

***Ross George, Managing Director Direct Capital***

***Investment Manager of Pohutukawa I, II, and V***

***Tuesday 23 May 2017***

Thank you once again for coming to the Pohutukawa Annual Meetings. For those of you who haven't been to one before Direct Capital are managers of Pohutukawa I, Pohutukawa II & now also Pohutukawa V.

Firstly, to clarify any confusion, when we commenced fund raising late last year, we decided to call the third Pohutukawa fund Pohutukawa V, to coincide with the institutional fund numbering. So there was no Pohutukawa III or IV!

We, as the manager, report to the Pohutukawa Board for each fund. We will be discussing all 3 funds in this presentation

**We are**

- 23rd year of Direct Capital
- Pohutukawa I has now completed its 12<sup>th</sup> year
- Pohutukawa II has completed its 7<sup>th</sup> year and
- Pohutukawa V is only 5 months old.

I would like to introduce the Direct Capital executives here.

Gavin Lonergan, Heath Kerr, Travis Sydney, Jonathan Wong, Chris Wills, Marcus Beresford, Freddy Greenslade, Andrew Frankham CFO, Craig Prosser, Finance Manager.

We meet the Pohutukawa Board of Directors every quarter to discuss & report on fund performance, governance issues, the portfolio valuations, any matter outside the funds management agreement, investment criteria, any related party transactions.

The Board represents you as investors and is a good sounding board for us as Managers.

Today's meeting is designed for us to update you as investors.

We at Direct Capital are involved in the investment and management of all 3 funds.

For Pohutukawa V there are some changes:

Firstly, Heath Kerr who you may know was involved in Pohutukawa II has moved to Auckland after 13 years in Sydney. This is a huge boost to the Direct Capital team having him in NZ.

Jonathan Wong has also returned to NZ after 7 years in London in PE & infrastructure investment with a fund associated with Credit Suisse. Travis Sydney (another senior Direct Capital executive) and he worked together at FNZC before Johnny left on his overseas experience. Johnny is from Auckland & went to

Canterbury University. He is an Investment Director with a focus on new investments in Pohutukawa V.

Marcus Beresford is from the UK & is a business analyst. He has been involved in primary industries, wholesale fisheries, building products and of course has a network in the UK which we are increasingly using. More on that later.

Freddy Greenslade is in week 2 with Direct Capital as investment analyst. He is also from Auckland & went to Otago University. Freddy was at PwC in their treasury and corporate finance units. He is about the age and stage Tony Batterton was at when he joined Direct Capital from PwC, so has big shoes to fill.

We have 1 other Investment analyst, Chris Hickey joining us next month as well. Chris is currently a corporate finance analyst at Deloitte and has been for 5 years.

Two other very important executive role changes & they are obviously Tony Batterton & Mark Hutton.

Mark, one of the founders of Direct Capital moves to non-exec director & Investment Committee member. Tony who joined us when we were 3 years old, moves to non-executive but is still involved in Pohutukawa I & II companies. Both remain shareholders in the Pohutukawa V manager.

Mark & Tony's changes are significant milestones for Direct Capital. We had a very good office function to mark their contributions & also a larger more public acknowledgement at our recent Direct Capital Portfolio Company Conference. They felt the farewell functions were great but I don't think were up for 1 more here! Rest assured we acknowledge their exec contributions & I know you do too and therefore we will take this as read.

### **Fund structure**

Pohutukawa I, Pohutukawa II & Pohutukawa V invest pro-rata and on the same terms as Direct Capital III, Direct Capital IV, and Direct Capital V.

#### TOGETHER

- a. Direct Capital III – \$130m
- b. Direct Capital IV – \$325m
- c. *Direct Capital V – \$375m*

### **Fund performance**

I read the last AGM presentation and although positive, was cautious too, so I thought this year we would deal with highlights & issues in this section and all the companies separately and in questions later.

Pohutukawa I – 9/10 happy

Pohutukawa II – 8/10 happy

Pohutukawa V – only in our 5<sup>th</sup> month so too early to rate.

However, I know some of you will have specific questions on individual companies in these funds and we will answer them.

First of all the 2016 fund highlights. The fund metrics for Pohutukawa I and Pohutukawa II are:

<b>As of today</b>	Contributed	Returned	Companies remaining in portfolio
Pohutukawa I	\$53m	\$96m	2*
Pohutukawa II	\$51m	\$69m	6

These numbers exclude the Direct Capital institutional fund amounts.

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.

### **Risk/Return**

We are proud of the returns and we hope you are satisfied. It is relatively easy to generate high investment returns if you take high risk positions such as leverage, single customer investments, or early stage or unprofitable businesses.

The background to these returns is that we have largely invested in secure, lowly leveraged, growing companies with exceptional management who have shareholdings like we do in the company.

### **GROWTH**

Our companies are very much in growth mode so it follows that they have lower debt levels than the average NZX company.

Over the last 2 years, Direct Capital/Pohutukawa companies have grown EBITDA by 50%, while the NZX 50 grew EBITDA at 17%.

We have the view that not growing & creating momentum, is also a risk

**AUSTRALIA** Our view is that not expanding to Australia may also be taking a risk & we encourage expansion there. Heath's involvement in Pohutukawa V will be hugely beneficial in this objective.

You have heard on numerous occasions that Australia has been a great friend to Direct Capital.

NZ private companies by and large are very successful in Australia, & we have urged the media to highlight this & it is not a graveyard.

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

## **LONG TIMEFRAME**

Direct Capital & Pohutukawa are different to the buyout model we see in Australia – leverage &, IPO or sale in short time frames.

We have a different focus and can be quite long term in investments we like. NZP is a good example where we were owners for over 10 yrs, and in Direct Capital II we held PFC for nearly 17 years.

One of the positives of the Pohutukawa V fundraising is that early in a new fund we are able to take a long term investment time frame, considering investments which may span over a decade. This is particularly attractive to large employee owned companies, family companies and for assets which require a time frame of 10 years or so to yield the returns we seek.

We are clearly marketing this ability at the moment in the early stages of Pohutukawa V and it is a message being well received.

## **Pohutukawa I & Pohutukawa II Portfolio Changes in 2016**

During 2016 we:

- Floated NZKS,
- Placed the remaining Scales shares
- Placed the T&G shares held by George H Investments to an off-shore investor.

All were high value events for the funds.

## **Portfolio review - Pohutukawa I**

We started the 2016 year with a portfolio of 4 companies with a fair value of \$40.8 m.

In March we realised NZP & floated NZKS in Sept. Gross proceeds of imputed dividends and capital totalling \$37m were distributed, & at 31 Dec the residual value of Pohutukawa I is \$0.8 million. While it was a very successful year, the remaining two investments were not realised like we hoped they would be.

## **Portfolio review – Pohutukawa II**

We started the 2016 year with a portfolio of 6 operating companies & the GHI investments. They had a fair value of \$32.9m

In March we realised the residual shares in Scales & in Sept GHI realised the majority of its 10.4% shareholding in TGG Global.

Gross proceeds of imputed dividends and capital of \$11.6 million were distributed, & at 31 Dec the residual value of Pohutukawa II is \$25.2m.

We are very pleased with the performance during the year. Given the level of activity in 2016, we have made a conscious decision to prioritise EBIT & growth opportunities over M&A activity but remain opportunistically ready.

## **POHUTUKAWA V**

Turning to the current fund which is dominating our time and resources at present.

Firstly thank you to investors for supporting the compact 2 month fundraising process. We are fortunate that there is a significant overlap amongst P1, P2 and P5 investors. Despite this, due to unprecedented demand, many P5 investors faced substantial scaling of interest, which we accept is frustrating. We advise that our Institutional investors were also heavily scaled.

The PE fund structure & funds management environment has been changing for our entire 23 years & we have moved in many respects to reflect that in Pohutukawa V.

The benefits to us both are significant, in that the Pohutukawa V structure allows us to spend more time investing & less in funds management tasks. You have a more investment focussed management team & of course the financial benefits of the adjustments creating lower fees. We are delighted with the position we reached.

As we speak we are working very hard on 3 opportunities and have 3 term sheets out to those companies. 3 at a time stretches our resources but we have always had the ability to use associates and professional advisors. We are currently using both.

In addition to completing near term investments, we continue to remain involved with the 833 private co's in NZ which meet Pohutukawa V investment criteria. In addition Heath in particular is active on Australian opportunities.

This is a pleasurable part of our job as people we invest with are very solid grounded individuals albeit in the absolute top wealth realms

We are keen to invest conservatively but aggressively over the next 2 years while our fund has a long runway and we are able to lock in what we perceive to be long term funding at attractive rates.

We are tending to focus on longer term stable businesses which we believe will be more immune to global shocks, the potential for which we believe has increased.

Our long term theme of primary industry production, particularly food to Asia remains live.

We believe the opportunity of Britain will increase during Pohutukawa V's life and

We continue to believe that export growth represents strong diversified, safe growth. This as you know has been our belief and focus for 23 years.

We are in turbulent times with stock markets trading high & Central/retail banks with historically low interest rates

### **Conclusion:**

Thank you for joining us. We are pleased with the financial returns Pohutukawa I and II have delivered to Shareholders, and remain committed to the remaining companies, whilst focusing our resources on sourcing new investments for Pohutukawa V. We expect to be back to you shortly with P5 investment drawdowns.

THANK YOU

