

# FROM THE undergrowth

MARCH08



And I thought last month's newsletter was difficult to write! February featured more share market falls, varied company profit results, and some internal changes at Fisher Funds which had us featuring in the media rather more than we would have liked. We have enjoyed chatting with some of our clients during the month and discussing what's going on in the markets, but I'm sure that some of you will be worried sick that you have lost money and can't afford to lose more. While we can't chat face-to-face with all of you, I hope that this newsletter will give you some confidence, and that you'll realize that if anyone knows how to recoup your losses and return to profitable growth, we do.

## At a glance

As at 29th February 2007

### Unit Prices (\$)

NZ Growth Fund	3.3543
Australian Growth Fund	1.9213
International Growth Fund	0.9737
Fledgling Fund	1.1707
KiwiSaver	0.8885

### Fund Sizes (\$m)

NZ Growth Fund	120.5
Australian Growth Fund	110.0
International Growth Fund	4.3
Fledgling Fund	3.0
KiwiSaver	19.9

### Performance (February 2008)

NZ Growth Fund	-10.7%
Australian Growth Fund	-1.8%
International Growth Fund	-0.9%
Fledgling Fund	-8.6%
KiwiSaver	-2.1%
NZ50 Gross index	-2.4%
S&P/ASX 300 (\$NZ)	1.8%
MSCI Global Small	
Cap Index (\$NZ)	-0.7%

## Your Portfolios

### What has been going on since we last spoke?

Volatility was once again the prevailing theme in world share markets with the one-step-forward-two-steps-back dance in evidence on every new piece of information. Given that February is profit reporting time, there was plenty of information for investors to react to. Problem is, the reactions weren't always logical ones, and the share price performances for the month of February bore very little relevance to the company announcements released. Global share markets began February reasonably positively and even managed some small gains – which was justified given that many of the profit results were good and pointed to profit growth in the year ahead – but then in the final week, markets reversed on renewed concerns about the US recession and credit markets.

Many of the comments that we made in last month's newsletter remain valid – emotion is conspicuous whereas rational behaviour is nowhere to be found. On the face of it, we should have experienced a positive month in February because our company profit results were broadly in line with expectations, and many of the accompanying management comments were positive about the year ahead. Yes, everybody had a circumspect view of the current global economic environment, but all were focused on what they could do in their individual businesses to manage through these times and still achieve profit growth.

Overall, the results season was broadly positive for our portfolios. The New Zealand portfolio companies reported a credible 23% profit growth with expected growth of 15% in the year ahead. Remember, our rule

of thumb is that our companies should double their profits every 3-5 years (i.e. achieve average annual profit growth of 15%). The companies in our Australian funds reported average earnings growth of 21% in the 2007 year, and forecast 2008 earnings growth of 43%. The companies in our International funds reported average earnings growth of 61% in the 2007 year, and expect, on average, to grow their profits in the year ahead by 29%. This forecast earnings growth across all our portfolios should yield good returns over the next 3-5 years, since share prices ultimately reflect profit performance (notwithstanding periods like the one we're in now, where the market is marching to a different beat).

“People are about as hungry for risk right now as a toddler is for spinach.”

Bill Mann, [www.fool.com](http://www.fool.com)

The results season was also useful as it provided real numbers for us to work with in ascertaining what each of our companies might be worth. If we had dived in to the market in January, trying to buy stocks as they were plummeting, there would have been an element of blind hope in our buying because the last profit numbers we'd had from our companies were five months old. But it is a lot easier to look at some of our share prices today, with the benefit of full disclosure, and buy confidently in the knowledge that based on comments from the company in the last three weeks, the shares are undervalued.

## Your Portfolios continued

Below we have provided some detail as to the individual profit results for each of our companies. You will understand our frustration when you look at the profit performances of our companies and their subsequent share price performance. Suffice to say, we had negative returns in our New Zealand, Australian and International funds during February, but you shouldn't read anything into what that says about your companies – they are doing just fine. We thought we'd finish this overview of the markets and our portfolios by sharing some of the comments contained in Warren Buffett's eagerly-awaited annual shareholder letter. We shared our philosophy and thoughts about the current market conditions in last month's newsletter, and it is wonderful to read Warren Buffett's views which are, admittedly more eloquent, but certainly consistent with ours.

"We do not measure the progress of our investment by what their market prices do during any given year. Rather, we evaluate their performance by the two methods we apply to the businesses we own. The first test is improvement in earnings, with our making due allowance for industry conditions. The second test, more subjective, is whether their "moats" – a metaphor for the superiorities they possess that make life difficult for their competitors – have widened during the year."

"We have, I believe, the lowest turnover of our shares relative to other big companies, which means we have more real investors. We don't want anybody to buy our stock to sell it in a month or six months or something. We really want it to be a holding like buying a farm or buying a house. We want it to be a real investment. So we try, by our policies and by our communications, to attract those people."

"I don't buy based on what I think the market will do in the next month, six months or year. If I buy something at an attractive price, I don't care what the stock does. You know, if I buy a farm, I don't get a quote on it every day. If I buy a house, I don't get a quote on it every day. And if I buy a stock, I want it to be a stock that I'm happy owning. If they close the stock market for a couple of years – back in 1914 they did close the stock market for many months, and, you know, it's what the business does over time that's going to determine how I do. I don't try and time stock price, I try to price stock prices. And it's true, there's a lot of negative sentiment around – I'm more likely to find good things to buy than if everybody's in a bullish mood."

# Your Companies

## A roundup of the February profit reporting season

Below is a summary of the New Zealand and Australian profit results for our companies. We have not detailed all of our international company results, but suffice to say that Ken is pleased with the quality of the results and the profit guidance from our portfolio companies. If you would like more detail or wish to discuss any of the results with our investment team, please give us a call or send an email and we'd love to have a chat.

Company	Profit Increase/ Decrease	February Share price movement %	Good, bad or indifferent result?	Points of interest
<b>Australia</b>				
ABC Learning	-51.2%	-51.5%	✘	Share price reaction related more to executive's margin loan position than to underlying profitability.
Arrow Energy	+530%	+42.9%	✓	Profit guidance suggests profit will more than double in the year ahead.
Austbrokers	+47.2%	-1.7%	✓	Management expects earnings growth of 13-17% in year ahead.
Aevum	+11.5%	-3.5%	✓	2009 is shaping up to be a bumper year.
Bravura Solutions	+14.2%	+9.6%	✓	Strong revenue growth across all regions has not been reflected in the share price reaction.
Centrebet	-10.6%	-2.4%	✓	Company has no debt and expects earnings growth of 10-15%.
Credit Corp	-32.1%	-84.1%	✘	Very poor result, we intend to reduce holding but not at the currently undervalued prices.
DWS	+26.6%	-25.1%	□	Like Oakton, DWS is suffering from investors aversion to IT companies in the current climate.
McMillan Shakespeare	+28.8%	+5.0%	✓	Company built on its history of healthy earnings growth.
Nick Scali	+2.1%	-19.1%	✘	Store rollout is continuing and the company's plan to diversify away from Sydney is a good one, but the retail environment is tepid at best.
Oakton	+31.8%	-25.2%	□	Investors have assumed that IT companies will suffer in a downturn as corporates spend less on their infrastructure in this climate. The company has yet to see any evidence of this.
Pipe Networks	+23.4%	+7.5%	✓	Management expects profit growth of 47% in the year ahead!
Reckon	+21.3%	+1.9%	✓	A strong high quality profit result with more to come.
ToxFree Solutions	+1.0%	-11.2%	✓	The actual 1% result masked a superb period for the company as it moved to a full tax paying basis having used up tax losses.
Treasury Group	+35.6%	-13.0%	✓	Strong growth in funds under management drove strong profit growth despite difficult financial markets.
Vision Group	+14.4%	-14.1%	✓	Price growth, volume growth and the addition of six new partner doctors underpinned healthy revenue growth of 17% in the period.
WHK Group	+14.3%	+0.9%	✓	Healthy result with forecast earnings growth of 15-20%.
<b>New Zealand</b>				
Comvita	-51%	-29%	✘	Likely loss for full year primarily due to foreign exchange losses. Overall harvest looks better than last year and company remains optimistic about the year ahead.
Delegat's	+268%	-23%	✓	Company indicated that the 2008 harvest is extremely favourable, and expected yields and quality is the best for some years.
Freightways	+12%	-0.6%	✓	Company performed soundly in a difficult environment with the benefits of recent acquisitions flowing through.
Mainfreight	+54%	+10%	✓	Great performance across the board, with a massive 22% lift in earnings from NZ despite a sluggish economy. Recent trading activity is very encouraging.
Metlifecare	+11%	-19%	□	Result was slightly confusing due to new tax treatment, but it confirmed that asset backing per share is at least \$1 above current share price.
Michael Hill	+27%	-3%	✓	Good result in keeping with company's policy of "controlled profitable growth". Management remain optimistic about results for year ahead.
NZ Exchange	+34%	-8%	✓	Strong result on the back of continued growth in demand for NZX data.
Opus International	+29%	-5%	✓	Ahead of prospectus forecast and on target to meet next year's target growth of 17%.
Pumpkin Patch	-22%	-22%	✘	Very strong performance in NZ and Australia but challenging conditions in the US and UK. Share price now attributes zero value to the US and UK operations and appears well overdone.
Rakon	+22%	-19%	✘	Company lowered its earnings guidance due to strong NZ dollar and delayed earnings in company's European business. Demand remains strong and, currency aside, the business remains on track.



# A bird's eye view

## What's new at Fisher Funds?

During February we announced the resignation of Warren Couillault, our Chief Investment Officer. Following Warren's recent decision to play a less significant role in the company and to sell his shareholding, it was agreed that in the best interests of the company, he would resign as Chief Investment Officer and Portfolio Manager of the New Zealand portfolios. The suddenness of Warren's decision, following a successful six-year period with the company, led to all sorts of speculation and comment, most of it negative. The timing of this news probably didn't help, since it came hot on the heels of one of the worst months for global share markets and the Credit Corp bombshell that had already put us firmly in the spotlight. While Warren made a real contribution to the company, and we wish him well in his future endeavours, we must stress that the Fisher Funds investment team works as a team and that the investment philosophy that has allowed us to achieve to date, is firmly embraced and implemented by each of our investment professionals. So, it is business as usual, and the team is pleased to have put February's distractions to one side and focus on making sure we have the very best companies in our portfolios.

As for the practical consequences of Warren's departure – Carmel maintains responsibility for the NZ funds; Frank and Terry are continuing to manage our Australian funds and Ken and Scott are busy finding new stocks for our international funds. We find that having two people concentrate on each portfolio works well – at company visits, one can take notes and the other can listen and maintain eye contact. Then after

meetings, we can compare notes and each will have taken something different from the meeting. We are therefore delighted to announce the appointment of experienced investment analyst, Murray Brown, who will work with Carmel in managing our New Zealand funds.

Murray has been Director of Research at share broker First NZ Capital for ten years and at Ord Minnett Securities for seven years prior to that. He has held senior analyst positions with other firms, spent some time co-managing an Australasian share portfolio, and was a finalist in the Research Analyst of the Year INFINZ award in 2006 (interestingly Terry was also a finalist that year!). Murray has consistently ranked as one of the country's top three analysts in his sectors and is known to the Fisher Funds investment team. We look forward to him joining in our robust discussions of our companies, the markets, and the world at large, from the end of March.

With Murray's appointment, we now have two analysts with Brown as a surname, and two who have been share market investors for more than 25 years (Terry is the other one, and Carmel says from now on she won't disclose her experience or age – it's a woman's prerogative!).

We are also delighted at the return of John Wells as an independent director of Fisher Funds. John was a director of Fisher Funds from its inception in 1998 until 2006, and the board is pleased to welcome back a director who has known and shared the company's values and goals from its early beginnings.

## Your questions

We have summarized our response to three of the more common questions of the past two months

**Q:** Given that Fisher Funds' recent performance has been so much worse than the market, and you've had a couple of dud stocks, does this mean you have lost your knack?

**A:** Our performance has been extreme because we manage concentrated portfolios – we own a relatively small number of stocks, and each can represent a large proportion of our portfolio. If one of our larger holdings performs badly, it has more of an impact on our performance than it would if we were more widely diversified. But it also allows us to achieve great returns when we own an outperformer ... and there have been too many of these over the years for us to list. Incidentally, we have broadly performed in line with the small company indices over the past six months. Unfortunately it seems that small growing companies are not where investors want to be right now, they prefer cash and defensive stocks. This will change though, and we want to be sure we are fully invested when the focus returns to growth companies, particularly given that ours are so cheap. There is no doubt that our unit price falls have been significant and amplified because they have happened in a short timeframe. But we have had far more positive periods over the years featuring strong unit price rises when our stocks perform well. These will occur again.

**Q:** Given the severity of the falls, Fisher Funds is unlikely to recoup these losses in a hurry, so shouldn't I cash up and at least get 10%pa by putting my money in the bank?

**A:** Investors around the world are renowned for selling at precisely the wrong time, and to our mind, selling now is foolhardy. By selling, you will turn your paper loss into a real loss, and by putting your money in the bank, you will be foregoing any opportunity to get some capital gains and therefore recoup your losses. After every downturn that we have experienced over the past decade, good stocks have recovered within eighteen months and then gone on to make further gains. We don't know exactly which stocks will lead us out of the downturn, or what the exact catalyst will be, but we do know that we have the best companies (and at the moment, some of the cheapest) to lead us forward in the year ahead.

**Q:** Is Fisher Funds losing clients at a rate of knots?

**A:** No. We have had less than 1% of our funds withdrawn, and typically the clients withdrawing have been those who have been with us for a relatively short period of time. Because they haven't experienced our periods of strong performance, we can understand their impatience. But longer term investors will always do better than those who try to time the markets.

# Fund facts

## Fund Performance

Fund Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-26.42%	3.5%	3.9%	12.5%	13.5%
Australian Growth Fund	-15.38%	2.55%	na	na	9.7%
International Growth Fund	na	na	na	na	-8.2%
Fledgling Fund	-22.09%	1.0%	3.6%	6.1%	2.5%
KiwiSaver	na	na	na	na	-25.0%

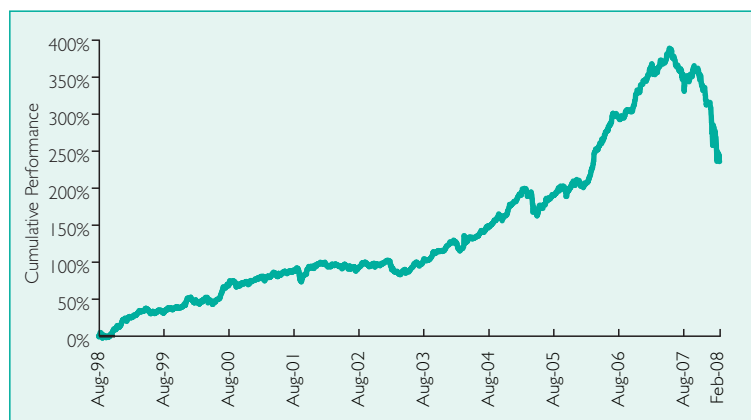
  

Market Indices	1 Year	2 Years	3 Years	5 Years
NZ50G	-11.3%	2.6%	3.7%	13.7%
90day bank bill	8.7%	8.2%	7.9%	7.1%
S&P/ASX300 (Calculated in \$NZ)	3.0%	12.9%	17.4%	21.4%
MSCI Global Small Cap Index (\$NZ)	-21.0%	-8.9%	2.9%	11.1%

*NB... annualised returns, after tax and fees*

February's Biggest Movers	
<b>New Zealand</b>	
Mainfreight	10%
Pumpkin Patch	-22%
Delegats	-23%
Comvita	-29%
<b>Australia</b>	
Arrow Energy	43%
Oakton	-25%
ABC Learning	-52%
Credit Corp	-84%
<b>International</b>	
Ebix Inc	21%
Hansens	19%
Midland Holdings	-13%
Gameloft	-18%

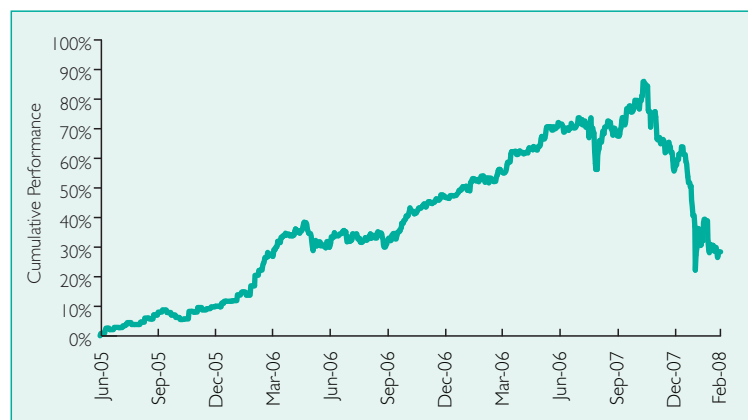
## New Zealand Growth Fund



**Fund Inception** August 1998

**Portfolio Holdings** - Comvita, Delegats, Freightways, Infratil, Mainfreight, Metlifecare, Michael Hill, NZ Exchange, Opus International, Pumpkin Patch, Rakon Limited, Ryman Healthcare, Sealegs.

## Australian Growth Fund



**Fund Inception** June 2005

**Portfolio Holdings** - ABC Learning, Aevum, Arrow Energy, Austbrokers, Bravura, Centrebet, Credit Corp, DWS Solutions, McMillan Shakespeare, Nick Scali, Oakton, Pharmaxis, Pipe Networks, Reckon, The Reject Shop, Toxfree, Treasury Group, Vision Group, WHK Group.

## International Growth Fund

The International Growth Fund has only recently been launched. The Fund's objective is to provide New Zealand investors access to a hand-picked portfolio of international companies designed to maximize returns while providing greater diversity on an industry, economic and geographic level.

**Fund Inception** October 2007

**Portfolio Holdings** – Celera, CityTelecom, Conceptus, EBIX Inc, Equinix, Gameloft, Hansens Natural, Home Inns, Hongguo, Icon PLC, Jamba Juice, Jumbo, Micros, Midas, Midland Holdings, OSI Pharma, Raffles Education, Roth & Rau, Sciele Pharma, Wirecard.

## Fledgling Fund



**Fund Inception** December 1999

**Portfolio Holdings** - Comvita, Delegats, Freightways, Infratil, Mainfreight, Metlifecare, Michael Hill, NZ Exchange, Opus International, Pumpkin Patch, Rakon Limited, Ryman Healthcare.

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