

Quarter Update Newsletter

31 December 2018 – 31 March 2019



- » Kingfish had its best quarter in 13 years.
- » The Kingfish Adjusted NAV for the three months was 13.9%, while the S&P/NZX50G Index returned 11.7% for the quarter, and the Kingfish gross performance for the three months was 15.3%.
- » We exited Michael Hill during the quarter and redeployed those funds into existing holdings.

We welcome dispersion and the opportunities it presents

The New Zealand share market had its best quarter in more than two years and fourth best quarter since the global financial crisis, based on returns for the S&P/NZX50G. Kingfish performed significantly better than the market.

There was substantial change in market dynamics in late 2018 and early 2019 with single stock dispersion, essentially the difference in returns between the weakest and strongest performers, increasing sharply after several quarters of very low dispersion in late 2017 and into 2018.

We welcome dispersion with open arms as it provides an opportunity to beat the market and allows the high quality companies we invest in on your behalf to shine.

During the March quarter portfolio heavyweights like **The a2 Milk Company**, **Fisher & Paykel Healthcare** and **Mainfreight** delivered significantly higher returns than the market. Of course dispersion is a two-way street. Our research process helped us avoid some of the weaker performers over the quarter. In particular it was satisfying that companies we have either previously exited (Metro Performance Glass, Abano Healthcare Group and Sky TV) or had run through our process and actively chosen not to invest in (Metlifecare, Comvita) returned significantly less than the market.

Keeping our eye on the ball – long-term thinking, like a business owner

You have heard us say before many times that we are long-term thinkers and approach investing like business owners, not financial analysts.

a2 Milk and Fisher & Paykel Healthcare by their very nature are ultra-long-term growth stories. Fisher & Paykel Healthcare is currently treating between two and three million patients with their Optiflow Nasal High Flow Therapy product. We think the total addressable market here could be as large as 40 to 50 million patients. This is a growth runway that can extend for decades.

a2 Milk has less than four percent market share in the huge Chinese infant formula market. We think this is a market the company can dominate. We also think a2 can take a meaningful

Notable Returns in the Quarter

VISTA GROUP	A2 MILK COMPANY	MERIDIAN ENERGY	FISHER & PAYKEL HEALTHCARE	MICHAEL HILL INTERNATIONAL
+31%	+28%	+25%	+21%	+18%

market share in the US liquid milk market where its market share is currently negligible. With the scale of opportunity these companies have ahead of them, it is critical not to get lost in the short-term noise and keep our eye on the long-term prize.

In recent months a2's share price has been battered by various fears. Firstly, the market grappled with concern that sweeping regulatory changes in China may impact a2, but as it turned out common sense prevailed, and the government did not draconically block Chinese mothers from using offshore infant formula as many in the market would have us believe. Secondly, the CEO sold a parcel of shares she had just received, prompting many in the market to suggest she must know something we didn't. As it turned out, like many sellers of shares, the CEO had personal reasons for selling which had nothing whatsoever to do with the health of the company. Thirdly, slowing consumption growth in China as the economy slows came onto investor's radars, but as it turns out, the huge total addressable market and low penetration allow a2 to prosper despite any broad slowdown in consumption. Fourthly, a sales 'miss' relative to consensus expectations led many to think the growth story was over, but the shortfall was due to a change in their infant formula labelling, which proved a temporary hiccup, has not impacted the long-term earnings power of the business at all.

We have added to our a2 position in several of those situations, which have all proved to be transitory and reflect the market's short-term focus.

Attending a meeting with the Fisher & Paykel Healthcare management team is like, excuse the pun, a breath of fresh air for us. The company thinks in decades, not quarters. This is the exact opposite of many investors who's nearsightedness on short-term issues such as the annual flu cycle and whether it will impact current earnings. Our view is that the flu cycle does not impact the long-term earnings power of Fisher & Paykel Healthcare one iota.

When we meet the management team, we spend almost no time focussing on the previous half yearly earnings. We spend almost the entire time focussing on the 5 to 20-year outlook. We focus on the long-term production capability of the Mexico facilities, we focus on the very large and untapped opportunities Fisher & Paykel Healthcare has with Optiflow outside the intensive care

¹ As at the date of this Newsletter the Kingfish year end NAV has yet to be audited, and therefore it may change.

² Share price discount/(premium) to NAV (including warrant price on a pro-rated basis)

unit, and we focus on the super long-term opportunity of using Optiflow or high flow nasal therapy in the home.

When the story changes, be prepared to change your mind

During the quarter we exited our longstanding holding in jewellery business, Michael Hill.

Over the last two years the investment case has changed meaningfully. During the last year or so, the company exited the US and its relatively new Emma & Roe 'demi-fine' jewellery concept, significantly changed its pricing strategy and then subsequently reversed that strategy.

With the structural shift to online sales and the pressure shopping malls around the world are facing to attract foot traffic and the fact that the underlying category growth of fine jewellery

is flat at best, Michael Hill requires near flawless execution to navigate that tricky backdrop.

During these turbulent times, it became clear to us that the strength of the business and the moat around the business is not what it once was. The recent share price recovery on the back of the new CEO's turnaround plan presented an attractive time to exit the position.

There are higher quality investment options where we can deploy our capital and we have begun to do that, adding to our positions in Mainfreight, Infratil and a2 Milk.



Sam Dickie, Senior Portfolio Manager
18 April 2019



Performance as at 31 March 2019

	3 Months	3 Years (annualised)	5 Years (annualised)
Company Performance			
Total Shareholder Return	+4.7%	+11.2%	+10.9%
Adjusted NAV Return	+13.9%	+14.3%	+12.5%
Portfolio Performance			
Gross Performance Return	+15.3%	+17.0%	+15.2%
S&P/NZX50G Index	+11.7%	+13.4%	+13.9%

Non-GAAP Financial Information

Kingfish uses non-GAAP measures, including adjusted net asset value, adjusted NAV return, gross performance return and total shareholder return. The rationale for using such non-GAAP measures is as follows:

- » adjusted net asset value – the underlying value of the investment portfolio adjusted for capital allocation decisions after fees and tax,
- » adjusted NAV return – the net return to an investor after fees and tax,
- » gross performance return – the Manager's portfolio performance in terms of stock selection, before fees and tax, and
- » total shareholder return – the return to an investor who reinvests their dividends, and if in the money, exercises their warrants at warrant maturity date for additional shares.

All references to adjusted net asset value, adjusted NAV return, gross performance return and total shareholder return in this newsletter are to such non-GAAP measures. The calculations applied to non-GAAP measures are described in the Kingfish Non-GAAP Financial Information Policy. A copy of the policy is available at <http://kingfish.co.nz/about-kingfish/kingfish-policies/>

Company News Dividend Paid 28 March 2019

A dividend of 2.83 cents per share was paid to Kingfish shareholders on 28 March 2019 under the quarterly distribution policy. Interest in Kingfish's dividend reinvestment plan (DRP) remains high with 44% of shareholders participating in the plan. Shares issued to DRP participants are at a 3% discount to market price. If you would like to participate in the DRP, please contact our share registrar, Computershare on (09) 488 8777.

Portfolio Holdings Summary as at 31 March 2019

LISTED COMPANIES	% Holding
Auckland Int Airport	5.0%
Delegat Group	3.5%
Fisher & Paykel Healthcare	13.9%
Fletcher Building	1.8%
Freightways	8.6%
Infratil	6.8%
Mainfreight	10.6%
Meridian Energy	3.3%
Port of Tauranga	3.3%
Pushpay Holdings	1.9%
Restaurant Brands NZ	4.6%
Ryman Healthcare	6.4%
Summerset	5.9%
The A2 Milk Company	13.2%
Vista Group International	4.9%
Equity Total	93.7%
New Zealand dollar cash	6.3%
TOTAL	100.0%

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