Pohutukawa

Manager Report: Ross George,

Managing Director Direct Capital

Investment Manager of Pohutukawa I and Pohutukawa II

Tuesday 13 May 2014

This presentation was given at the Pohutukawa I & II Annual Shareholders Meetings on Tuesday 13th May 2014.

This is the investment Management presentation for both PI and PII

PI has finished its investment horizon and is now looking to crystalise value in its 5 remaining companies.

PII is actively investing in new companies and will do so until the end of the investment period this year.

In both funds we continue to be active in growth initiatives and particularly follow on investments for the portfolio companies.

Follow-on investments in all the companies are a key focus for us.

<u>What we Do</u>

You often hear of us or from us when we make a new investment. Ironically that is a small part of how we spend our time. We spend a lot of time studying industries we should invest in.

We rule in and rule out industries as a result of those studies.

People approach us with opportunities.

We visit companies on a weekly basis.

When we do invest in a company, that sets a whole new growth direction in work load for us and the company.

We have board representation on all the companies we invest in.

We help management on finance and strategy matters.

We study and meet people in their industries.

We assist when they make acquisitions or expand to Australia and most of our businesses become trans-Tasman.

So work post investment is often where the value add occurs.

The businesses we float for example may be quite a lot larger than the one we invested in.

These growth initiatives post initial investment use up the bulk of our time.

The key matters since we last met:

Pohutukawa I

NZKS & NZP now represent 75% of the portfolio

NZP has commenced its plant upgrade increasing capacity by 30%.

Successful NZ King Salmon appeal processes have resulted in 3 new salmon farms with 30 year leases increasing capacity by 70%. This was vital to NZ King Salmon as water space is impacting most global salmon producers. NZKS management is confident of the domestic and export demand for its premium Chinook Salmon.

Pohutukawa II

Two distributions (May 2013 and November 2013 7cps or $5.8m

Pohutukawa II has been investing in the GFC downcycle at sensible prices which became abundantly clear to us during the course of 2013.

Recent investment activity:

Transaction Services purchased two businesses in the UK recently. Replicating its current business in the UK through acquisition and providing an entry into the European direct debit market.

The Bayleys purchase of the asset management business of NZX listed Augusta. This means they manage the physical building assets and handle leasing and sales as well.

The Investment into Energyworks completed in January this year.
Management fees were reduced in March 2014 to being based on invested capital levels which is approximately a 40% decrease.

Heath Kerr has joined Direct Capital and re-established our Sydney presence.
A summary of the current position for the two funds respectively is:

In Pohutukawa I – the 5 portfolio companies are continuing to execute their game plans and Direct Capital is working with management to crystalise value. We continue to support each company with additional growth capital which we have recently done in Rodd & Gunn and Stratex;

In Pohutukawa II – it now has 7 portfolio companies. This portfolio is proving to be, in our view, a very successful group of companies. Our challenge has been to add new companies to this portfolio without diluting the quality of what we have. We have found some great companies but you will know from your experience in the listed markets that values skyrocketed during 2013.

You will recall that we are trans-Tasman investors. Australia is not currently enjoying the positive sentiment that we have here and values reflect that, and so we are spending increasing amounts of time in Australia looking for new companies and adding to those we have.

We are very pleased with the makeup of the Pohutukawa II portfolio to date. It represents a broad cross section of New Zealand industry whilst also having extensive exposure to offshore markets.

48% of the portfolio is in the two largest investments - Transaction Services and Scales - with the remaining 52% reasonably evenly spread among the other four.

Scales is a diversified group involved in horticulture and other industries servicing the primary sector. Its operating businesses can be classified into

Horticulture – encompassing the Mr Apple brand

Storage and Logistics (cold store and bulk liquid stores) and

Food ingredients.

The property and investment element of Scales has been demerged into a separate entity called George H Investments Limited. Scales is leveraged to the growing agri and food sectors of the New Zealand economy. The company has completed a successful year and has exceeded its internal targets. As a result Scales declared its first dividend during our ownership which was included in the Pohutukawa distribution in May 2013. The current financial year is also tracking well, with the important apple crop now successfully harvested.

Within Transaction Services, the company has expanded in the UK with two recent acquisitions. The UK acquisitions represent a substantial move into the UK market. We have secured a strong business and management group in the UK. The Australian and New Zealand businesses continue to operate and grow profitably.

DebitSuccess had some notable contract wins in new sectors such as optician retail and TV shopping.

Hiway is involved in creating strong substructures for roads. It is heavily involved in remedial ground works in Christchurch and in Queensland. The company has completed a very successful year bedding down its Christchurch and Queensland expansion. Its focus now is to grow from these established bases and to make sure Australia continues to be a meaningful contributor to the Group.

Bayleys grew revenues and earnings in 2013 and had a very successful year. In addition it has continued it's organic and acquisition growth strategy with the largest of these being the asset management business I mentioned previously. Bayleys now manage 690 buildings in NZ.

Cavalier Wool Holdings continues to support the consolidation within the industry and is continuing to pursue this strategy. The company continues to pay frequent imputed dividends to shareholders.

The outlook for sheep numbers is reasonably constant at approximately 31m. The vast majority of course wool is processed here rather than in China and the industry as a whole has done well to ensure this is the case.

During the year we experienced price decreases from one of the core by-products of the scouring industry namely wool grease. It is a little known fact that a lot of wool grease is further refined into aquaculture feed, and in particular, into prawn food. It is also little known that the prawn industry has been on a significant downer over the last 12 – 18 months and this has been a large contributor to wool grease price decreases.

Since our investment in PF Olsen in late 2011, the company has secured two significant forest management contracts in Australia, which when fully planted, will represent a substantial increase in forestry managed hectares. PF Olsen has increased its number of employees in Australia from 5 to 30 in the time we have been a shareholder. And in New Zealand, the company continues to take a leadership position in all aspects of forestry management, and in particular health and safety in the forestry industry.

Energyworks is NZ's leading provider of mechanical services to the on-shore gas and petrochemical industry. We are very pleased to add the company to the Pohutukawa II portfolio.

We have continued the steady growth in New Zealand and continued to look at off-shore opportunities. There is always some pricing volatility in the forestry industry but the company believes the medium term outlook for log prices to be very sound.

Investment outlook

Pohutukawa II continues to look for new investments.

I should reiterate at the outset the portfolio Pohutukawa II has invested in is a very good well balanced portfolio, so the bar for new investment is set very high. The fund is currently 57% drawn and are targeting 2 new investments in the balance of this year.

We are looking at sustainability of earnings and valuations and weighing those up with opportunities. It is a balancing act, but we are holding our stringent investment criteria intact at the moment and I should say, with the full support of your board.

Pohutukawa II has received strong distributions of earnings and capital from the existing portfolio, and we would expect this to continue. Having said that, we have recently invested in 2 reasonably sizeable businesses in Transaction Services and as a result of those growth initiatives, TSL distributions will be curtailed until we have bedded those in.

We continue to measure investments on their ability to make distributions to shareholders and substantially lift value.

We are growth investors, enhancing dividend flows and creating value. We invest in a longer term than a number of other private equity funds. There is an opportunity for the LBO investors to buy businesses, leverage them and sell them on reasonably quickly at good gains. This is not our style but also not the risk profile we put to you when we raised the fund.

Each of the investments we have made have very real add-on or bolt-on acquisition opportunities. When we trace back our investment performance a substantial amount of the gains we achieved was through this activity.

You have all seen the stock markets take off over the last couple of years. This probably helps increase the value of our existing portfolio and probably inhibits our investment activities. We are always aiming to look through current cycles in the business and current valuation cycles because we know we have a longer hold period.

New Zealand is looking very good at a macro level but pricing of assets is reflecting that. Australia is not so buoyant at the moment and pricing is also reflecting that. It makes sense for us to look at a number of add-on acquisitions for our existing portfolio in Australia and we have been quite active in that area in the portfolio.

You may recall that Pohutukawa retains 25% of its capital for follow-on investment into the existing portfolio.

Private Company Investment Environment

Like all industries the landscape in our investment area is changing too, and it is important that we are thought leaders and influencers in how our industry evolves.

Arguably there is over exuberance to invest at the moment.

We continually consider new investment and funding strategies to operate successfully in our industry.

What are you looking at?

Manufacturing and services will always be a part of any Direct Capital portfolio.

There are large/mega industries in NZ often in the primary sector, eg Dairy, Forestry, Horticulture and Infrastructure services.

The core businesses in those sectors often have production risk, are property based or are too big for Direct Capital – Fonterra for example. But there are high value add high margin spinoffs around those large industries that we can invest in and still be part of large industries.

We will continue to hunt around these satellite industries servicing these large industries.

It looks like interest rates will rise but we have always had a policy of covering our interest rate risk and ensuring our facilities have good longevity. At the moment our average interest rate cost is 7.1%.

The Manager's focus for new investments will continue to be on profitable privately owned New Zealand and Australian companies with good management teams. We continue to pursue our established investment approach to make sound investments with your funds. We will remain cautious in our approach to new opportunities.

We continue to believe that our existing portfolio companies are well placed to continue to perform well, and continue the level of distributions Pohutukawa investors have become used to well beyond 2014, albeit recognising 2013 was a very good year.

A further distribution in Pohutukawa II is being made 23 May 2014, totalling 3cps

Thank you for your continued support and we look forward to continuing to provide you with the financial returns you have come to expect from Pohutukawa.