

# Quarter Update Newsletter

30 June 2019 – 30 September 2019



NAV	SHARE PRICE	DISCOUNT <sup>1</sup>
<b>\$1.52</b>	<b>\$1.44</b>	<b>5.2%</b>
as at 30 September 2019		

- » While the September quarter was not as excruciating as a combined tonsillectomy and adenoidectomy, it was painful.
- » In August alone Kingfish was down [-5%] and almost all of that poor performance was driven by a2 Milk and Vista
- » To ensure our investment decisions are not impacted by human emotions, we stick to our process. We take a step back and ask ourselves: Has the big picture thesis changed?

## Pain, taking medicine and ice-cream and jelly

*How I learnt from my son that there are bumps in the road but it is important to focus on the big picture.*

A tonsillectomy is a surgical procedure to remove the tonsils. An adenoidectomy is a surgical procedure to remove the adenoids. Both are fairly common procedures for children, but they are nonetheless painful. My 9 year old son Jack had both operations recently. During the recovery period, when we woke him each night at 2am to give him his medication, he could have easily slipped into a quagmire of complaint and self-doubt – am I ever going to get better? He however seemed to ride it out with a surprising lack of complaint. It reminded me that there are always bumps in the road on any journey but as long as you keep your eye on the bigger picture, which in Jack's case (in my opinion) was long-term good health, it allows you to retain perspective. Perhaps for Jack, the bigger picture may have simply been the copious amounts of ice-cream and jelly and two weeks off school, but hey, whatever gets you through the pain!

## a2 Milk guided for an unexpected retraction in profit margin and gave only vague revenue guidance of "continued growth".

The company specifically called out investment in higher levels of marketing and organisational capability. Since then, the share price has fallen 22%.

Vista sharply downgraded its revenue guidance for the 2019 calendar year from "around 20% revenue growth" to "10-12%". The company fell 29% on the day of the release because of: 1. The shock reduction in guidance after "around 20%" had been reiterated as recently as the AGM in May; 2. Vista signalled it is accelerating towards a 'multi-tenant Software as a Service (SaaS)' product offering which carries the sticker shock of higher up-front investment in product. There is also uncertainty of what impact it will have on revenues and profitability in the short-term versus the status quo. This was not well communicated to the market.

When stocks react sharply in an unexpected manner, human nature ensures market participants suffer the full range of emotions. Those might range from self-doubt (do I still believe in the company?) to anger with the management (how could you possibly do this to me?).

## Notable Returns in the Quarter

SUMMERSSET GROUP	RESTAURANT BRANDS	RYMAN HEALTHCARE	PUSHPAY HOLDINGS	VISTA GROUP
+20%	+18%	+13%	-13%	-36%

To ensure our investment decisions are not impacted by these human emotions, we stick to our process. We take a step back and ask ourselves: Has the big picture thesis changed? We pay particular attention to any change in the width of the moat and any change in our view on management. Do customers still love the product? Has the medium-term earnings power of the company changed?

The key metric we use to judge whether a2's customers still love their product in China is infant formula market share. For the 6 months ended June 2019, market share accelerated at the fastest pace in almost two years. Revenue growth in liquid milk in the US also accelerated from 140% for the 6 months ended December 2018 to ~175% for the 6 months ended June 2019. Customers still love a2 Milk's product! The targeted investment a2 is undertaking in both China and the US will widen a2 Milk's moat. If the company hadn't materially stepped up its investment, it could have harvested more profit in the next 1-2 years than it is now going to. However, with the step up in investment it is likely to harvest materially more profit in years 3-10 than it could have otherwise. That is classic long-term thinking and it is a classic Kingfish company. We are taking advantage of the short-term weakness and are buying shares in a2 Milk.

Vista continued to grow market share to 50% for its core cinema product outside of China. It is multiple times the size of its next biggest global competitor. Vista recently entered Japan, the third largest cinema market globally, and has already landed the largest customer in that market. Customers still love Vista's products and the moat around its core business is intact. We continue to buy shares in Vista.

For long-term investors, these bumps in the road will inevitably come and go. While we are not yet eating ice-cream and jelly, we have removed the tonsils and adenoids and we do see the bigger picture on the horizon.

Sam Dickie  
Senior Portfolio Manager  
18 October 2019



<sup>1</sup> Share price discount/(premium) to NAV (using NAV to four decimal places)

# Performance

as at 30 September 2019

	3 Months	3 Years (annualised)	5 Years (annualised)
<b>Company Performance</b>			
Total Shareholder Return	+3.4%	+12.7%	+12.4%
Adjusted NAV Return	(0.1%)	+12.2%	+13.2%
<b>Portfolio Performance</b>			
Gross Performance Return	+0.5%	+14.9%	+15.9%
S&P/NZX50G Index	+4.0%	+14.1%	+15.8%

#### 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 expenses, fees and tax,
- » adjusted NAV return – the net return to an investor after expenses, fees and tax,
- » gross performance return – the Manager's portfolio performance in terms of stock selection, before expenses, 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 26 September 2019

A dividend of 3.23 cents per share was paid to Kingfish shareholders on 26 September 2019 under the quarterly distribution policy. Interest in Kingfish's dividend reinvestment plan (DRP) remains high with 43% 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 30 September 2019

LISTED COMPANIES	% Holding
Auckland Int Airport	5.1%
Delegat Group	3.5%
Fisher & Paykel Healthcare	13.7%
Fletcher Building	1.6%
Freightways	6.7%
Infratil	9.2%
Mainfreight	13.5%
Meridian Energy	2.9%
Port of Tauranga	3.8%
Pushpay Holdings	1.5%
Ryman Healthcare	7.4%
Summerset	7.9%
The A2 Milk Company	14.3%
Vista Group International	5.4%
<b>Equity Total</b>	<b>96.5%</b>
New Zealand dollar cash	3.5%
<b>TOTAL</b>	<b>100.0%</b>

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