SALT
Funds Management

Salt NZ Dividend Appreciation Fund Fact Sheet – September 2018

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees which specialises in managing NZ/Australian equity and listed property mandates for wholesale and retail clients.

Investment Strategy

The Salt NZ Dividend Appreciation Fund targets a portfolio of shares of New Zealand companies that may, in our opinion, pay high and sustainable dividends. A considerable body of robust research suggests that stocks with strong and sustained dividend policies tend to generate higher free cash flow than average and outperform their index benchmarks over time. The strategy is not intended to naively generate the highest possible yield but rather to generate a high and sustainable dividend yield.

Fund Facts at 30 September 2018

Benchmark	S&P/NZX 50 Gross Index
Fund Assets	$72.8 million
Total Strategy Assets	$154.6 million
Inception Date	30 June 2015
Portfolio Manager	Matthew Goodson, CFA

Unit Price at 30 September 2018

Application	1.4576
Redemption	1.4516

Investment Guidelines

The guidelines for the NZ Dividend Appreciation Fund are shown below:

NZ shares	95% – 100%
Cash	0% – 5%
Unlisted securities	0% – 5%
Maximum active position	8%

Target investment Mix

The target investment mix for the Salt Dividend Appreciation Fund is:

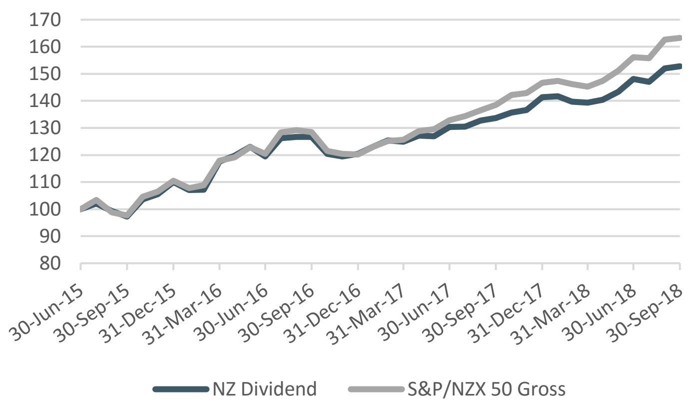
Australasian Equities	100%

Fund Performance to 30 September 2018

Period	Fund Return	Benchmark Return
1 month	0.55%	0.41%
3 months	3.13%	4.56%
6 months	9.62%	12.41%
1 year	14.29%	17.91%
2 year p.a.	9.82%	12.71%
3 year p.a.	16.25%	18.69%
Inception p.a.	13.93%	16.29%

Performance is after all fees and does not include imputation credits or PIE tax.

Cumulative Fund Performance to 30 September 2018



Fund performance has been rebased to 100 from inception.
Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Fund Allocation at 30 September 2018

NZ shares	97.84%
Cash	2.16%

Top Overweights	Top Underweights
Investore Property	Ryman Healthcare
Turners Automotive Group	EBOS Group
Scales Corporation	Infratil
Tower	Mainfreight
Metlifecare	Auckland Intl Airport

SALT FUNDS MANAGEMENT
Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143
P: +64 9 967 7276 | E: info@saltfunds.co.nz | www.saltfunds.co.nz

Quarterly Equity Market Commentary

Summary

- The Fund lagged its benchmark for the quarter, returning +3.13% compared to +4.56% by the S&P/NZX 50 Gross Index.
- The NZ market had a stronger quarter with the S&P/NZX50 Gross surging +4.6%, bringing the market up +11.3% for the first 9 months of the year.
- Tailwinds were headed by our underweights in Sky TV, Tourism Holdings & Push Pay.

Global markets surged +5% over the September quarter, as measured by the MSCI World Accumulation Index, largely driven by the US as most markets besides Japan were notably weaker.

Propelled by a good earnings season, continued growth in non-farm payrolls and low unemployment, US stocks largely shrugged off the China-US trade wars and performed well over the quarter. The S&P 500 hit an all-time high on the 20th of September before retracing a tad to end the month up +0.4% and +7.7% for the quarter. The tech heavy NASDAQ did similarly well posting a strong 7.1% return over the quarter. The Federal Reserve hiked the funds rate target range by 0.25% as expected and reiterated confidence in hiking once more in December and three hikes in 2019. The 10-year US Treasury yield ended the quarter at 3.06%, slightly below the high of the year at 3.12% during September.

During the quarter the UK central bank lifted rates, while Theresa May saw her most recent Brexit proposal rejected by the EU, raising the prospect of a no-deal Brexit. The FTSE 100 ended the quarter down -0.7%. European markets were roiled by US tariffs on Turkey with heightened fears of a hit to European banks that had funded Turkish Lira earners in foreign currency denominated debt. Germany's DAX 30 ended the quarter down -0.5% while France's CAC 40 posted a solid +3.4% return.

Affected by the US-China trade war and the prospect of lower growth rates, the Hong Kong Hang Seng ended the quarter down -4.0%. The principal Chinese index, the Shanghai Composite fared slightly better at -1% for the quarter as the Government signalled new measures late in the quarter to help stimulate local demand and maintain growth rates. Japan's Nikkei 225 posted a strong result +8.1% for the quarter.

The Australian S&P/ASX 200 Accumulation index returned +1.5% after a negative month in September. It was an eventful quarter where the market multiple expanded through reporting season as the index climbed despite analysts revising forecasts downwards on average, former Prime Minister Malcolm Turnbull was replaced by Scott Morrison, and the Royal Commission continued to weigh on Banks and Financials. Morrison also announced a Royal Commission into aged care, sending exposed stocks down around -20%.

The NZ market had a stronger quarter with the S&P/NZX50 Gross surging +4.6%, bringing the market up +11.3% for the first 9 months of the year. During the quarter EBO (EBO, +24.2%) surged on a new Chemist Warehouse deal, Chorus (CNU, +14%) on a good result, and Ryman (RYM, +17%) on no news despite a deteriorating housing market backdrop, whilst the worst performers were Sky TV (SKT, -11.4%) after disclosing continued loss of subs and Tourism Holdings (THL, -14.6%) after disappointing outlook comments and bigger than expected losses in TH2.

Quarterly Fund Commentary

The Fund lagged its benchmark in the quarter, returning +3.13% after all fees and expenses compared to +4.56% by the S&P/NZX 50 Gross Index.

It was something of a perfect storm for an income and value focused strategy with a small group of extremely expensive large cap companies accounting for the great bulk of the benchmark's performance. NZ's one year forward PE rose from a high 24.7x to an extraordinary 26.4x (using FNZC data) due to a combination of the market advance and earnings downgrades for 2019. Analysis by JP Morgan in the Australian context showed how the top quintile of stocks with the most expensive PE multiples experienced a PE multiple expansion in August of 4.2 PE points despite EPS downgrades of 3.9%. Contrastingly, the bottom two quintiles of the cheapest 40% of stocks saw little valuation movement.

Contributors

Tailwinds were headed by our overweights in Methven (MVN, +15.4%) and Scales (SCL, +7.8%). MVN benefitted from a solid result and it rose sharply when the large shareholder, Brendan Lindsay upped his stake. SCL delivered a sound interim result and it is benefitting from the weakening NZ$. We await details of how they will reinvest the proceeds from selling their cool-store business at a very attractive price. This could potentially be highly accretive. The weaker NZ$ is a key theme behind several portfolio holdings.

Detractors

A large proportion of the Fund's lag came from its large underweight in the low yielding Ryman Healthcare (RYM, +17.0%), which caught a powerful offshore bid in line with many other high multiple stocks. It saw an unusual +2.6% increase on the last day of September and +1.4% at end-August. Directors and management sold shares and the actual fundamental news regarding the NZ housing market has been mediocre, with numerous negative measures yet to hit. Melbourne house prices are outright falling according to Corelogic data and Ryman's AGM in late July talked to cost pressures from nurse wage increases. Competitor results from Summerset and Metlifecare were solid enough but did show signs of rising inventory levels, which dovetails with aggressive marketing incentives and promotions being particularly aggressive at present.

The other headwind of note was having no holding in Ebos Group (EBO, +27.3%) which rose sharply on winning the large trans-Tasman wholesale supply contract with Chemist Warehouse off Sigma Pharmaceuticals. Given Sigma's claims that the contract was struck at sub-economic levels and a degree of uncertainty existing around the exact terms for EBO, the enthusiasm of the market was surprising. EBO's forward PE ratio of 21.8x appears aggressive for a business that has an EBIT margin of circa 3%.

Other headwinds came from underweights in Auckland International Airport (AIA, +7.7%) and Trade Me (TME, +21.8%). Overweights in Turners (TRA, -6.3%) and Evolve Education (EVO, -15.5%) also hurt. TRA did reiterate guidance at their AGM late in the quarter, while EVO saw the highly successful Australian entrepreneur, Chris Scott buy a 19% stake.

Positional changes over the quarter saw corporate actions used to buy modest positions in Steel & Tube and Oceania Healthcare at attractive prices. A half-position in Trade Me was purchased near its lows and prior to its sharp increase post-result. The remaining holding in Restaurant Brands was sold as it hit new share price heights despite potential headwinds from higher fuel prices and a slowing economy. Pullbacks were used to lift Freightways, NZ Refining and Summerset, while strength was used to lighten Spark and Contact Energy.