KINGFISH

LANDING TOMORROW'S TROPHIES

QUARTERLY NEWSLETTER

1 April 2022 – 30 June 2022

Share Price	Warrant Price	KFL NAV	PREMIUM[1]
$1.54	$0.01	$1.35	14.0%

as at 30 June 2022

A stark divide between share prices and underlying earnings

Stock prices have fallen sharply, but the real-time earnings picture for most of our portfolio companies continues to hold up well.

As always, the market is forward-looking, but share prices seem to be factoring a fairly severe economic slowdown which we may not see. The onus is shifting to the bears to prove that a recession is imminent or already here – and, importantly, to prove that there are sharp corporate earnings cuts to come.

In a normal market, conventional wisdom is not to buy a company until near the end of the earnings downgrade cycle. In other words, investors should buy companies when the second derivative improves (that is, the rate of change in the growth rate begins improving). Say a company has a 10% earnings downgrade, and then another 10% earnings downgrade, and then a 5% earnings downgrade; with all else being equal, it would pay to buy around the time of the 5% earnings downgrade.

To be clear, we expect some of the companies in our portfolio will experience earnings downgrades as economic growth slows. However, given the yawning gap between share prices and real-time underlying earnings, a sharp slowdown is already at least partially priced.

Fund performance – a tough quarter for investors

Kingfish underperformed the local market in the quarter, with the gross performance falling -12.1% and the adjusted NAV return down -12.3%. This compares with the S&P/NZX50G index which was down -10.3%. We recognise this is a disappointing result.

However, we're seeing more attractive opportunities emerging than we've seen in some time.

Portfolio update – scant signs of a growth slowdown in corporate earnings so far

We're seeing signals across our portfolio that buck the slowdown trend. Here's how things are tracking across Mainfreight, Summerset, and Fisher & Paykel Healthcare.

Mainfreight shares fell during the quarter as concerns about a global economic slowdown overshadowed the strong result it announced at the end of May. The company is winning new customers on its superior service proposition and gaining business from existing customers in new regions.

Mainfreight beat expectations, noting at the time of the result that year-on-year growth continued into April and May. So we know the strong momentum from the 6 months to March 2022 has continued. Management acknowledged the murky outlook in May, but also had the confidence to say that, despite inflation and recession concerns, "we remain confident of continued growth and improving performance."

While management is unashamedly confident in Mainfreight's long-term prospects, they are wary of letting investor expectations get ahead of reality.

In the Transport division, the outlook was for volumes and organic growth to see "ongoing improvement in all regions." We think the share price fall to recent levels is now more reflective of a significant slowdown. It remains to be seen whether a slowdown that justifies this pessimism will actually materialise.

We know that Mainfreight's investment in the network and inbound enquiries from prospective customers currently bode well. Looking back in time, our analysis shows that, aside from the Global Financial Crisis (GFC), Mainfreight's own execution has had more influence on its performance than the economic climate. Even during the GFC, the New Zealand business was able to protect profits with adept cost management, as branch managers operated like business owners to tightly manage costs.

We think the Australian business is more mature now than it was back then and would show similar resilience, should economic activity slow. There are now experienced regional leaders in Europe and a strong focus on the US. In a milder slowdown, we expect the core Transport and Warehousing businesses will still be able to grow year-on-year.

Summerset has significantly underperformed the New Zealand Index in the year to date as investors are concerned about the local housing market, where the median house price is now 9% below the November peak.

The price buffer between retirement village units and local houses will help offset the impact from a softer housing market. Retirement village units are typically priced at a discount to local house prices. For example, in Auckland, 2-bedroom retirement units are 30% below local house prices. That gives operators scope to increase prices in a falling housing market. We saw this during the GFC, when Ryman increased unit prices 4% on average while national house prices declined 7%.

The divergence between Summerset's share price and its performance is particularly stark. Negative sentiment has punished Summerset's valuation, with the price-to-book ratio below 1.00 – its lowest ever. This is despite Summerset seeing a surge in demand, with sales increasing 25% in 2021. The March 2022 quarter was its second-best ever, even as Omicron peaked in New Zealand. Demand is supported by the "safe haven" status retirement villages attained through the pandemic, as operators are well-versed in disease control and prevented widespread outbreaks.

Longer-term, Summerset's growth is underpinned by an ageing population. New Zealand's population of over 75-year-olds is forecast to increase by 40% over the next decade – four-times the rate of overall population growth. Ryman and Summerset's "continuum of care" retirement village model is best placed to support the healthcare and accommodation needs of the growing elderly population.

While the deteriorating housing market presents a challenge to earnings, this is more than accounted for in the price., We feel Summerset offers compelling value, supported by a long runway for growth and excellent execution.

Fisher & Paykel Healthcare (FPH) finished the 2022 financial year below expectations, which weighed on its share price performance.

At its Investor Day, the company announced surprise new products which strengthen its longer-term growth runway. Two of these products, Switch and Trace, allow anaesthesiologists to make better use of its Optiflow high flow nasal oxygen system in this large and underpenetrated market.

The anaesthesia opportunity is estimated to be 50 million patients per year, and a $5 billion annual sales potential. This is the same size as FPH's hospital respiratory support segment, which has reached around $1 billion sales annually (and growing). The company spends over $150m annually on research and development to continue its long-term growth trajectory.

However, the market seemed to focus short-sightedly on softer sales in the wake of COVID. We're excited that others in the market have given this little attention. Of course, the opportunity to have hospitals fully utilise the large equipment base deployed through COVID remains a high priority, and the company is bolstering its sales force to drive greater usage.

Analyst expectations for sales in the Hospital division have been greatly reduced after sales finished the year at a suppressed run rate. Several factors led to weaker sales in early-2022: Omicron requires less hospital respiratory support than earlier COVID variants, hospitals have been reducing stock from above-average levels, seasonal flu was down in the March quarter, and elective surgeries were slow to resume. We increased our position size during the quarter.

Sam Dickie
Senior Portfolio Manager
15 July 2022

[1] Share Price Premium to NAV (including warrant price on a pro-rated basis and using the net asset value per share, after expense, fees and tax, to four decimal places).

SIGNIFICANT RETURNS IMPACTING THE PORTFOLIO DURING THE QUARTER

FREIGHTWAYS	DELEGAT GROUP	SUMMERSET GROUP	FISHER & PAYKEL HEALTHCARE	MAINFREIGHT
-26%	-21%	-18%	-17%	-17%

PERFORMANCE
as at 30 June 2022

	3 Months	3 Years (annualised)	5 Years (annualised)
Company Performance			
Total Shareholder Return	(10.7%)	+12.8%	+14.3%
Adjusted NAV Return	(12.3%)	+4.4%	+9.4%
Portfolio Performance			
Gross Performance Return	(12.1%)	+6.5%	+11.8%
S&P/NZX50G Index	(10.3%)	+1.2%	+7.4%

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 combines the share price performance, the warrant price performance, the net value of converting any warrants into shares, and the dividends paid to shareholders. It assumes all dividends are reinvested in the company's dividend reinvestment plan, and that shareholders exercise their warrants, (if they were in the money), at warrant expiry date.

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/

PORTFOLIO HOLDINGS SUMMARY
as at 30 June 2022

LISTED COMPANIES	% Holding
Auckland Intl Airport	8.7%
Contact Energy	2.0%
Delegat Group	2.9%
EBOS Group	1.5%
Fisher & Paykel Healthcare	15.2%
Freightways	3.2%
Infratil	16.9%
Mainfreight	18.5%
Meridian Energy	1.1%
Port of Tauranga	2.4%
Pushpay Holdings	1.7%
Ryman Healthcare	3.8%
Summerset	9.7%
The a2 Milk Company	5.5%
Vista Group International	4.0%
Equity Total	**97.1%**
New Zealand dollar cash	2.9%
TOTAL	**100.0%**

COMPANY NEWS
Dividend Paid 23 June 2022

A dividend of 3.16 cents per share was paid to Kingfish shareholders on 23 June 2022 under the quarterly distribution policy. Interest in Kingfish's dividend reinvestment plan (DRP) remains high with 41% 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.

FOREIGN TAX COMPLIANCE ACT (FATCA) AND COMMON REPORTING STANDARD (CRS)

As a result of the New Zealand Government agreeing to participate in the exchange of information with other jurisdictions under the Foreign Tax Compliance Act (FATCA) and Common Reporting Standard (CRS), Financial Institutions are required to undertake due diligence to determine the account holders' jurisdiction of tax residence. All shareholders will have received a Tax Residency Self-Certification form from Computershare depending on when they first purchased their securities. Please ensure you complete and return this important document if you have not already done so. For more information please visit the IRD website: https://www.ird.govt.nz/international-tax/exchange-of-information/crs/registration-and-reporting or contact Computershare if you are unsure of whether you have completed your form.

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