Quarter Update Newsletter

1 October 2018 – 31 December 2018

marlin
growing globally

MLN NAV	SHARE PRICE	WARRANT PRICE	DISCOUNT[1]
$0.86	$0.83	$0.05	1.7%

as at 31 December 2018

I am currently on a research trip to China, digging into some potential investment ideas and keeping up with the state of play in the Chinese economy. As it turned out, China was the worst performing global share market in 2018, and perhaps the timing of my trip is fitting given these difficult market conditions have recently spread well beyond China. In the most recent quarter we have witnessed significant declines in most global share markets, and while market volatility can be unsettling, it can also offer up attractive investment opportunities. This is why I decided to travel to China so early in the new year.

Throughout most of 2018 Marlin's only investment in China was Alibaba, (the world's largest ecommerce platform) which we have held since 2015. However, we used market weakness in the fourth quarter to add a second Chinese investment to the Marlin portfolio, Tencent Holdings, (the social media and gaming giant) which we discuss in more detail below.

Review of markets

In the December quarter, global equity markets recorded the worst quarterly performance since 2011, with our global benchmark falling 15.2%. The declines have been caused by weaker global economic data, ongoing US-China trade tensions, and interest rate hikes by the US Federal Reserve spurring concerns that economic growth may have peaked. Against this backdrop the Marlin portfolio delivered a gross performance loss of 15.6% broadly in line with the broader market in the fourth quarter.

Market declines in the fourth quarter resulted in all major global equity markets ending the year in negative territory. For the calendar year, the US market performed the best, falling only 6.2%, while China (-24.6%) was the worst performer having been hit by both slowing economic growth and trade concerns. Whilst it was a challenging year in many respects, the Marlin portfolio held up significantly better than the broader market, with gross performance of 0.4% in the 12 months to 31 December 2018, compared with our global benchmark which fell 8.4%.

Our take on market volatility and the current investment opportunity set

With the declines we have seen in the most recent quarter, it is clear that some investors are getting jumpy. Newspaper headlines echo this sentiment and warn that further losses may be looming. The extreme volatility we have seen in US share markets since mid-December, (with markets often down 2% to 4% one day, and up 2% to 4% the next day) is a helpful reminder of the futility of trying to guess where markets may go next week or quarter. At times like these it is more important that investors monitor what is in their control - their behaviour - and make sure investment decisions aren't clouded by emotions and are made adopting

Notable Returns for the Quarter in local currency

CORE LABORATORIES	FRESENIUS MEDICAL CARE	ELECTRONIC ARTS INC	LKQ CORPORATION	DESCARTES SYSTEMS
-49%	-38%	-35%	-26%	-23%

long-term thinking. While the share market has delivered strong returns for investors over the long run, the market has always been characterised by periods of solid returns, punctuated by periods of stress and volatility.

What allows some investors to generate better long-term performance than the pack is not somehow magically avoiding periods of higher volatility, but holding the right companies in their portfolio over the long-term. Disciplined investors can benefit from heightened volatility and the knee-jerk reactions of other investors.

We believe the steep declines we have seen in certain parts of the market have materially improved the investment opportunities that are currently available. While the market has fallen on growth concerns, the global economy continues to grow and some companies are benefitting disproportionately. As I write this from China (where the economy has slowed), consumers are still seeing their living standards improve and are out spending. In fact, retail sales in China are growing at double the rate of more developed countries. Chinese ecommerce companies, like our portfolio company Alibaba, are growing even faster as consumer spending moves online.

In the recent market correction many high growth stocks have fallen by more than the market, and this creates an interesting dynamic in our opinion. Since 2005 almost all corporate earnings growth globally has been driven by the technology sector. This means that there are large parts of the market (like consumer staples and utilities) where companies aren't really growing much at all. Despite this, nervous investors have been piling into these defensive sectors in recent months to take cover. We believe this short-term behaviour has left a number of the growth companies we follow attractively priced relative to their earnings prospects. Examples in our portfolio that we have added to recently include Alphabet (Google's parent company), TJX Companies, MasterCard, Alibaba and PayPal.

New portfolio holding

Another example of an opportunity being presented by market turbulence is Chinese company **Tencent Holdings**. Tencent is a company we have followed for quite some time, but it has often been fully valued. Recent weakness in the Chinese market finally

[1] Share price discount/(premium) to NAV (including warrant price on a pro-rated basis)

gave us the opportunity to add Tencent to the Marlin portfolio at an attractive price, (with its share price having falling more than 40% from its peak).

Tencent is China's largest online gaming company and leading social network, with leading positions also in digital payments, music & video streaming, and cloud computing. Tencent's WeChat app is the largest social media and messaging platform in China, with over a billion users on the platform and average usage of over an hour per day. WeChat provides much broader functionality than western social media platforms. In addition to providing a Facebook equivalent newsfeed, WeChat also allows users to read the news, shop online, check bank balances, pay utility bills, watch videos and make in-store & online payments.

Tencent also has a dominant position in the Chinese online gaming market, with over 55% market share. It distributes a mix of its own titles and licenced third party content and has built up a number of strategic partnerships with global gaming companies, (including EPIC, the publisher of hit game Fortnite).

Its online gaming and social media businesses are highly cash generative and this cash flow is being reinvested in new growth areas including its video and music streaming services (like Netflix and Spotify) and its mobile payments business Tencent Pay (like PayPal). Tencent also recently announced its collaboration with Paramount Pictures on two new up and coming films, Bumblebee and Top Gun. Tencent is run by its visionary founder Pony Ma, and we see many years of growth ahead.

Ashley Gardyne
Senior Portfolio Manager
Fisher Funds Management Ltd
18 January 2019

Performance

as at 31 December 2018

	3 Months	3 Years (annualised)	5 Years (annualised)
Company Performance			
Total Shareholder Return	(10.6%)	+9.3%	+10.4%
Adjusted NAV Return	(16.2%)	+5.6%	+6.2%
Portfolio Performance			
Gross Performance Return	(15.6%)	+9.1%	+9.7%
Benchmark Index[1]	(15.2%)	+6.9%	+9.2%

[1] Benchmark index: World Small Cap Gross Index until 30 September 2015 & S&P Large Mid Cap/S&P Small Cap Index (hedged 50% to NZD) from 1 October 2015

Non-GAAP Financial Information

Marlin 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 fees and tax,*
- *adjusted NAV return – the net return to an investor after fees and tax,*
- *gross performance return – the Manager's portfolio performance in terms of stock selection and currency hedging before fees and tax, and*
- *total shareholder return – the return to an investor who reinvests their dividends, and if in the money, exercises their warrants at warrant maturity date for additional shares.*

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 Marlin Non-GAAP Financial Information Policy. A copy of the policy is available at http://marlin.co.nz/about-marlin/marlin-policies/

Company News

Dividend paid 21 December 2018

A dividend of 2.07 cents per share was paid to Marlin shareholders on 21 December 2018, under the quarterly distribution policy. Interest in Marlin's dividend reinvestment plan (DRP) remains high with 40% 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.

Portfolio Holdings Summary

as at 31 December 2018

Headquarters	Company	% Holding
Canada	Descartes Systems	2.4%
China	Alibaba Group	5.7%
	Tencent Holdings	3.5%
France	Essilor International	3.4%
Germany	Adidas	3.1%
	Fresenius Medical Care	3.4%
Ireland	Icon	3.0%
United States	Abbott Laboratories	3.2%
	Alphabet	7.9%
	Cerner Corporation	3.5%
	Cognizant Technology Solutions	3.6%
	Core Laboratories	1.8%
	eBay	2.4%
	Ecolab	3.7%
	Edwards Lifesciences	2.4%
	Electronic Arts	3.4%
	Expedia	2.8%
	Facebook	4.0%
	Hexcel Corporation	3.9%
	LKQ	3.3%
	Mastercard	5.0%
	PayPal	6.3%
	Signature Bank	3.7%
	TJX Companies	5.0%
	United Parcel Service	2.5%
	Zoetis	2.4%
	Equity Total	**95.3%**
	New Zealand dollar cash	1.5%
	Total foreign cash	0.9%
	Cash Total	**2.4%**
	Forward foreign exchange contracts	2.3%
	TOTAL	**100.0%**

marlin
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