
STATEMENT OF INVESTMENT POLICIES AND OBJECTIVES

18 August 2016

1. INTRODUCTION

- 1.1. Punakaiki Fund Limited is an investor in high-growth New Zealand-based private companies. It is structured as a company and has a contracted external manager Lance Wiggs Capital Management Limited (the “Manager”, “LWCM”) to source and manage its investments.
- 1.2. This Statement of Investment Policies and Objectives (“SIPO”) sets out the investment philosophy, strategies, objectives and policies of Punakaiki Fund. The SIPO is an integral part of the Punakaiki Fund’s wider model of financial governance.
- 1.3. For policies in relation to the committing of Punakaiki Fund’s funds for **non-investment** purposes, reference should be made to Punakaiki Fund’s Delegated Authority Policy. For guidance in respect of sourcing, making and managing investments, reference should be made to Punakaiki Fund’s Investment Guidance document.

2. INVESTMENT PHILOSOPHY

- 2.1. Punakaiki Fund’s approach to investing is based on the following four philosophies. Together, Punakaiki Fund believes these philosophies provide the greatest opportunity to generate significant shareholder returns.
- 2.2. **Market Opportunity.** There is a significant opportunity in New Zealand to generate high risk-adjusted returns by investing in high growth private companies. We believe this because:
 - a) On average, high growth companies provide high shareholder returns over the long term;
 - b) The market for high growth private companies in New Zealand is relatively inefficient (including information asymmetries), resulting in mispricing;
 - c) There is a shortage of growth capital in New Zealand; and

- d) Punakaiki Fund's Manager has access to many high quality investment opportunities.
- 2.3. **Fund of Choice.** We aim for Punakaiki Fund to be the preferred provider of capital by the founders of New Zealand's premier high growth companies. By attracting the best high growth companies to Punakaiki Fund's portfolio, Punakaiki Fund will generate positive risk-adjusted returns for its shareholders.
- 2.4. **Long Term Investment Horizon.** We expect to generate higher risk-adjusted returns by holding for the long term, eliminating the impact of short-term market fluctuations and sub-optimal behaviour in the companies in which we invest. This is discussed further in Appendix 1.
- 2.5. **Diversification.** We believe that diversification usually reduces the level of risk incurred for a given amount of return. Punakaiki Fund has a philosophy of actively diversifying its portfolio to avoid a significant concentration to any one company, very small companies, unprofitable companies or a particular industry, product or service.

3. INVESTMENT OBJECTIVES

- 3.1. Punakaiki Fund has a **primary objective** of delivering shareholders **significant returns over the medium to long term**. The current target is to deliver five year rolling annual returns of at least 20% net to shareholders (after all costs, fees and fund-level taxes). We note that the Manager does not receive a performance fee unless an average annual return (subject to high-water mark thresholds) of at least 10% net to shareholders is generated.
- 3.2. This level of return is expected to decline over time as Punakaiki Fund grows in size and its investments mature and have lower risk and return profiles. The Board will review this return target from time to time as the profile of Punakaiki Fund's portfolio changes.
- 3.3. Punakaiki Fund also has an objective of becoming self-sufficient (i.e. not relying on raising new capital on an on-going basis) in respect of meeting its expense obligations in the long-term. This will require Punakaiki Fund to invest in companies with a mix of strong short, medium and long term dividend flow prospects.

4. INVESTMENT STRATEGY

- 4.1. Punakaiki Fund has contracted LWCM to source, execute and manage investments, through a Management Agreement dated 25 March 2014. Punakaiki Fund aims to put its philosophies into practice via the activities of LWCM.
- 4.2. Punakaiki Fund aims to achieve its objectives by:

- a) **Supporting high growth companies and their founders:** We aim to find and support high-growth companies in New Zealand with capital and advice (as required) and be easy to work with for founders in order to attract the best investment opportunities to Punakaiki Fund;
 - b) **Having a low rate of investment failure:** We aim to invest in opportunities that have been significantly de-risked by displaying traits such as addressing a genuine end user need, a growing revenue curve, an effective and efficient company with strong people and culture, and a strong financial investment case;
 - c) **Having a long life:** We are a permanent capital fund and as such have a long-term investment mandate. We aim to hold our investments for considerable periods of time in order to allow our portfolio companies to grow and provide Punakaiki Fund both dividends and capital gains over time;
 - d) **Strong and diverse portfolio:** We aim to lower Punakaiki Fund's market risk by having a well-diversified portfolio; and
 - e) **Holding for dividends:** We aim to hold Portfolio Companies over the long-term to receive ever increasing dividend payments.
- 4.3. This approach has been adopted as we believe that LWCM has the skills, expertise, alignment to Punakaiki Fund's philosophies and access to high quality investment opportunities required to give effect to this SIPO.
- 4.4. LWCM has a wide mandate to find and execute investments, subject to certain limits imposed by the Management Agreement and the Board, including those limits and operating procedures set out in this SIPO. The Board is responsible for monitoring the manager and updating this SIPO from time to time as required to reflect the evolving requirement of Punakaiki Fund.
- 4.5. Investment guidelines applicable to the Manager which reflect the philosophies and objectives of Punakaiki Fund are set out in Punakaiki Fund's Investment Guidelines document.

5. ASSET ALLOCATION

- 5.1. Punakaiki Fund's target asset allocation is 97.5% of Net Asset Value in equity securities and 2.5% of Net Asset Value in cash. There are likely to be times when Punakaiki Fund's actual asset allocation is significantly different to this, especially immediately following a capital raising event (when cash assets are likely to be significantly above 2.5% of Net Asset Value) and immediately prior to a capital raising (when cash assets may be below 2.5% of Net Asset Value).
- 5.2. Punakaiki Fund aims to have a diversified portfolio when measured by the stage and size of companies in which Punakaiki Fund invests. Table 1 below sets out Punakaiki Fund's target diversification allocations. These targets are for the

benefit of the Manager when making investments. If an investment will cause or exacerbate the breaching of these targets, Punakaiki Fund's Board approval will be required. The definition of Target Stage categories and Target Profitability categories are contained within Appendix 2.

Punakaiki Fund Limited - Diversification Targets					
Stage Targets	Seed	Early Growth	Growth	Turnarounds	Cash
Weighting Range (by NAV)	0-10%	15-40%	30-80%	0-40%	*2.5%+
Maximum for Individual Investment (by NAV)	2%	10%	20%	20%	*2.5%+
Typical Investment Size (guidance only)	\$50-250k	\$200k-\$1m	\$1m+	\$500k+	*\$500k+

Profitability Targets	Unprofitable	Profitable (or near profitable)	Cash
Weighting Range (by NAV)	50-75%	25-50%	*2.5%+
Maximum for Individual Investment (by NAV)	20%	20%	*2.5%+
Typical Investment Size (guidance only)	\$1m+	\$1m+	*\$500k+

**Based on nil projected dividend income. No investments should be made which result in cash balances falling below this ratio.*

Table 1: Punakaiki Fund Diversification Targets

- 5.3. While Punakaiki Fund has an overall philosophy of diversification; targets or limits in respect of exposure to individual industries (based on the GICS definitions), individual business models or in companies that require additional rounds of funding before becoming cash flow positive do not form part of this document. Instead, these exposures will be monitored by Punakaiki Fund's Board.
- 5.4. Notwithstanding the previous paragraph, any investment which results in an individual company comprising more than 20% of Punakaiki Fund's Net Asset Value shall require the approval of the Punakaiki Fund Board.

Cash Investments

- 5.5. Punakaiki Fund's assets will be managed in such a way as to ensure that it will have sufficient liquidity to meet its expense obligations. In order to achieve this aim, Punakaiki Fund will not make any investments which cause its cash reserves to fall below 2.5% of Punakaiki Fund's Net Asset Value, in order to meet its operating costs. The 2.5% reserve will comprise the following components:
- The forecasted receipt of dividends by Punakaiki Fund from its Portfolio Companies over the next 12 months; and
 - The balance held as cash on hand in Punakaiki Fund's bank accounts.

5.6. *Rebalancing*

5.7. From time to time increases or decreases in one or a number of Punakaiki Fund's Portfolio Companies' carrying value as the result of revaluation may result in minimum or maximum thresholds for certain asset allocation categories being exceeded. In this situation, Punakaiki Fund is not required to rebalance its portfolio to be in-line with the asset allocations or diversification targets set out in this SIPO, however the Manager will need to ensure that subsequent investments in other businesses are tailored to bring the actual asset allocation and diversification targets back into line with the SIPO.

5.8. Tactical Asset Allocation (varying the target asset allocation away from the SIPO asset allocation to take advantage of short term market conditions) and Dynamic Asset Allocation (varying the target asset allocation away from the SIPO asset allocation to take advantage of medium term market conditions) will not be permitted.

Reporting

5.9. The Manager shall report the actual asset allocation of Punakaiki Fund's investments to the Board on a quarterly basis. The Manager shall also immediately report to the Board in the event that asset allocation thresholds are breached.

6. GENERAL INVESTMENT POLICIES

6.1. The following sets out general investment policies of Punakaiki Fund not previously discussed in this SIPO.

Performance Measurement

6.2. The change in Punakaiki Fund's share price (or if Punakaiki Fund is not listed on a recognised market, its NAV per share) will be used as our return measure, which reflects the performance of Punakaiki Fund's portfolio after the deduction of all fees and other costs.

Management Agreement Restrictions

6.3. Clause 2.5 of the Management Agreement sets out certain restrictions on the Manager's ability to invest. These restrictions are paraphrased below:

- a) The Manager may not invest an aggregated amount (whether in a single transaction or series of related transactions) greater than 20% of the Punakaiki Fund's Net Asset Value; and
- b) The Manager may not invest in a business where that business is not primarily associated with or carrying on its business in New Zealand.

6.4. Any departures from these restrictions require Board approval.

Divestments

- 6.5. One of Punakaiki Fund's philosophies is to hold Portfolio Companies over the long-term to receive ever increasing dividend payments. It is possible that the divestment of a Portfolio Company may occur, generally to follow the Founders position on the sale, unless that position would result in the destruction of value in relation to Punakaiki Fund's investment.
- 6.6. In the event that a divestment is proposed and the Manager supports the divestment, the Manager shall seek approval for the divestment from the Board in accordance with clause 2.6 of the Management Agreement.

Socially Responsible Investing

- 6.7. Punakaiki Fund will take into account environmental, social and governance issues when making investments. Punakaiki Fund's objective is to avoid investing in companies that cause or contribute to significant social or environmental harm.

Investing in Listed Companies

- 6.8. The manager may not invest in a publicly listed company without the approval of Punakaiki Fund's Board.
- 6.9. For investments in publicly listed companies that have resulted from one of Punakaiki Fund's Portfolio Companies undertaking an Initial Public Offering, Punakaiki Fund may continue to hold that Portfolio Company with approval from the Board.
- 6.10. For investments in publicly listed companies that have resulted from an unrelated publicly listed company acquiring a Portfolio Companies for scrip (or for scrip and cash), then the scrip investment in the acquiring company needs to be considered as an investment on its own merits. Continued holding of these types of investments requires the approval of Punakaiki Fund's Board.

Investments

- 6.11. Punakaiki Fund will not invest in the following investment classes:
- a) Real estate;
 - b) Speculative derivatives;
 - c) Hedge funds;
 - d) Speculative currencies;
 - e) Bonds and other debt types (e.g. mortgages); and
 - f) Commodities.

6.12. Punakaiki Fund will not invest in the following structures:

- a) Unincorporated Joint Ventures;
- b) Partnerships (limited or otherwise);
- c) Trusts; and
- d) Unit Trusts.

6.13. Punakaiki Fund will not invest using loans, unless these are quasi-equity such as convertible notes, however there is a strong bias to invest in ordinary shares only.

Management of Cash Investments

6.14. Punakaiki Fund's cash balances are to be held in major New Zealand-registered trading bank accounts (or their wholly owned subsidiaries), either on call or as investments in short-term term deposits. The bank(s) at which Punakaiki Fund's cash balances are held should have a minimum investment rating of "AA-" or higher as issued by Standard & Poors or Moody's.

6.15. Punakaiki Fund's maximum exposure to any single bank or bank group shall not exceed the larger of \$NZ10 million or 35% of the cash held by the fund.

Hedging and Derivatives

6.16. With the exception of options and convertible notes held in respect of Portfolio Companies, Punakaiki Fund will not enter into any other type of derivative contract or undertaking, including interest rate or currency hedging. The hedging (if any) of Portfolio Companies interest rate or currency risk is the responsibility of those individual companies.

Leverage

6.17. The Management Agreement sets out that "Borrowing must not be incurred if, immediately afterwards, the aggregate principal amount of the borrowing of the Group would exceed an amount equal to 25% of the Net Asset Value."

6.18. All borrowing arrangement must be approved by the Punakaiki Fund Board.

Valuation Policies

6.19. Punakaiki Fund's portfolio valuation policies are contained within its Investment Valuation Policy dated 2 February 2016.

7. BENCHMARKS

7.1. Punakaiki Fund targets a total shareholder return net of all taxes, fees and other charges of 20% per annum, over a rolling five year period. These return levels

are absolute in basis and, in the long-run, are expected to be largely independent of general market movements. Given Punakaiki Fund's absolute return model, it does not compare itself to a benchmark or a reference portfolio.

8. CONFLICTS OF INTEREST

- 8.1. Conflicts can arise when the interests of the Manager or any officer (including directors and managers) or employees of the Manager are inconsistent with, or diverge from, some or all of the interests of Punakaiki Fund.
- 8.2. In particular the Management Agreement specific prohibits the Manager engaging in the following activities:
- a) The Manager may not make any investment on behalf of Punakaiki Fund in which the Manager has an ownership interest (clause 4.1 of the Management Agreement); and
 - b) The Manager will not undertake investments into businesses which fall within the investment mandate of Punakaiki Fund without Punakaiki Fund having the first opportunity to invest (clause 4.2 of the Management Agreement).

In both of these cases, the Manager may apply to the Board for an exemption to these prohibitions on a case by case basis.

- 8.3. It is the responsibility of the Manager to disclose any potential conflict of interest to the Board prior to an investment, or if the conflict arises after an investment is made, as soon as is practical.

9. MONITORING & COMPLIANCE

- 9.1. It is the responsibility of the Manager to comply with the policies and objectives set out within this SIPO. It is the responsibility of the Board to monitor the Manager's compliance with this SIPO on a quarterly basis or more frequently if warranted.
- 9.2. Should the Manager be found to be in breach of this SIPO or not adhering to the SIPO philosophies as a result of investment or divestment activity or other behaviours (or lack there-of as the case may be), the Board has a wide range of tools to caution or discipline the Manager including, but not limited to, the termination of the Management Agreement under clause 9.2 of the Management Agreement.

10. CONFLICTS BETWEEN DOCUMENTS

- 10.1. Should any clause in this SIPO conflict with any clause in Punakaiki Fund's Constitution or the Management Agreement, then Punakaiki Fund's Constitution or the Management Agreement (as the case may be) shall take precedence.

11. REVIEW

- 11.1. As the size of Punakaiki Fund grows we expect that companies will graduate to different stages and that the size of both our new and existing investments will become larger. These effects will see the portfolio gradually change to have more emphasis on later stage and larger companies. As a result of this, this SIPO will require periodic review, particularly in respect of asset allocations.
- 11.2. This SIPO:
- a) will be reviewed at least every second calendar year by the Board; and
 - b) may be reviewed more frequently as considered appropriate by the Board.
- 11.3. Any changes to this SIPO require prior approval of the Board.

APPENDIX 1 – WHY WE ARE A LONG TERM INVESTOR

- 1.1. Punakaiki Fund believes that there are many benefits from holding its investments over the long terms. From the perspective of potential investee companies and companies which Punakaiki Fund has already invested in (“Portfolio Companies”), these benefits include:
 - a) Receiving an ever increasing stream of dividends from maturing portfolio companies;
 - b) Sending signals supporting the growing of a sustainable long-term business;
 - c) Preventing forced business exits which can lower value;
 - d) Avoiding short-term investment horizons that can force founders to sub-optimally accelerate the growth of their business and hence avoid wastage; and
 - e) Over time, capturing the full value of investments as they grow to maturity.
- 1.2. From the perspective of Punakaiki Fund and its shareholders, long-term investment horizons avoid the crystallisation of short-term fluctuation in value or the decoupling of value and price during period of market instability. In particular, Punakaiki Fund believes that:
 - a) The power of compounding growth over the long-term is a powerful value creation mechanism;
 - b) Risk and return are strongly and positively correlated over the long term;
 - c) Short-term returns may be significantly different to the long-term average returns for any particular period;
 - d) Fair value is driven over the long-term by business fundamentals, rather than by periods of extreme market optimism or pessimism; and
 - e) The value of an asset will return to its fair value over time.

APPENDIX 2 – INVESTMENT TARGET DEFINITIONS

- 1.1. Definitions of each of the Targeted Stage categories which Punakaiki Fund will seek to invest in are set out below:
- a) **Seed** investments are made into businesses with minimal or no sales, or no evidence of sales growth (revenues from legacy or non-core products are not be counted when considering whether a business falls into the seed investment category);
 - b) **Early Growth** investments are made into businesses with increasing revenue from customers who are buying a product that may be relatively unrefined but is becoming ever-more acceptable;
 - c) **Growth** investments are made to businesses who have a successful product, who know how to sell it but need to build capability and capacity across the range of functions including sales, operations and product development; and
 - d) **Turnarounds and Transformations** investments made into businesses which are often unpopular with investors, made with the primary motive of reinvigorating sales, technology, design and/or management practices.
- 1.2. Definitions of each of the Targeted Profitability categories in which Punakaiki Fund will seek to invest in include:
- a) **Unprofitable** businesses are those which operate at a loss in pursuit of growth, and which typically have raised sufficient capital to grow revenues to a level which makes the business cash flow neutral. When this occurs, these business will typically raise additional capital in order to increase sales, marketing or product development in order to pursue additional growth, and will fall back into unprofitability as a result;
 - b) **Profitable (or near profitable)** businesses can be classified as being in one of the three following categories:
 - i. Dividend Paying: The business is profitable and can meet all of its sustainable growth costs from free cash flow, with the surplus distributed as dividends to shareholders;
 - ii. Profitable (non-dividend paying): The business is profitable but are investing all profits into growth and/or the repayment of debt; and
 - iii. Near Profitable: The business has the ability to be profitable (and pay dividends) if it foregoes investment in growth. These businesses are expected to move into the Profitable and Dividend Paying categories over the medium term (1 to 4 years).