



Ophir Asset Management  
Level 26, Governor Phillip Tower  
One Farrer Place  
SYDNEY NSW 2000

Dear Fellow Investors,

Welcome to the **May 2018 Strategy Notes** – thank you for investing alongside us for the long term.

Due to a fairly intensive travel schedule through the back end of April, we took the decision to delay our monthly 'Strategy Notes' to a little later this the month. We hope you enjoy the updates.

### **Strategy Notes – From Auckland to Omaha**

With an investment mandate that allows both Ophir Fund's to invest in Australian and New Zealand-listed equities, it is not surprising that New Zealand is one of the more frequently visited international destinations for the investment team. Prior to heading to the US for an extensive trip later in the month, we took the opportunity in April to also touch base with a number of existing NZ-based portfolio holdings in addition to a handful of exciting emerging companies that the nation is now beginning to produce with some degree of regularity.

In many ways, **the NZ-listed company space has proven to be a happy hunting ground for the Ophir Fund's for some time** and we certainly enjoy the innovative and motivated entrepreneurialism that seems embedded in many management teams in businesses across the Tasman. The 'tyranny of distance' facing emerging Kiwi companies quite often works in their favour as founders and management teams are required to think about product scalability and global expansion opportunities far earlier in their company lifecycle than in perhaps other regions.

With fairly limited opportunities in the domestic market (the entire population of New Zealand is ~300k less than that of Sydney's), any budding entrepreneur with a desire to grow a meaningfully-sized business will almost automatically be crafting that idea with global growth goals in mind. We like this natural inclination and desire to expand offshore as it almost immediately sets the success bar higher for businesses and encourages management teams to take intelligent risks early on in their growth journey.

Of course, this doesn't mean there is a dearth of very large companies in NZ that have built significant businesses servicing the domestic populous – indeed the top ten largest companies (as measured by total profit) are dominated by a collection of businesses that generate the bulk of their revenues onshore. In a similar vein to the Australian large cap experience, the majority of these businesses also represent fairly 'older world' businesses models entrenched in the more mature stages of the company lifecycle.

Of the top ten (**Fonterra, Spark New Zealand, Air New Zealand, Ryman Healthcare, Kaingaroa Timberlands, Auckland Airport, Transpower New Zealand, Z Energy, Meridian Energy and Mercury NZ**), four essentially operate as majority state-owned enterprises, one is a listed dairy farming co-op, another an unlisted timber plantation and another a national chain of petrol stations.

While certainly not a 'high-growth' collection of businesses, it is interesting to note that a good number of domestic-facing NZ businesses actually achieve higher EBITDA margins and better overall returns on capital than their listed Australian counterparts. This is primarily a reflection of the broadly smaller market size and the fact that the region tends to sit fairly low on the priority list

for foreign companies looking to aggressively disrupt existing offshore markets. In our view, this geographical moat will not last forever, however, and a number of businesses in the larger end of the NZ market that have effectively been ‘over-earning’ versus global peers in recent years will likely experience some competitive pressures in the years ahead.

Like Australia, however, **scratching below the surface of the larger listed company names has uncovered some wonderful examples of entrepreneurial drive and global innovation** – with many small NZ companies in recent years rapidly expanding to become far more substantial in size. While we are limited in our own investment universe to those businesses that are publicly-listed on the NZX, we can only be impressed with the speed in which New Zealand’s start-up community has rapidly developed into a globally relevant destination for local and international venture capital. According to a recent report from the NZ Ministry of Business, Innovation and Employment, more than NZ\$875m in capital was raised in 2017 by New Zealand-based businesses across the private equity and venture capital space.

Early stage capital commitments tend to favour higher-growth opportunities and it has been the burgeoning Kiwi tech sector that has proven to be the key attraction for foreign capital in recent years. From barely rating a mention only a decade ago, technology now sits as the country’s third largest export (behind tourism and the dairy industry) with the NZ tech industry contributing over NZ\$10bn in combined revenue in 2017 and employing more than 40,000 people.

### 3-Year Revenue CAGR (%) - Selection of High-Growth NZ Companies



Source: NZ Ministry of Business, Innovation & Employment

No event could perhaps be more symbolic of the heights to which the emerging and start-up environment in New Zealand has reached than **the pending first commercial rocket launch from NZ-based start-up Rocket Labs** – expected sometime toward the end of June this year. Started in 2006 by New Zealander **Peter Beck** as a company focused on developing smaller, lower-cost satellites for the telco, mapping and space research industries. The business has developed a pilot rocket (in their manufacturing site in Auckland) entirely powered by engines that are constructed by 3D printers that are expected to provide...

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