Quarter Update Newsletter

31 March 2019 – 30 June 2019

marlin
growing globally

MLN NAV	SHARE PRICE	DISCOUNT[2]
$0.96[1]	$0.90	6.1%

as at 30 June 2019

Market Overview

Global equity markets notched up solid gains in the June quarter despite a brief interruption in May when President Trump escalated trade tensions with China. The rally in the US propelled the S&P 500 Index to record highs during the quarter and its best first half year in 22 years. Stocks rose despite mounting fears of an economic slowdown, with markets taking comfort from accommodative comments from Federal Reserve Chair Jerome Powell who said he is monitoring trade developments and prepared to cut interest rates if the environment deteriorates. An agreement at the G20 summit late in the quarter between President Trump and Chinese President Xi Jinping also soothed markets as they committed to get the troubled trade talks back on track.

Marlin had gross performance of +5.2% for the June quarter, while the adjusted NAV return was +4.5% and the benchmark return was +3.5%.

Market exuberance

Despite the muted global economic backdrop, we are starting to see signs of excess in parts of the market, driven in part by lots of capital chasing returns in a low interest rate environment.

The US initial public offering (IPO) market has sprung to life in recent months. A host of new listings has seen a group of unicorns (start-ups with a $1 billion+ valuation) including Uber, Lyft, Beyond Meat and Luckin Coffee list on the stock market. A busy IPO schedule can highlight investor over exuberance, with owners of these businesses taking the opportunity presented by elevated valuations to sell shares and take money off the table. One of the common threads in many of these IPOs is that the businesses are generally still loss-making and some are yet to prove they have a viable business model. The percentage of loss-making US IPOs is now back to levels seen in 1999.

There are areas of risk-taking and excess in other parts of the equity market as well. We have been witnessing increasing debt levels in certain sectors, with companies borrowing to fund acquisitions or simply to repurchase shares. One side-effect of the scramble for yield by investors is that some corporates are playing the game of borrowing money in order to pay unsustainable dividend yields, which can be rewarded with a higher share price (at least temporarily). This has led to high debt levels among smaller businesses and in low growth sectors like manufacturing and retail, as a lack of organic growth forces them to take elevated risks. On the other hand, many of the largest and most profitable businesses like Apple, Microsoft and Visa have little or no debt.

The hunt for yield has also driven some of the traditional defensive parts of the market, like utilities and consumer staples companies, to valuation levels that we think are extreme.

Notable Returns for the Quarter in local currency

ADIDAS	CERNER CORPORATION	ESSILOR-LUXOTTICA	HEXCEL CORPORATION	CORE LABORATORIES
+27%	+24%	+20%	+17%	-28%

All of these dynamics mean investors really need to pick their spots in the current market. We believe that longer-term it will pay to avoid the excesses we are seeing in the IPO market. We also believe investors should avoid companies that are simply growing by borrowing at low interest rates and investing in questionable projects or repurchasing shares. To make matters even more complex, investors should be wary of some of the more highly-priced consumer staples and utilities stocks, as their defensiveness may prove illusionary at these high valuation levels. After a 10 year bull market there are clearly some areas of exuberance investors need to navigate carefully.

Portfolio positioning and recent changes

Despite the difficult market backdrop, we are comfortable with the portfolio and how it is positioned. Most of the companies in our portfolio are high quality businesses with limited or no debt. They are also generally experiencing steady organic growth and have valuations that we view as reasonable.

As discussed in last quarter's newsletter we are spending more of our time looking for businesses with defensive characteristics given we are getting further through the economic cycle. At the margin we are trying to add more of these businesses to the portfolio and reduce our exposure to our more cyclical investments.

We added US discount retailer **Dollar Tree** to the portfolio during the quarter, which fits firmly with this theme. Dollar Tree sells a mix of everyday products at a fixed price of $1, with the catalogue including items ranging from bread and eggs, to pencils and plastic cups. The company caters to low and middle-income consumers with stores normally placed close by a Walmart or a grocery store to help drive store traffic. Dollar Tree still has significant room to roll out stores across the US and we like its counter-cyclical properties, which were exhibited when the business continued to grow in the GFC despite the difficult retail environment.

To make room for Dollar Tree we sold our holding in online travel agent **Expedia**. While we still think Expedia is a well-run company in a growing industry, its business is highly cyclical and it also faces continued risks from Google pushing further into online travel booking.

[1] As at the date of this Newsletter the Marlin Global year end NAV has yet to be audited, and therefore it may change.
[2] Share price discount/(premium) to NAV.

Another change we made to the portfolio was to switch one of our current software holdings, **Cerner**, for another US software player called **Tyler Technologies**.

Tyler Technologies is the leading provider of software to the local government sector in the US. The specialised nature of this software has resulted in hundreds of regional software players that provide some solutions, but none with the broad coverage and scale of Tyler (ERP, finance, billing and collection, HR, payroll, justice/courts, public safety, appraisal and tax).

Local authorities are well behind the software adoption curve in the US and two-thirds of local authorities are still maintaining old in-house systems or using legacy systems that are no longer supported by competitive vendors. Most of these government entities will need to upgrade over the next 10 years and drive steady growth for Tyler. Despite being the industry leader, Tyler only has 13% market share and we see continued market share gains and margin expansion over the long term.

Tyler has a longstanding management team and a great track record, having grown revenue at close to 15% per annum and earnings per share by over 20% per annum over the last decade.

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

Performance

as at 30 June 2019

	3 Months	3 Years (annualised)	5 Years (annualised)
Company Performance			
Total Shareholder Return	+12.0%	+15.3%	+11.8%
Adjusted NAV Return	+4.5%	+15.4%	+10.6%
Portfolio Performance			
Gross Performance Return	+5.2%	+19.5%	+14.5%
Benchmark Index[1]	+3.5%	+12.5%	+12.5%

[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 27 June 2019

A dividend of 1.95 cents per share was paid to Marlin shareholders on 27 June 2019, under the quarterly distribution policy. Interest in Marlin's dividend reinvestment plan (DRP) remains high with 39% 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 30 June 2019

Headquarters	Company	% Holding
Canada	Descartes Systems	1.9%
China	Alibaba Group	5.6%
	Tencent Holdings	4.0%
France	EssilorLuxottica	3.2%
Germany	Adidas	4.8%
	Fresenius Medical Care	4.4%
Ireland	Icon	3.7%
United States	Abbott Laboratories	4.6%
	Alphabet	8.7%
	Cognizant Technology Solutions	3.0%
	Dollar General	4.4%
	Dollar Tree	3.1%
	Ecolab	1.9%
	Edwards Lifesciences	2.2%
	Electronic Arts	3.3%
	Facebook	5.8%
	Hexcel Corporation	3.5%
	LKQ	2.4%
	Mastercard	5.0%
	PayPal	5.3%
	Signature Bank	3.8%
	TJX Companies	4.8%
	Tyler Technologies	2.0%
	United Parcel Service	2.7%
	Zoetis	2.8%
	Equity Total	**96.9%**
	New Zealand dollar cash	0.9%
	Total foreign cash	1.3%
	Cash Total	**2.2%**
	Forward Foreign Exchange	0.9%
	TOTAL	**100.0%**

marlin
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