall be interest free. The liability and recourse of the Trustee in respect of the loan shall also be limited to the value of the shares held by the Trustee, provided that the Trustee shall have the right to offset certain costs, expenses and other outgoings.

As noted, in the event that any Award and Performance shares are transferred to eligible Executive Employees, under the terms of the Loan Agreement contained within the Deed, The Warehouse will reimburse the Trustee an amount equal to the original cost of the shares transferred to the eligible Executive Employee. This will enable the Trustee to repay the loan, in respect of these shares transferred to the Executive Employee, back to The Warehouse.

In our opinion the cost to The Warehouse under the Scheme is not materially different to the cost of a deferred cash remuneration plan under an alternative long-term incentive scheme, where any payment is also conditional upon the achievement of certain performance criteria. In this respect we understand the value of the Award and Performance share package aspects of the Scheme is part of that Executive Employee's overall remuneration package based on market data and other appropriate benchmark information. Thus, if shareholders do not approve the Scheme, then the current total remuneration package for eligible Executive Employees may not be considered market competitive. In this case The Warehouse may need to offer alternate incentive remuneration payments to attract, retain motivate and reward its skilled Executive Employees.

A potential advantage of the Scheme, however, compared to a long-term cash deferred remuneration payment is that the value of shares that may be transferred to eligible Executive Employees at their relevant transfer date will depend on the share price of The Warehouse as at that date. Executive Employees therefore have an ongoing incentive to take actions that maximize the Company share price consistent with the interests of shareholders.

Cap on the number of Award and Performance shares

Under the Deed the maximum dollar value of financial assistance to be made available by The Warehouse to the Trustee will provide a cap on the number of Award and Performance shares that may be offered to eligible Executive Employees for any year. For the 2005 year shareholders are being asked to approve a loan up to a maximum value of \$5.1 million by the Company to the Trustee. Accordingly this amount of \$5.1 million will be the maximum potential cost to The Warehouse under the Scheme for the 2005 year.

We understand that each year The Warehouse Board will seek shareholder approval on the level of financial assistance that the Company may provide to the Trustee. This will mean that shareholders will have the right to reject the provision of ongoing financial assistance in the event shareholders consider the cost of the Scheme to be excessive.

Under the Deed an overall cap of 2 million shares (approximately equal to 0.7% of the total number of issued shares by the Company) in The Warehouse will also apply to the total number of Award and Performance shares that may be offered to eligible Executive Employees in any one year.

In respect of the 2005 year, the number of shares that eligible Executive Employees may be offered a conditional right to be allocated and transferred is likely to be less than the level of the cap. However, the cap may be relevant in future years if more eligible Executive Employees are invited to participate in the Scheme.

Conclusions

In preparing this Report we consider KPMG has obtained all relevant information it believes desirable for the purposes of preparing the Report, including all material information, which is known or should have been known to any Director of the Company and has been made available to the Directors.

In our opinion the information to be provided by The Warehouse together with the contents of this Report is sufficient for shareholders to understand all the relevant factors and reach an informed decision as to the fairness of the Scheme. Shareholders in The Warehouse may also obtain a copy of the Deed by contacting the Secretary to the Board of The Warehouse.

The Deed does not specify the remuneration package, Profits Targets and hurdle criteria that may apply to an eligible Executive Employee in respect of any offer of Award and Performance shares under the Scheme. In our view it would be impractical to incorporate these features into the Deed and at the same time retain flexibility for the Board to approve, on an ongoing basis, remuneration packages that are market competitive and that attract, retain motivate and reward eligible Executive Employees. Accordingly, in our view, the responsibility to determine the eligible Executive Employee's compensation and to approve the Profit Targets and hurdle criteria under the Scheme are matters best left to the Board.

We note the Board has formally constituted a Corporate Governance Committee and a Remuneration, Talent and Nomination Committee.⁷ The Corporate Governance Committee is a committee of the board of independent directors that are responsible to ensure the Company maintains a high degree of corporate governance through the continuous monitoring of international corporate governance best practice as promulgated by the relevant authoritative bodies. The Remuneration, Talent and Nomination Committee, the majority being independent directors, is responsible for determining and reviewing compensation arrangements for the chief executive officer and the executive management team.

On balance we believe the rules incorporated in the Deed benefit shareholders while providing sufficient flexibility to enable the Scheme to operate in an efficient manner. As noted in this Report the Deed also incorporates a cap on the total number of Award and Performance shares that may be offered to eligible Executive Employees in any year. Furthermore the requirement for shareholder approval for the giving of further financial assistance provides an additional cap on the value of Award and Performance shares that may be offered to eligible Executive Employees.

In reaching our conclusions we, nevertheless, make the key assumptions that:

- The value of Award and Performance share aspects of the scheme, approved by the Board, are part of the eligible Executive Employee's total remuneration package determined in accordance with the Executive Employee's skills and responsibility and based on market data for executives with similar qualifications and working experience; and
- The Warehouse Board will only approve fair and reasonable Profits Targets, minimum hurdle criteria and individual performance targets that are consistent with shareholders' interests and that must be achieved before eligible Executive Employees would be offered any Award shares under the Scheme.

⁷ Copies of the terms of reference of these committees are available on The Company's website at: www.thewarehouse.co.nz

We therefore conclude:

- The terms and conditions under which The Warehouse will provide financial assistance to the Trustee to enable the Trustee to purchase Award and Performance shares under the Scheme is fair and reasonable to shareholders (other than persons associated with the relevant Associated Persons);
- A significant proportion of the eligible Executive Employee's remuneration that is variable and linked to Company performance enhances the incentives of the Executive Employee to act in the best interests of The Warehouse. This provides significant potential benefits to shareholders;
- The value of the incentives provided to eligible Executive Employees under the Scheme do not appear to be excessive;
- The terms of the Award share aspect of the Scheme provide a significant direct link between the eligible Executive Employee's remuneration and Company performance. This increases the motivation of eligible Executive Employees to take actions that increase shareholder wealth. Most of the benefits of any out-performance of Profit Targets of The Warehouse will likely accrue to existing shareholders (other than eligible Executive Employees);
- The benefits under the Performance share aspect of the Scheme only reward eligible Executive Employees in the event the growth of The Warehouse share price exceeds the Company's cost of equity capital (adjusted for assumed annual cash dividends). In our opinion this is a reasonable benchmark that must be achieved for eligible Executive Employees to be transferred the Performance shares. Most of the benefits of any out-performance of The Warehouse share price will likely accrue to existing shareholders (other than eligible Executive Employees);
- Overall the Scheme will increase the focus of the eligible Executive Employees' on Company performance and reinforce the concept of share ownership. This has the potential to provide significant benefits to the shareholders of The Warehouse;
- The Scheme provides incentives for skilled Executive Employees to remain with the Company for the benefit of The Warehouse shareholders; and
- The annual cost of the Scheme is effectively capped through the requirement of the Board of The Warehouse to seek ongoing shareholder approval on the level of financial assistance that may be made available to the Trustee each year and the overall cap of 2 million shares that can be offered under the Scheme to eligible Executive Employees each year.

In summary, in our opinion, the terms and conditions of the provision of financial assistance by The Warehouse to the Trustee and the terms and conditions of the Scheme are fair to shareholders of The Warehouse (other than the relevant Associated Persons and eligible Executive Employees who may participate in the Scheme).

Yours faithfully

Tony McNaught
Partner – KPMG Corporate Finance

Troy Newton
Director – KPMG Corporate Finance

Appendix

Declarations

This Report has been prepared for the benefit of the shareholders of the Warehouse Group Limited, not associated with any relevant Associated Persons.

KPMG will receive a fixed fee for the preparation of this Report. The fee is not contingent on the outcome of the proposed transaction. The terms of reference to prepare this Report were issued by The Warehouse.

This Report is based upon financial and other information provided by The Warehouse. KPMG has considered and relied upon this information. We have obtained all relevant information we believe necessary for the purposes of preparing this Report. We believe that the information provided was reliable, complete and not misleading and have no reason to believe that any material facts have been withheld.

The information provided by The Warehouse or obtained from other sources has been evaluated through analysis, enquiry and review for the purposes of forming an opinion as to the fairness of the proposed financial assistance to the shareholders of The Warehouse (other than the Associated Persons and eligible Executive Employees that participate in the Scheme). However, KPMG does not warrant that these enquiries have identified or verified all of the matters which an audit, extensive examination or due diligence investigation might disclose.

KPMG has not undertaken a due diligence investigation and has not audited in any way any information provided. It is understood that the financial information provided to us was prepared in accordance with generally accepted accounting principles.

KPMG in no way guarantees or otherwise warrants the achievability of future profits, cashflows or dividends. Forecasts are inherently uncertain. They are predictions of future events, which cannot be assured and are necessarily based on assumptions, many of which are beyond the control of management. The actual future results can be significantly more or less favourable.

KPMG provided drafts of this Report to The Warehouse solely for the purpose of confirming the factual accuracy of the Report. There was no alteration to the opinion methodology, or conclusion as a result of issuing the draft Report

Our Report was prepared on 5 October 2004 based on the information available at the time. We have no obligation to update our Report or revise the information contained therein due to events and transactions occurring subsequent to the date of the Report.

Disclaimer

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 The Warehouse and that all such information is true and accurate in all material aspects and not misleading by reason of omission or otherwise. Accordingly, neither KPMG nor 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.

Authors of the Report

Tony McNaught and Troy Newton of KPMG prepared this Appraisal Report having been approved by the NZX on 3 October 2004 to undertake the Report pursuant to Listing Rule 6.2.2 (c). A copy of the approval letter is available on request.

Use of the Report

Because of its particular nature, our Report may not be suited for any purpose other than as described above and as such should not be relied on for any other purpose.

Independence

Our investigations have confirmed that The Warehouse is not an SEC Issuer audit client of KPMG.

KPMG follows the ethics and independence requirements of the Institute of Chartered Accountants of New Zealand and is required to comply with KPMG International's professional policies and guidelines relating to independence.