Quarter Update Newsletter

1 October 2018 – 31 December 2018

NAV	SHARE PRICE	WARRANT PRICE	DISCOUNT[1]
$1.40	$1.32	$0.04	5.3%

as at 31 December 2018

- **A tough quarter, with most of the volatility occurring during October;**
- **Despite the unpleasant end to the year, the 2018 calendar year delivered a positive +5.2% on a gross performance basis for Kingfish investors, significantly outperforming more volatile global markets;**
- **We took advantage of the volatility to add to high quality names, Fisher & Paykel Healthcare and a2 Milk; and**
- **Core portfolio holding Restaurant Brands received an attractive takeover offer.**

NZX Market News

The S&P/NZX50 had its worst quarter in two years and the third worst quarter since the global financial crisis. The Kingfish portfolio fell 7.0% on a gross performance basis for the quarter compared to the S&P/NZX50 which fell 5.8% for the same period.

It was a quarter for low growth defensive names. The Utilities sector (+3.4%), Real Estate sector (+2.0%) and the Telecommunications sector (+0.2%) were the only sectors up for the quarter and all sharply outperformed the market, and are sectors which do not suit our more growth oriented style.

While most of the quarter's fall occurred in the month of October (S&P/NZX50 -6.4%), November (S&P/NZX50 +0.8%) and December (S&P/NZX50 -0.1%) still seemed fragile given the ongoing extreme turmoil experienced by global markets. December especially was an odd month, with the New Zealand sharemarket an island of calm in a storm, with flat performance and very low intra-month volatility compared to global stock markets that had extremely elevated levels of volatility and fell sharply.

The S&P/NZX50 performance for the full calendar year has been +4.9% which compares favourably to the -8.4%[2] that global equity markets delivered. It's also important to note that the NZ equity market has delivered average annual market returns of approximately 13% for the past decade, and that market corrections, similar to the volatility experienced over the last quarter are an inevitable part of global share market cycles.

The good news is that the valuations of some of the core portfolio holdings are looking much more attractive. The question we always ask ourselves is: Has anything significant changed with regards to the fundamentals of the company? Is this still a company we would be proud to own in 5 years time? If the answer to those questions is yes, then the market has just thrown up an opportunity to add to quality companies at more attractive prices. We took advantage of the severe volatility in October to add to quality companies Fisher & Paykel Healthcare and a2 Milk.

Notable Returns in the Quarter

MICHAEL HILL INTERNATIONAL	FLETCHER BUILDING	PUSHPAY HOLDINGS	RYMAN HEALTHCARE	SUMMERSET GROUP
-34%	-25%	-23%	-23%	-18%

Key Portfolio Movers

Mexican financial investor Finaccess made a partial takeover offer for 75% of **Restaurant Brands** (+7%) in October at $9.45 per share (24% above the previous close of $7.60). The offer is attractive as it is at a premium to our best case valuation, which implies strong value in future risky or unproven growth options, including expansion into the US, KFC in Hawaii, or Taco Bell in Australia (NSW) and New Zealand. Finaccess is a Mexican private equity fund that has a shareholding of almost 60% in AmRest Holdings SE, a large Polish-listed fast food operation that includes the Yum! brands KFC and Pizza Hut. AmRest appears to be a credible player. Any offer would be subject to the Overseas Investment Office and Yum! Brands approval. At $8.29, the share price is implying an approximately 50% probability of success, which in our opinion seems low. An alternative way of looking at it is assuming 100% probability of success, the 25% Finaccess is not bidding for, (the rump) is trading at an implied price of around $4.80 which is quite attractive. Restaurant Brands also announced during the quarter it is bringing Taco Bell to both NZ and NSW Australia. Taco Bell is a brand the company has sought in this part of the world for a long time and Taco Bell, under Restaurant Brands ownership, is trading solidly in Hawaii.

Infratil (+4%) had a very busy quarter. It sold its under-performing asset NZ Bus, it showcased its high-quality data centre assets CDC in Canberra to investors and analysts, it continued to negotiate the full take-over of Tilt with its partner Mercury, it announced major value accretive transactions at its Longroad investment and it reported a strong result. There are many reasons why Infratil continues to be one of the largest portfolio holdings, including the significant degree of upside optionality that the portfolio manager continues to drive into the Infratil portfolio. We travelled to Canberra during the quarter to visit Infratil's key growth asset, Canberra Data Centre (CDC) and came away very impressed with management, CDC's cost advantage in deploying data centres, and the ongoing growth in data centre demand. Demand for CDC's services is accelerating with CDC contracting space in unbuilt data centres faster than in the past.

Michael Hill (-34%) had an extremely poor quarter. The company announced first quarter 2019 financial year sales, which revealed a sharp -11% decline in same store sales growth (SSSG), as it

[1] Share price discount/(premium) to NAV (including warrant price on a pro-rated basis)
[2] Global Benchmark Index S&P Large Mid Cap/S&P Small Cap Index (hedged 50% to NZD).

cut back its practice of allowing store staff the autonomy to discount to close sales. This was only slightly offset by a modest improvement in gross margin (up by 1.5%, i.e. the gross margin increased from 63.1% to 64.6%). This move was part of its change in strategy to move away from price-based competition on generic product and towards more unique collections. We were very disappointed by the worse-than-expected decline. The company had previously advised that it expected a 5% to 6% SSSG decline, which would be offset by a 2.5% increase in gross margin. The company has flagged a greater promotional pipeline in the important December quarter, which is expected to improve results. We have almost halved the portfolio weighting in Michael Hill and we further cut the weighting in the December quarter, (as we are yet to be convinced that the new strategy is the correct one). The new CEO Daniel Bracken has an impressive CV and we look forward to meeting him in January.

Portfolio Exit

In October, we exited the portfolio position in **Abano Healthcare**. On-going disappointing same store sales growth from its Australian dental business (Maven) and limited margin improvement has meant Abano has been on watch over the last year and we have progressively been decreasing the investment. Two of the key attractions of a roll-up (the purchase of other similar small businesses), are the ability to take organic market share and the delivery of operating leverage via scale and Abano continues to struggle to deliver on both of these. As always, capital is precious and we have better uses for the capital currently.

Sam Dickie, Senior Portfolio Manager
18 January 2019

Performance
as at 31 December 2018

	3 Months	3 Years (annualised)	5 Years (annualised)
Company Performance			
Total Shareholder Return	(3.3%)	+12.0%	+10.5%
Adjusted NAV Return	(7.1%)	+10.7%	+10.8%
Portfolio Performance			
Gross Performance Return	(7.0%)	+13.2%	+13.4%
S&P/NZX50G Index	(5.8%)	+11.7%	+13.2%

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 21 December 2018

A dividend of 3.04 cents per share was paid to Kingfish shareholders on 21 December 2018 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 December 2018

LISTED COMPANIES	% Holding
Auckland Int Airport	5.6%
Delegat Group	4.0%
Fisher & Paykel Healthcare	13.4%
Fletcher Building	2.5%
Freightways	10.1%
Infratil	7.0%
Mainfreight	10.4%
Meridian Energy	3.0%
Michael Hill International	2.5%
Port of Tauranga	3.5%
Pushpay Holdings	2.0%
Restaurant Brands NZ	4.6%
Ryman Healthcare	6.1%
Summerset	5.7%
The A2 Milk Company	11.5%
Vista Group International	4.3%
Equity Total	**96.2%**
New Zealand dollar cash	3.8%
TOTAL	**100.0%**

KINGFISH
LANDING TOMORROW'S TROPHIES

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