Pohutukawa

Manager AGM Report: Ross George,

Managing Director, Direct Capital

Investment Manager Pohutukawa I and Pohutukawa II

Wednesday 11th May 2016

Thank you once again for coming to Pohutukawa's 11th and Pohutukawa II's 7th Annual Meeting. For those of you who haven't been to one before, my name is Ross George and I am Managing Director of Direct Capital, and we are managers of both PI & PII funds in conjunction with Craigs Investment Partners. We, as the manager, report to the Board, and John and Maurice are the independent directors of that board.

There are many familiar faces here and I read the last AGM speeches and although positive, they were cautions too, so I thought this year I would branch out and deal with the highlights and issues rather than just run through all of the companies as I have done in the past.

I am reporting to you on our two current funds, PI and PII. Those two funds invest pro-rata and on the same terms as our two institutional funds Direct Capital III and Direct Capital IV. You will recall the objective was for Pohutukawa to mirror the institutional funds as best we could.

We at Direct Capital are involved in the investment and management of both funds and I would like to introduce the team that does that. And those that are here are

Mark Hutton, Tony Batterton, Gavin Lonergan, Travis Sydney, Andrew Frankham, Chris Wills, and Craig Prosser.

However, I know some of you will have specific questions on individual companies and we have allowed time at the end for that and I will get the Direct Capital company director to answer those questions.

The Highlights

In both funds you have received all your capital back, your preferred return of 8% pa and are now receiving 80% of the profits above that. We are proud of the returns over the last 11 years and we hope you are satisfied. It is easy to make high returns if you are willing to accept high risk positions such as highly leveraged investments, single customer investments, or very early stage or unprofitable businesses. The background to these returns is that we have invested in very secure, lowly leveraged, growing companies with what we think to be exceptional management who all have shareholdings like we do. Our companies in aggregate have a lower level of debt than the NZX companies in aggregate. Over the last two years (FY14 – FY16, while the focus has been on the portfolio), our portfolio companies have grown EBITDA by 17.5% pa, while the NZX 50 grew EBITDA at 9.5% pa.

We are fortunate in that we spend most of our time working with management growing these companies. You have heard on numerous occasions that Australia has been a great friend to Direct Capital, and almost all of our companies operate there when we make our investment or grow there following our involvement. New Zealand private companies by enlarge are very successful in Australia, and we have urged the press to stop promoting the myth that it is a graveyard for New Zealand.

On the contrary if you get Australia right, Sydney on its own doubles the size of your New Zealand market. It is a cheaper market to operate in as the 5 million people are all within an hour or so of the CBD. Logistics, advertising, promotion and recruitment are all much simpler exercises in a concentrated population market.

The 2014 Strategy

If you recall in 2014 we said we were struggling to find investments that we could put our hand on our heart and say we had found a good company at an appropriate price. The world was full of frothy forecasts and interest rates were forecast to drop. Corporates were struggling for growth so had decided to make acquisitions instead. This made it hard for us as a growth investor. The corporates and leveraged players were able to outbid us.

Happily, the strategy we formed of focussing on the investments we had and growing them and floating other businesses has paid off handsomely. The businesses we are in with the exceptions above, are going extraordinarily well and they are continuing to grow.

The private company investment market is very people heavy. The work that goes in to making an investment, managing it, growing it, effectively being the strategy and M&A executives in those companies, and realising them is an enormous multiple person job.

If I can just highlight the NZP process by way of example. Five years ago we received an unsolicited approach to buy our shareholding in the business. After a 4 month intensive process the approach didn't culminate to a transaction.

NZP is a specialty Pharmaceutical and chemical manufacturing business. It is highly specialised and understanding and valuing it is a difficult exercise that only a handful

of players can come to grips with. Its main manufacturing plant is in Palmerston North and has raw materials supply arrangements in a large number of countries and a large R & D operation in the UK. It is one of 2 manufacturers in the colic acid manufacturing industry in the world, (after the merger of 2 manufacturers in Europe).
We considered a possible float of this business as we believed in its strengths.
Because of its highly specialised nature and because of its 30 year relationship with a Japanese Wholesaler who represented approximately 30% of the sales, institutions did not take to it immediately. Ironically, from our point of view the entrenched Japanese market position was a strength and had been for 30 years for NZP.
There were suggestions that some of the customers for NZP's products should buy it, and we explored this avenue with them as we needed them on side to sell the business in any event. Those customers were in the US and Japan. In the course of the last calendar year, we had approaches and strong expressions of interest to buy the business.
You will see that a combination of those factors would have kept all of us at Direct Capital busy and 2 or 3 people almost full time for a period. That is in addition to advisers and NZP company executive's time. This was run primarily by Tony,
We continue to work on the remaining portfolio across Pohutukawa I and II, and hope to provide further distributions, with the first of which, likely to be from PI in the next 3 – 6 months.

Speech ends.

Questions and answers followed.

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