



Qualitative Fund Research

Salt NZ Dividend Appreciation Fund

February 2017

About the Manager

Salt Funds Management Limited (the Manager, Salt) was founded in May 2013, in a seamless transition from BT Funds Management (NZ), with agreements to manage existing NZ equities and listed property portfolios, which included all associated research and intellectual property. Salt look to develop strong partnership-type relationships, to deliver superior long term investment outcomes. The Manager has provided a brief profile available [here](#).

Salt's investment philosophy which underpins the investment process, is predicated on the belief that the value of any financial asset is the net present value (NPV) of some measure of future cash flow, discounted appropriately.

Salt is a signatory to the United Nations Principles of Responsible Investment (UN PRI) [here](#) and harbours a culture of "fail fast, learn fast, fix fast",

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimers, Disclosures and Warnings at the end of this document.

The Salt NZ Dividend Appreciation Fund ("the Fund") is a 'long only' dividend focused New Zealand equity product and as such will generally sit within the growth component of a balanced portfolio.

The Fund is suitable for investors with an investment horizon of more than five years.

The Fund is subject to equity market risk and movements (both positive and negative) in the share prices of the underlying securities in the portfolio. Investors should therefore be aware that

where employees are encouraged to contribute and debate the status quo [here](#).

Salt manages three funds:

- [Salt NZ Dividend Appreciation Fund](#)
- Salt Enhanced Property Fund
- Salt Long Short Fund

These funds are managed by a team of two portfolio managers and four analysts. The Salt investment team work through the Investment Committee who is responsible for determining investment objectives, strategy and policy, rather than security selection. For the number and type of funds being managed, the team is adequately resourced and governed, with well tenured executives and portfolio managers. The Manager has provided individual bios for the team [here](#).

the Fund may experience periods of negative returns and that there is a risk of potential capital loss being incurred on their investment.

The fund intends to be fully invested, and is expected to have a minimal cash holding, with the Manager capping the cash holding at 5%. The Fund's investment policy allows for borrowing. This facility, yet to be utilised, is in place for liquidity purposes and not to gear the Fund.

The Fund is a Portfolio Investment Entity (PIE). The Fund has a semi-annual distribution policy (at the Manager's discretion).

Question	What the Manager says	What FundSource think								
<p>What are the Manager's assets under management - in total and in this Fund?</p>	<p>As at 30 November 2016, Salt Funds Management is responsible for funds under management (FUM) of approximately \$1.7 billion, managed on behalf of a diverse range of New Zealand clients including superannuation schemes, Community Trusts, charities, foundations, Maori trusts, KiwiSaver schemes and individual investors.</p> <p><i>As at 30 November 2016:</i></p> <table border="0"> <tr> <td>Dividend Appreciation:</td> <td>\$ 30.5M</td> </tr> <tr> <td>Enhanced Property:</td> <td>\$ 3.7M</td> </tr> <tr> <td>Long Short Fund:</td> <td>\$196.8M</td> </tr> <tr> <td>Total in PIE Funds:</td> <td>\$231.0M</td> </tr> </table>	Dividend Appreciation:	\$ 30.5M	Enhanced Property:	\$ 3.7M	Long Short Fund:	\$196.8M	Total in PIE Funds:	\$231.0M	<p>The business has significant funds under management across its five strategies.</p> <p>The strategy which underpins the Salt NZ Dividend Appreciation Fund (the Fund) has been in operation since October 2008, however the Manager only came into being in May 2013, and the Fund, in current format, from 1 July 2015.</p> <p>Prior to 2013 the strategy was managed by the same Portfolio Manager (PM), at BT Funds Management.</p>
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<p>Who is accountable for managing the Fund, and how long has the investment team worked together?</p>	<p>Salt Funds Management's investment team is well established and well resourced. Matthew Goodson has primary responsibility as Portfolio Manager for the Salt NZ Dividend Appreciation Fund whilst Paul Harrison provides seamless back-up.</p> <p>David Oxley heads the company's investment research function, which includes a further three full-time research analysts, who have primary research responsibility split along sector lines.</p> <p>Our senior team members all have greater than 20 years' experience each in NZ and international equity markets on both the buy and sell side and have been working together prior to the company's inception in May 2013.</p>	<p>Goodson has been the Portfolio Manager for this Fund since its inception and has leveraged the sector input from the investment team, since inception. These roles predate the Managers commencement, as Goodson and Harrison had worked together at a previous employer. FundSource notes that the previous employer became the Managers founding client.</p> <p>Operational and administration aspects of the business are separated functions from the investment capability, this ensures appropriate attention is being given to the operational aspects of investing, assisting in keeping the investment personnel focused.</p> <p>FundSource notes that key person risk is not high, but does exist. This is in part mitigated by the substantial ownership by the Managers executive team.</p>								
<p>What objective is the Manager trying to achieve?</p>	<p>The Fund's investment objective is to outperform (after fees and expenses but before tax) the S&P/NZX 50 Gross Index over a full market cycle.</p>	<p>The Fund's since inception performance history is attributable to the Salt investment team, led by Goodson, applying a fundamental, bottom up stock selection process. The Manager employs a specialist approach, focusing its resources to managing New Zealand equities that do, or, are likely to in the near future, produce a regular dividend revenue stream, to achieve the funds objective.</p> <p>The Funds ability to meet its stated objective can be seen in the funds factsheet. The expected quantum of performance, above the Funds benchmark, is not clearly stated by the Manager. Accordingly, investors should remain abreast of the Funds' performance, to ensure it still meets the investors needs and objectives.</p> <p>FundSource notes that the Funds reporting on a net of fee basis is preferred, and believes this is reflective of an investors experience, without considering the investors personal situation.</p>								
<p>What does the Manager invest your money into?</p>	<p>The Fund targets a portfolio of shares of New Zealand companies that may, in our</p>	<p>Salt invests with no specific style biases, focusing on companies, the Manager</p>								

	<p>opinion, pay high and sustainable dividends.</p> <p>The Fund is fully invested with exposure to NZ shares of 95%-100% and cash 0%-5%.</p>	<p>believes, will add value for shareholders. To achieve its stated objective, the Manager employs a disciplined process built around a robust quantitative and qualitative scoring system combined with pricing targets.</p> <p>The Fund is suitable for investors who want an actively managed, benchmark aware, New Zealand equity fund that looks to maximise the investors potential return through companies that generate strong free cash flows, giving them the ability to pay sustainable dividends.</p> <p>While not beholden to the Funds benchmark the Manager is benchmark aware. The Fund can make meaningful positions in companies, ranging between $\pm 8\%$ of a stocks index weighting.</p> <p>FundSource believes the Manager's transparency, courtesy of publishing the Fund's holdings on the Disclose website, to be a strong positive. The underlying securities are predominantly long only equity positions.</p>
<p>What are the inherent risks imbedded in the Fund?</p>	<p>The principal risks of investing in the Fund are risks relating to:</p> <p>investing in shares;</p> <ul style="list-style-type: none"> • the concentration of the Fund in one geographical region (New Zealand); • key persons (Matthew Goodson, Paul Harrison and David Oxley); and • the performance of the parties involved in the Funds (the Manager, Supervisor and Administration Manager). 	<p>The Manager is aware of the broad range of risks and is mindful of them when constructing and managing the Fund. Key parameters of the fund are developed by the Investment Committee. Importantly the Investment Committee does not manage or interfere with the day to day decisions of the portfolio, these rest solely with the Portfolio Manager and investment team.</p> <p>Consistency in the decision making process assists in managing risk. The Manager achieves this by using a scoring and ranking system for each security that is researched and included in the portfolio. FundSource believes the investment team, led by Goodson, has appropriate experience, insight and tenure to identify opportunities and execute on that decision making process.</p>
<p>Why do they believe the future prices of the Fund's investments will vary?</p>	<p>The Fund's strategy is to invest in shares listed on the NZX that have high and sustainable dividend yields. Research suggests that stocks with policies of strong and sustainable dividends also exhibit future earnings growth and outperform their index benchmarks.</p> <p>The Fund's investment process has been designed to facilitate selection of stocks such that the overall portfolio generates an above market dividend yield after each stock is qualified through a number of quality and sustainability screens generated by Salt's disciplined research effort. It is important to note that the strategy is not intended to generate the highest possible yield. It is intended to generate a high and sustainable dividend yield.</p>	<p>Models provide a basis from which consistency can be applied to decision making. As the Manager points out, models are only as good as their inputs. There are many drivers in the movement of a share price that are out of the Managers' control, and therefore may not be reflected in the Managers' model.</p> <p>The Manager has an ideology based on 'picking up \$20 notes from the pavement', that is, taking advantage of specific aspects of investing, for example, cum/ex dividend anomalies, selective activism, special situations, predictive index models and investing in non-benchmark securities.</p> <p>The Manager believes that the changing expectation of the future risk adjusted free cash flows drive changes in share prices. FundSource view this as a sound foundation, however notes that</p>

		<p>fundamentals do not always drive share prices, especially in the short term.</p> <p>Management of a company is considered a key consideration in determining whether a company is investable or not. The Fund incorporates an Environment, Social and Governance (ESG) overlay in to its decision making process, however, this does not imply that the companies it invests in are signatories.</p>
<p>Why does the Manager believe you should give them your money rather than to someone else or to an inexpensive index fund?</p>	<p>Salt's investment philosophy centres on the belief that the New Zealand market has peculiar characteristics that lead to market inefficiencies that can be exploited over time to deliver superior risk-adjusted returns.</p> <p>In our view there are no shortcuts to successful investing – the key is to understand companies, their financials and the markets in which they operate. Making the effort to model a company's financial performance is essential to gaining the requisite insight.</p> <p>More specifically, our investment philosophy is based on the belief that the value of any financial asset is the net present value of some measure of future cash flows, discounted appropriately. Our focus is on understanding what the equity market is implicitly pricing in to a company's value at a particular point in time and we do this by explicitly modelling the likely financial performance of companies within our universe.</p> <p>Salt's long-term track record in consistently managing mandates with this investment strategy highlights favourable risk adjusted returns as measured by both outperformance to the benchmark and the Fund's Information Ratio.</p>	<p>The Manager is providing investors with an opportunity to gain exposure to listed New Zealand companies, focusing on those companies that currently deliver or a likely to deliver a regular dividend stream. Of the 27 funds in the FE Analytics NZ Equity sector, this is one of two funds that specifically focus on the dividends of New Zealand listed companies, or in the case of this Fund, potentially soon to be listed New Zealand Companies. FundSource believes this Fund is unlikely to regularly invest in unlisted companies.</p> <p>Investors should expect the fund to be fully invested with cash weights limited to maximum of 5%. With an inception date of July 2015, the performance history, under the Funds current structure, is insufficient, to determine if the Funds' processes consistently contribute to risk adjusted excess performance. However, the Funds' longer term track record has shown strong risk adjusted returns. The performance history of the Fund is available on the Managers website.</p> <p>The Disclose website outlines the Funds' performance since inception, on a net of fees and tax basis. FundSource notes that reference performance benchmark, on the Disclose website, is gross of fees and taxes.</p>
<p>How does the Manager decide to buy or sell investments?</p>	<p>The Fund incorporates a combination of quantitative and qualitative elements to selecting individual investments.</p> <p>The regression model/ranking screen informs Salt's initial view of each stock, based on the difference between the actual Adjusted Dividend Yield for each stock relative to the yield estimated by the model. The higher the differential between the actual Adjusted Dividend Yield and the model estimate, the higher that company's implied active position.</p> <p>Unlike traditional long-only strategies, the Fund is also able to express its high conviction sell ideas via short selling. This is undertaken within a carefully constructed risk management framework that takes into consideration appropriate levels of diversification, position sizing and other total portfolio risk metrics.</p>	<p>The Manager typically takes a long term view on the companies in which it invests. The dividend level and sustainability focus of the portfolio means the Manager will have to critically evaluate each position regularly, and exit companies that have reached 'fair value' in their view or where the sustainability of the dividend stream of the business has declined, even if this is over a short time period.</p> <p>The structured process employed by Salt across its product suite contributes significantly to the buy/ sell decision making process. The quantitative process strongly assists in the decision making process, including the potential size of the company in the portfolio. FundSource notes that the Manager views the quantitative process as being powerful and statistically robust. FundSource highlights that the fund is not a quantitative fund, and the Manager is acutely aware that</p>

		investing remains a blend of art and science.
Has the CIO/ PM personally invested in the Fund? If so, paying the same fees as other investors?	The Portfolio Manager has invested in the Fund, and at the same fees and conditions as other investors in the Fund.	<p>FundSource believes that 'eating your own pudding' should be an aspect potential investors consider, when deciding to invest in any financial product.</p> <p>Investing in funds alongside investors aligns the interests of investment personnel with those of the investors, when investment personnel are significantly invested in a fund they are managing, and at the same fees.</p> <p>The Manager believes alignment of interest is an important aspect as well, to the point that not only are Goodson and Harrison significant shareholders in the Manager, but are significantly invested in Salt funds. Importantly, all investment personnel pay the same fees as other investors, enhancing the alignment of interest with an investors experience.</p>
How much latitude does the Manager have to deviate from the weightings of the Benchmark portfolio?	<p>The allowable range for any individual company is +/- 8% relative to its benchmark weight in the S&P/NZX 50 Index.</p> <p>Tracking Error n/a Cash Allocation: 0% to 5% Single Stock Limit: ±8% of market cap Sector Limits: n/a Unlisted Companies 0-5%</p>	<p>The Manager has some restrictions placed on how they can invest, with most being softer in nature, as opposed to hard limits which require the manager to take action. FundSource believes that the Manager is unlikely to use the full range of discretion, except in exceptional circumstances.</p> <p>Both sector and stock positions can have a significant impact on the overall return of the portfolio, especially over shorter time periods, say, one year. FundSource views that the Portfolio Manager's level of discretion is expected to result in the return of the Fund differing significantly from that of the benchmark, as it has since inception. Thus investors seeking a benchmark-like return may not be suited to the Fund.</p> <p>There is a speculative element to the portfolio, being the ability to invest in unlisted securities, proposed listings may or may not occur within the timeframe proposed, or at all. FundSource believes the small and very infrequent allocation allowed at both the Fund and security level does not significantly contribute to risk, however, may not be palatable to some investors.</p>
On what basis does the Manager believe the fees they charge are justified?	The Fund charges a management fee of 0.95% p.a. plus GST. Other management and administration fees, including Supervisor's Fees, Custodian's Fees and Administration Manager's Fees have been capped at 0.20% p.a. plus GST.	<p>FundSource believes the Manager is transparent from a fees perspective, noting the administration and underlying manager fees are disclosed in the Product Disclosure Statement (PDS) available here, and via the Disclose website.</p> <p>FundSource observes that the management basic fee is in line with the average peer relevant funds, as represented in the FE Analytics NZ Equity sector.</p>
How would you describe the quality of your organisational and investment governance processes?	Salt has spent considerable time implementing best-of-breed governance	The Manager has a robust governance framework. FundSource believes this could be strengthened by appointing Non-

	<p>structures and compliance infrastructure to manage operational risks.</p> <p>To assist Salt's Board in undertaking its responsibilities we employ the following two Committees:</p> <p>Investment Committee - chaired by the Head of Research, this Committee has delegated authority from the Board to oversee investment decisions and control Portfolio Manager discretion. This includes developing, implementing and modifying internal controls on Portfolio Managers, reviewing portfolio risk profiles and performance, and approving investment decisions if required.</p> <p>Compliance Committee - chaired by an independent subject matter expert the Committees' objective is to assist the Board in discharging its duties in relation to compliance obligations of the company.</p> <p>Both Committees meet at least quarterly and include the Managing Directors of Salt.</p> <p>The Supervisor, Custodial and Registry/Administration functions have been outsourced to specialist, reputable firms.</p> <p>All outsourced services provided for the Fund are through reputable service providers and are subject to regular, on-going due diligence and monitoring.</p>	<p>Executive Directors, and appointing them to more Committees, including Compliance, and expanding committees to include Remuneration, and Audit, chaired by non-executive directors.</p> <p>FundSource views the formal Investment Committee positively, however the inclusion of external advisers to the Investment Committee is considered industry best practice.</p> <p>The Manager does outsource some functions, and regularly reviews each provider throughout the year, for example quarterly or half yearly. FundSource highlights that the Funds administrator and custodian functions are considered to be material relationships and the Manager reviews these key functions more regularly than a typical annual review.</p>
<p>Is there alignment of interests through; ownership of the Manager, and remuneration of the investment team?</p>	<p>The Manager, Salt Investment Funds Limited, is a wholly owned subsidiary of Salt Funds Management Limited which in turn is 100% owned by interests associated with its staff . The business was established in May 2013 by the founding principals and equity investment staff who were previously employed at BT Funds Management.</p> <p>Salt views the role of equity as critical in recognising talent and contribution and ensuring that the business creates long-term value for its clients. Accordingly, all employees are eligible to be offered shares in Salt, with the offer of shares entirely at the discretion of Salt's Board to reflect the value and contribution of that employee to the organisation.</p> <p>All Salt employees are eligible for a Short Term Incentive, with the payment relative to target being a function of the individual's overall fulfillment of their role.</p>	<p>FundSource observes that to preserve capital and generate a long-term positive return for investors, the Manager must remain operational.</p> <p>Being 100% owned by staff, including key investment personnel, is a strong buy-in from the team to work hard for the firm's long-term success. FundSource considers this a positive alignment with investors</p> <p>The Manager believes that their structure means that, unlike institutional managers, the Managers primary duty is not to an external shareholder.</p>

Conclusion and Rating

The Fund provides an investor with exposure to a New Zealand equity fund that is focused on companies that generate strong free cash flows and pay sustainable dividends. The fund can invest in some non-benchmark securities, including unlisted companies, however, FundSource do not expect this to be material or feature significantly. With a focus on sustainable income, the Funds sector allocation may be materially different to that of the Funds reference benchmark.

The Funds focus on sustainable dividends does make this a relatively unique opportunity for New Zealand investors. This is one of two funds, that focus on dividends, with the Salt fund being actively managed versus a more passive ETF based strategy. FundSource notes that the Funds FUM is relatively low. The Managers total FUM across all funds and strategies is significant, materially reducing the impact of low FUM in any one fund, as well as business risk.

The Manager has grown the investment team as FUM has grown, indicating that the Manager is aware that developing talent over time will assist in transitioning investment responsibilities in the long term. FundSource's conviction in the Manager is underpinned by the ownership structure, which assists in reducing key person risk. Furthermore, the interests of the investment team are aligned to those of the investor via the investment team's investment in Salts' Funds, and paying the same fees as retail investors.

FundSource recommends that investors carefully consider that the Manager's focused approach to managing New Zealand equities, meets their investment needs and objectives.

FundSource Rating: AA

Fund ratings are current as at the date of publication of this report. FundSource reserve the right to review and update fund ratings from time to time.

Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score
Corporate & Investment Governance	15%	3.92 / 5
Investment Philosophy & Process	20%	4.40 / 5
People	25%	3.67 / 5
Portfolio Construction & Implementation	15%	3.00 / 5
Risk Management	15%	3.53 / 5
Investment Fees	10%	2.95 / 5
Overall Average Score:		3.50 / 5

FundSource Rating Guide

The qualitative rating of a fund is a function of the FundSource Research Factor Weighting process, which is built around the six core qualitative research process categories. The weighted scores result in an overall score, out of five, which is then matched to the following rating:



AAA: Highly Recommended

Funds that have superior average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, significantly experienced and stable senior personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management company will also have established effective controls to maintain that philosophy.

AA: Recommended

Funds that have strong average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced and stable personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management philosophy must be coherent and consistent with existing portfolios and processes.

A: Investment Grade

Funds that have good average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced personnel, a sound track record a defined investment philosophy and process, and a portfolio consistent with that philosophy and process.

FW: Fund Watch

There has been a material change with either the manager, this may include, but is not limited to, departures, new hires, process changes, changes to the investment philosophy. This is considered to be an interim measure, to enable further investigation, re-evaluation and an appropriate course of action to be determined.

S: Sell

This category covers previously recommended funds that are no longer recommended because of some material change. Removal from recommended status might be for a variety of reasons such as a fundamental change in the fund management company or in the manager's investment strategy, or because a fund did not meet its original expectations. The implications for ongoing service are that the fund should be reviewed on an individual client basis to ensure it still matches their original investment objective.

NR: Not Rated – Screened/ Not Rated

Funds in the Not Rated – Screened category have provided information and/or FundSource has conducted an initial analysis of the fund, but has chosen not to provide a recommendation at this stage. FOR Not Rated funds the manager may have provided information, but no review meeting has been conducted

Disclaimers, Disclosures and Warnings

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