# QUARTERLY REPORT #12: PERIOD TO 30 JUNE 2019[1]

**Performance and net asset value[2]**

*Quarterly portfolio return: (8.8%)*

*A world of inconsistency*

The June quarter, especially the month of June 2019, has beguiled us. It has been a period of numerous inconsistent trends across financial markets, equity valuations and more importantly earnings downgrades which we believe increase the probabilities of a more proximate and potentially worrisome dislocation in markets.

Value investing – defined here as purchasing securities priced below conservatively assessed sum of the parts valuations – has come under its fiercest questioning since 1999[3]. On many measures, "value" type stocks are priced at their lowest levels relative to the wider market since the height of the dot.com boom of 1999-2000; this had a negative impact on our performance for the period.

The quarter was dominated by the June month; the strong rebound in global equity markets as bond yields declined, together with hopes of short term interest rate reductions propelled indices to recoup the losses of May 2019. In Australia, where we have a significant short index position "hedging" against our physical portfolio, there was no May downturn, but we were temporarily hurt by our "value" long positions being subject to tax loss selling and in two specific cases, fund mandate transitions. Additionally, our largest fundamental short, Tesla, gapped up 20% from its May 2019 close. The move in Tesla reinforces that these reports are at a point in time, are involuntary and arbitrary measurement dates, and that our strategies in stock selection are driven by fundamentals, not reporting dates.

But what's "value"? Quantitative research typically defined "value investing" as purchasing securities exhibiting low price/earnings or price/book value ratios. On that basis, the tenet of value investing is increasingly being brought into question. Recent research suggests that very low interest rates, emanating from quantitative easing, low inflation and easy monetary policy have systematically reduced discount rates applied to future cash flows – a feature Australian investors are very familiar with in the infrastructure sector[4]. The argument goes that this makes "hard" book value plant and equipment less of a factor and is reflected in the winning strategies and large protective moats of mega-cap technology companies.

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1 East 72 Holdings Limited (**E72**) provides monthly **unaudited** updates on its company performance and exposure supplemented by a more substantial quarterly note. Readers are referred to footnotes 2 and 22-27 explaining the derivation of the numbers. All returns are pre-tax unless stated otherwise. At the current level of net assets, cost imposition is estimated at 0.45% per month over the course of a full year (excluding capital raising related expenses) and is fully accrued monthly according to the best estimates of management. Readers are explicitly referred to the disclaimer on page 15.

2 Month by month tabulation of investment return and exposures is given on page 12, along with exposure metrics.

3 An excellent piece in this respect by Bernstein "Value Investing may be Fundamentally Broken" 23 June 19 cited in "Business Insider"

4 ibid Bernstein above

We too use discounted cash flow to value certain parts of businesses; where we are not prepared to go, is in being far too liberal with the cost of money. Other investors clearly are; for the time being in a first but ultimate inconsistency: applying near all-time low bond rates to optimistic earnings profiles.

With interest rates so low, banking shares are one area of value investing which has come under severe pressure; inverted yield curves depress the earnings of entities ostensibly borrowing short and lending long, aside from other aspects of disintermediation currently at play.

A second inconsistency is now especially marked in Australia. In the wake of a Federal Election which returned the underdog right-wing Government and allowed retention of all facets of the tax-effective franking credit scheme, financial securities assisted in propelling the equity market upwards in a "retiree yield fest". The negative impact of subsequent central bank rate reductions on banking spreads, margins and forward profit estimates was put to one side. This results in a large inconsistency with global bank shares; the ramifications of this are discussed in some detail below, as they underpin a more cautious view on Australian equities, given banking is ~30% of the core ASX 200 index.

We see other areas of meaningful inconsistency; some may be small but carry strong messages, others far larger. For example, in a third inconsistency, over the past quarter, the discounts to net asset value of our main investment company holdings (PM Capital Global Opportunities Fund, Monash Absolute and RENN Fund) have all blown out towards or above 20% despite good performance in recent times. Historically, such moves tend to occur close to market peaks.

A fourth theme, discussed in detail is the massive pricing inconsistency between perceived "new world" payment companies – let's call them Afterpay – and old world credit/debit card operators. 50 time earnings three years out versus ~7x next years. Moreover, the potentially deliberate obfuscation of payments which represent interest margin continues to fuel erroneous assessments of these newer companies. This is magnificently captured in one of Canada's go-go stocks, Shopify, where growth is being increasingly funded by Shopify Capital,. But don't look for interest income in the accounts; this "income" is rolled in with embedded loan repayments as subscription fees: the difference between a single digit earnings multiple and the attraction of a high-priced (non-annuity) annuity stream.

But in a quarter which saw the IPO listing of Uber Technologies, a major inconsistency lies in the pricing of its largest shareholder, Softbank Corporation. Softbank and its affiliate Vision Fund held some 16% of Uber equity prior to the IPO[5]. However, deconsolidating the Softbank Corporation Group (9984.JP) parent into its mobile (Softbank Corp – 9434.JP), Yahoo Japan (4689.JP) and Sprint Corporation (S) ownerships, along with the ongoing 29% stockholding of Alibaba (BABA) shows the company to be priced at a 20% discount to these values alone. Hence, there is **negative** attributable value to the general partner carried interest in Vision Fund, which contains all of the "unicorn"[6] company investments – and others[7] totalling US$70billion - made by the revered Masayoshi Son, and 60% funded by Government arms of Saudi Arabia and Abu Dhabi.

So if you believe in this stuff, in Softbank Group Corporation, you get paid to own it.

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5 Uber Technologies S-1 filing 11 April 2019
6 A private equity company with an equity market capitalization of over $1billion
7 Vision Fund's most well-known private equity investments are stakes in Bytedance, Coupang, PayTM, Arm Limited (vended in by parent at extravagant valuation) WeWork, GM Cruise, DiDi, PayTM, Grab, Katerra

Our portfolio structure at end June 2019 is highly symmetric and reflects our views on how the inconsistencies we observe will resolve themselves over time. For every $100 of pre-tax equity, we have roughly $198 of long investments – seven of the ten largest being securities priced at below their stated net asset value – and $198 of short positions ($157 indices; $41 short individual securities). Hence, we have effectively zero net equity exposure at present, the lowest level since January 2018. It does mean we have a geared exposure to this value-growth divide.

**Australian banks: sifting the sensational from the real negative issues**

Your author has the benefit of being a sell-side banking analyst through the period of greatest upheaval in Australia's banking sector: 1998-1992. The aftermath of the entry of sixteen foreign banks, rampant decentralised credit growth, asset price inflation and an entrepreneurial set of "bold riders"[8] culminated in the effective rescue of two state-owned banks, emergency rights issue for Westpac, biggest lost opportunity in the great career of Kerry Packer[9], and significant capital raisings for ANZ. Across the three major publicly listed banks prior to 1991 (CBA was privatised in April 1991) at end September 1992, 8.3% of $198billion gross loans (after prior write-offs and excluding Westpac's $1.8billion of foreclosed real estate & Channel 10 TV licence) were non-performing (ANZ: 8.7%, NAB 5.6%, WBC 10.4%).

However, the events of the early 1990s – despite some sensationalist commentary to the contrary - have next to no relevance to today's travails and emerging risks. Most of the major banks' problems stemmed from higher risk subsidiaries lending to entrepreneurs and property magnates on a negative pledge basis. There was not a residential lending catastrophe , despite (or because of) interest rates of 15% and above. Many borrowers kept tightened belts, maintained repayments and as interest rates subsided, bizarrely but beneficially learned about compound interest via its reverse impacts.

Assessing potential bad debts in residential property depends on analysis of <u>flow</u> not <u>stock</u>, which can be deployed when analysing a corporate bust; how many/what value of poorly analysed loans did a bank pump out over a period of overly aggressive lending, with potentially false borrower disclosures.

The following "pot-pourri" of residential lending charts[10] shows fairly clearly the lunacy of the Reserve Bank of Australia's four by 0.25% rate cuts in February 2015, May 2015, May 2016 and August 2016: pouring petrol onto the fire which was <u>gradually</u> petering out of its own accord.

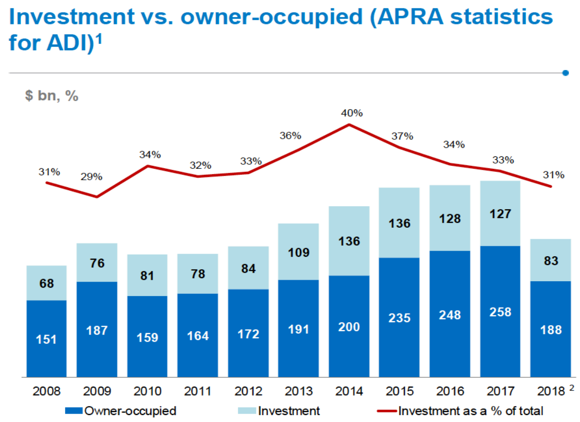
Cross checking against the charts below shows clearly the inappropriate medium term timing of interest rate cuts, being made when foreign capital was flowing in, sales levels were high, investment loans were over 33% of the market, around half the loans written were interest-only and clearance rates were 70-80%.

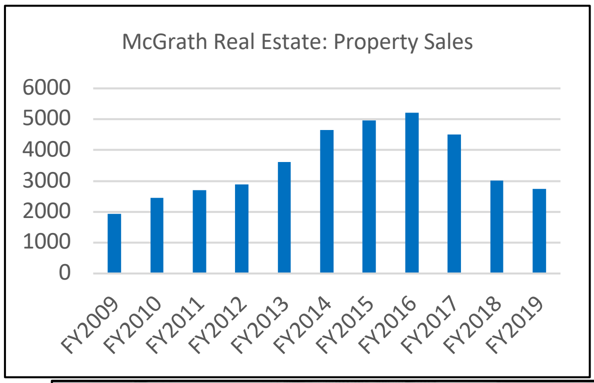
8 A phrase coined by the eponymous book of Australian business boom and bust of the 1980s by Trevor Sykes (1994, Allen & Unwin)

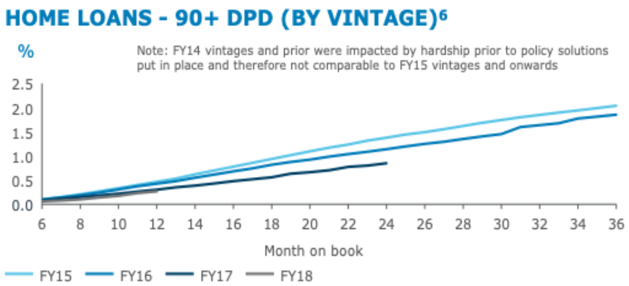
9 Packer's stake in Westpac acquired for $407million would ultimately have been worth ~$16billion (Australian Financial Review 31 May 2017)

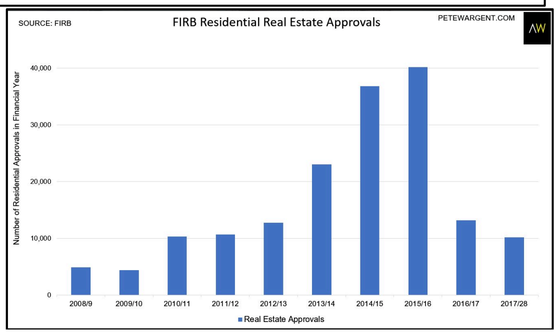
10 Clockwise from top: Genworth Mortgage Australia, McGrath Holdings (compiled), Pete Wargent, Core Logic, ANZ interim results FY2019

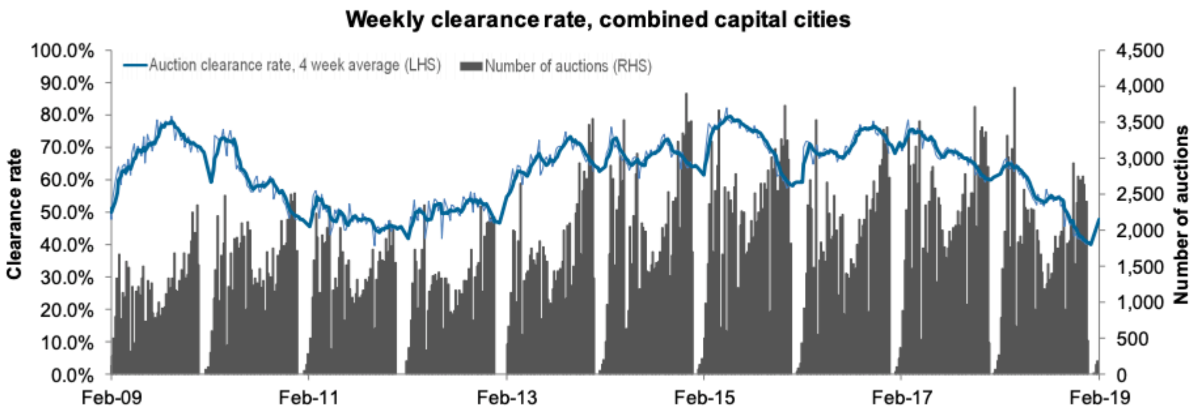
One might ask, even without the benefit of hindsight, but with the full knowledge of economic history: **What were they thinking?** Looking forward, it's likely to be the loans written in that period which are likely to be the poorest over time, as the ANZ chart clearly shows:




Australia's banks provide sufficient disclosure of home lending through the crucial 2014-2017 period when house prices took off in the key Sydney and Melbourne markets to perform a reasonable back of the envelope analysis of a more downbeat environment than has currently appeared. Let's assume 5% of loans written through that period become delinquent (around Spain and US numbers in GFC), loans written were at 75% LVR, property falls 30% and so there is an effective extinguishment of equity and 5% additional loss (or 6.7% on the loan):

| | ANZ | CBA | NAB | WBC |
|---|---|---|---|---|
| Gross loans written ($billion) 2015-2017 | 204 | 343 | 305 | 241 |
| Loan delinquency at 5% ($billion) | 10.2 | 17.2 | 15.3 | 12.1 |
| 5% delinquency scenario loss ($million) | 680 | 1,143 | 1,017 | 804 |
| Equity† at Mar 19 (Dec 18 for CBA) ($million) | 53,658 | 58,129 | 45,980 | 50,311 |
| Scenario loss/equity | 1.26% | 1.97% | 2.21% | 1.60% |
| Remediation charges & fines to date†† | 928 | 1460 | 1200 | 1080 |

† tangible equity excluding deferred tax assets
†† estimates given mix of remediation as ongoing compliance work as well as fines, penalties & refunds

The first derivative assessment suggests little more than superficial damage to each of the mainstream banks; it might be seen in the context of the fines and remediation expenses already charged off in the wake of the Hayne Royal Commission (and pretty much glossed over by investors).

The far bigger issues are the second and third derivative imposts. Australia has the world's second largest pile of personal debt relative to GDP (122%), predominantly levered against residential real estate. The country is obsessed with property prices – a fact noted in the creation of the world's most valuable property portal (REA Group – market capitalisation $12.2billion) a second competitor (Domain Group – $1.9billion) and strong infrastructure back-ups of statistical providers.

Until the recent demise of "Your Money" (nee Sky Business), TV channel live actions were broadcast; mainstream media provides extensive lists and freely published commentary on auction results. These are phenomenon not extensively seen elsewhere; indeed, many other countries either have seen property as a utility rather than financial speculation (Germany) or have morphed into that (Japan).

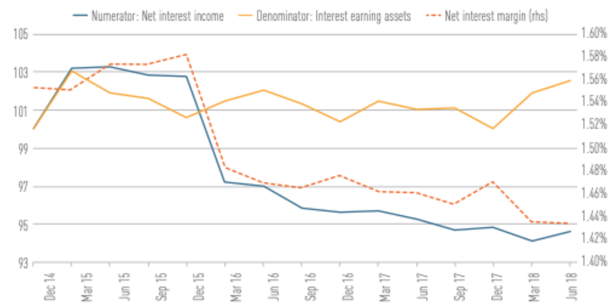
It's against this psychological as well as financial backdrop that residential property price declines need to be seen. So $55billion of delinquent loans in our hypothetical scenario would result in ~$14billion of directly extinguished equity amongst the customers (direct and brokered) of the large four banks. Up that to ~$20billion across the system, perhaps. So the second round impact is not **that** great either, when set against a $1.9trillion economy.

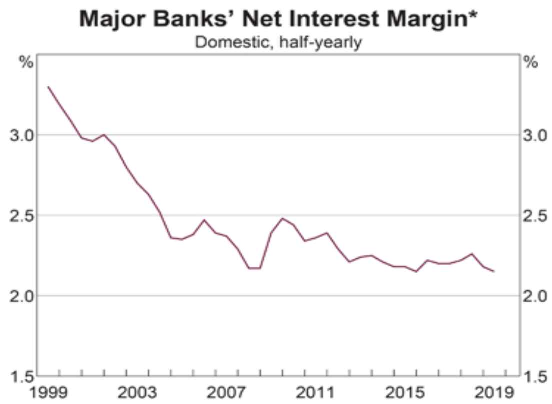
All the Monte Carlo analysis in the world won't produce the answer to the third derivative impact - the wealth effect – being the impact of fear over consumer spending, small business leveraged against residential property, and reduced demand in Australia's high (read extortionate) rental sector and high cost service sector.

One of the intertwined impacts is within the banking sector itself. Ongoing restrictions on lending such as investor lending caps, allied to likely requirements – despite bank push-back -for higher capital bases, at home and in New Zealand, are turning the four majors into utility-type organisations. The chances of returning to very high teens ROE seem remote. Competitors are riding the wave of technology disruption, but are also coming from investors and markets where regulators have been strong for 10 years plus, rather than a year or so, as Australia's regulatory bodies move out of the gilded cages built for them by the banking industry. Low cost bases and large funders like ING and Pepper (KKR) are somewhat trickier foes.

Moreover, the sector has to face up to an previously incompetent central bank now desperately paddling to make up for the monetary policy errors in 2015/16 – detailed above - which had to be reined in by the banking regulator, APRA. Asking folks to borrow even more money relative to GDP, because interest rates are low, to buy domestic asset classes seems foolhardy, unless such assets have global fungibility. They do to some degree – more so than Irish residential real estate ever did – but the main source of global liquidity, Chinese investors, are now largely disappearing.

So the major Australian banks are now subject to the previously unexperienced water torture of ultra-low interest rates, which we know from the European experience, is a major deterrent to ROE and thus any kind of respectable P/BV rating. Australian bank net interest margins – at around 2.1% (RHS chart below) - are still some 65bp ahead of their European counterparts (LHS chart below) – before the impact of the two latest RBA rate reductions[11].




*Source: European Banking Authority; Reserve Bank of Australia*

Add together crimped margins, reducing fee income, (albeit with some potential respite from low quality trading income) escalating compliance costs, third derivative impact of slowing/falling home prices in the two cities comprising 40% of the Australian population, demands for more compliance and capital – in a more competitive transforming environment. Virtually the only lever capable of being pulled is cost reduction. Australia's four main banks have just less than 150,000 fte employees, mainly but not exclusively in Australia (& NZ). Average employee cost pa is ~$133,000 so these are highly paid folks to be slinging out of work.

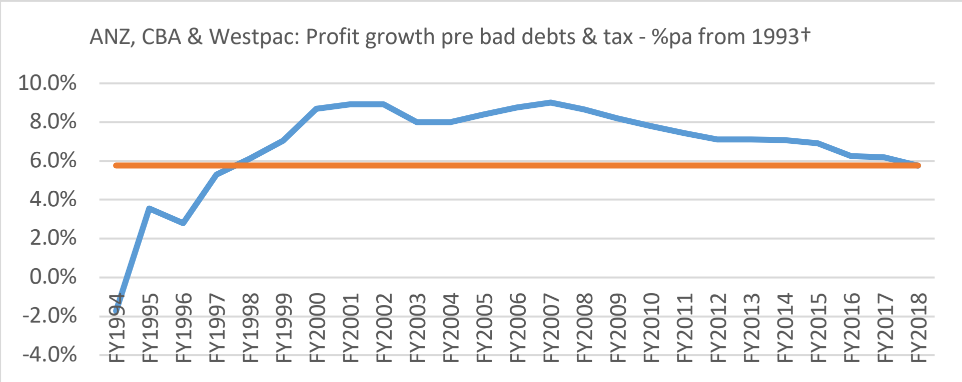
Not too many analysts stand back and look at the **longer term** picture in this sector, preferring to focus on short term influences. And yet, we would argue, the long term ramifications of what is happening are very material.

It is clear from the very low share price ratings of European banks – and two in particular we have picked out – that pan-European retail shareholders did not rush to buy bank shares to gain income in an ultra-low rate environment. Australians are being driven too heavily by franking considerations, potentially to their detriment, in the pursuit of yield. Europeans were not.

[11] It should be acknowledged that the non performing loan ratio in EU at over 3.5% is a significant net margin drag versus the Australian counterpart.

About 28 years ago, your author posited that Australian banks were about to go through a glorious secular bull market[12]. Whilst a year early, the core of the thesis was that lowered inflation, lesser capital demands, cost reductions, securitisation and other reduced capital requirements would see return on equity not only rise **but be stable** – a recipe for far higher share price ratings.

The subsequent picture over the past 25 years from 1993 (a year after the nadir), is one of near 6%pa compound growth in the core business, adjusting for capital raisings. But that peaked at ~9%pa from 1993- 2007, as Australian banks were forced to de-gear in the wake of the GFC.




† adjusted for capital raisings; NAB excluded due to UK business

So core profit before bad debt charges has slowed to a crawl and is starting to track negative. There are fewer levers to pull to change this than at any time in the past two decades; that's before bad debt charge offs which are at the lowest levels ever seen in Australian banking history since they were disclosed in the early 1980's. The positive **secular** factors of 1993 are virtually all reversing, or have already reversed.

The short sale thesis on Australian banks, by and large by foreign domiciled hedge funds, has been a rocky ride (on a local currency basis); it has tended to be focused on re-run of "The Big Short" with some supplementary comments regarding other constraints[13].

On consensus figures, the sector trades at a forward P/E of 14.2x, prospective ROE of ~ 11%, fully franked dividend yield of 6% on a payout ratio of ~ 85%. As an alternative, Lloyds Banking PLC (LLOY.L) trades on a forward P/E of 8.6x, 5.5% yield on a 55% payout ratio, 18% discount to book value and earns 12.5% ROTE, with NIM around 2.9%. ING Groep (INGA.AS) yields 6.6% (on 57% payout), trades at a 21% discount to tangible book, earns 11% ROTE and trades at a P/E of ~7.3x. They both suggest Australian banks to be expensive conveyances indeed. Given banks make up ~30% of the Australian equity market, it's easy to be less than sanguine.

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12 County NatWest Securities April/May 1991 "Structural Change in Credit Markets: Implications for the Economy and the Banks" Andrew Brown/Daris Delins. Mr Delins is currently the Honorary Consul for Latvia in New York as well as a private financial and business forecaster.

13 The SumZero Top Stocks for 2017 featured Westpac as a runner up in its "short" category featuring a thesis by Ismail Guennouni (Meridian IMA) is typical of the genre. The return from the recommended short in December 2016 is marginally negative after dividend funding, but before cost of borrow in A$. There would have been a currency gain to a US$ domiciled trader.

**Afterpay: Poster child for a world devoid of valuation frameworks**

One of our standard methods to assimilate with an audience of retail investors has been to try and provide examples where the audience can rapidly distinguish between a "superior" and "inferior" business – airport (retailing) versus department store retailing for example. It's an attempt to show that the average person, with a bit of thinking and discipline, can fathom out that a specific activity is a "good" or "bad" business, and that they can work it out as well as a professional. I accept a slight "overegging of the pudding"; the point is that the audience can judge a business – but by and large, they don't know what this good business is worth. That's our job to find out or work it out.

Australia's equity market has been a long term hot-bed for over-valued growth companies. Whilst the market outside of the resources sector has some genuine high growth global players (CSL, Cochlear), some moated annuity streams (Transurban) and well-run, disciplined honest-to-goodness operators (Reece, TPG, ARB), the proliferation of banking shares, desires for "growth di-worsification" (Wesfarmers) and broad absence of IT/pharmaceutical sectors leaves Australian capital markets with a shortage of growth companies. Hence, when one looks as though it may have come along, the desire to buy in at any price becomes magnetic.

The "magnetic attractions" have now turned into a frenzy, with several commentators noting that Australian mid-caps are the worlds most expensive such sector in developed markets[14]. We have noted our past or current short positioning in a basket of these companies: Pro-Medicus, Wisetech, A2 Milk, Afterpay, Altium, Corporate Travel Management and HUB24. We made excellent returns from this group in October 2018, but are currently under-water on the basket.

The most controversial amongst the sample is the "buy now , pay later" pioneer, Afterpay (APT.AX), and bears out closer examination for what it tells us about investor behaviour amongst these stocks.

Afterpay is a simple but highly effective idea of charging a retailer a merchant fee which funds the shopper to make purchases with four equal payments over a six week period. As long as you pay on time, there are no fees at all to the shopper; if you miss a payment, you pay a late fee. Combined with a 55-day "interest free" credit card, at least part (25%) of the purchase cost would not be paid, free of charges for 86 days. The idea is that the fee charged to the merchant – 4% - funds the loan costs, administration and bad debt imposts. In the latest six month period to 31 December 2018, this "net transaction margin" – fees less admin less bad debt charges (excluding the costs of using the banks on unpaid amounts) - before the overhead cost of running Afterpay, was the equivalent of 2.57% of underlying sales, of which 80bp came from late fees.

Fairly obviously, Afterpay is a volume game, needing to increase sales through merchant and customer expansion, preferably into larger retail markets. As a consequence, the company has (seemingly) successfully commenced operations in the US and imminently so in the UK.

Bulls on APT point to the seemingly limitless opportunity to penetrate developed retail markets, through an appealing modern (and free of charge) product. In general, we observe a disconnect

[14] Australian Financial review 30 May 2019 "Our growth stocks are the world's most expensive" citing a report by Goldman Sachs.

between their assessments and the company's financial statements, with an alternative focus on company provided customer data, with limited (to no) reconciliation back to statutory financials.

Our analysis suggests Afterpay has a real future, but one which will not be a smooth road. We see risks to the business growth in a number of areas, some of which are noted below:

- Potential for net transaction margin to be degraded by competitors – is there something magical about the 4% merchant fee? What if it was only 3.5% on an immature fixed cost model?
- Potential for net transaction margin to be reduced by higher payment delinquency; APT's bad debt charges (excluding not insignificant payments to be made to banks) in the latest six months equate to ~1.19% of the underlying sales in the period – a favourable comparison to main peer Zip Co (Z1P.AX) at 1.93%;
- Regulatory imposts from authorities (Austrac) concerned about money laundering, notably from the merchant side of the transaction, and which is currently being probed in Australia;
- Potential regulatory queries over the quantum of late fees charged – an embedded component of the business model; and
- Ability to build out in international markets at a sensible fixed cost – the biggest mystery of the business on its path to a target level of $20billion of underlying sales by 2022[15] – four times the prevailing number; fixed costs in H1 2019 ran at an annual rate of $120million (including share based payments). The full extent of that cost base when Afterpay "matures" in its current four markets will dictate when the company breaks even and the extent of profits by (say) 2022 on target revenue. It's an area generally given little thought by analysts of the company.

Our stab in the dark, generous, and reasoned though it is, has massive error potential. We see how profitable Afterpay should be and get the great operational leverage in the model, but figure the shares trade at between 40-55x P/E for 2022. Given that assumes near perfect execution towards the corporate target, we hold a short position. Better hope Afterpay stay on track, rather than Austrac stay on Afterpay.

**Alliance Data Systems: The other end of the spectrum– c.7x earnings**

Alliance Data Systems (ADS) is a provider of credit card lending, marketing and loyalty services to a variety of consumer-facing businesses, principally online and physical retailers. The company is organized in three segments, the largest of which is the credit cards business, as well as a loyalty program which includes the Canadian Air Miles program, and Epsilon, a marketing and analytics business first acquired in 2004 for $310 million[16] (the company has also since acquired other marketing businesses that have been integrated into Epsilon).

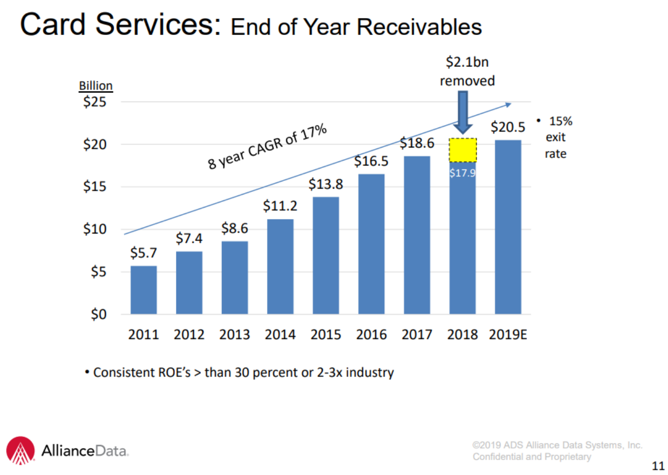
Perhaps in part because of the confusing collection of tangentially related businesses in ADS, the stock has consistently underperformed in recent years: from touching above $300 a share in 2015, it currently trades at around $140. The last fall has come as a result of the company's

[15] Afterpay presentation ASX Release "Capital raising to support mid-term targets" 11 June 2019
[16] Alliance Data Systems, 2004 10-K. Available online at https://d18rn0p25nwr6d.cloudfront.net/CIK-0001101215/c56883b7-55a3-469e-b14f-cd07bd14d688.pdf

attempt at simplifying its narrative by selling Epsilon to Publicis Group for $4.4 billion ($3.5 billion net of taxes and fees), which the company plans to use for share repurchases and debt paydown.[17] The market was disappointed with the sale price, as prior valuations had pegged Epsilon's value as being higher, and the stock has fallen further to its currently depressed levels. The sale of Epsilon was duly completed on 1 July 2019.

Irrespective of whether the sale price is disappointing, we think that at this stage the business is unambiguously cheap. According to our calculations, which adjust 2018 annual earnings for the Epsilon sale and subsequent debt paydown and share repurchases (assuming they happen around current price levels), the remaining credit card and loyalty businesses are trading at around 6.5 – 7 times trailing earnings.

Several assumptions underlie this analysis: in particular, use of a trailing multiple may not make sense if the trend of falling credit card receivables seen during 2018 continues. However, the decline in balances during 2018 was the result of a deliberate move by the company to clean its portfolio of failing and underperforming retailers, and the company is confident they can continue to grow receivables over time by signing new clients with better growth profiles and ramping up recently signed clients. If the company's estimates for 2019 prove accurate, they will have grown the balances by a compound annual growth rate of 17% over 8 years[18]:




Since the end of 2018 several new signings have already been announced which gives us confidence that the company will be able to return to growth in receivables.[19]

We've also taken the company's estimates for corporate expense reductions resulting from the sale at face value. Here, too, signs are encouraging: in particular, ADS already eliminated one layer of management by replacing the CEO and CFO with the previous CEO and CFO of the card business, both of whom have been with the company for many years.[20] This move also suggests

[17] https://www.alliancedata.com/news/press-releases/press-release-details/2019/Alliance-Data-Enters-Into-Definitive-Agreement-To-Sell-Its-Epsilon-Business-To-Publicis-Groupe-For-44-Billion/default.aspx
[18] https://s23.q4cdn.com/525801907/files/doc_presentations/2019/Q1-2019-AllianceData-PPT-Earnings.pdf, slide 11.
[19] Houzz, Burlington Stores and Carter's. See https://www.alliancedata.com/news/press-releases/default.aspx
[20] https://www.alliancedata.com/news/press-releases/press-release-details/2019/Alliance-Data-Announces-Organizational-Changes/default.aspx

– although nothing concrete has been confirmed by the company – that the loyalty business may also be sold, further simplifying the company's narrative and freeing up more capital for share buybacks which, at these levels, are likely to prove extremely accretive.

The restructured ADS remains cheap within a cohort of inexpensive credit card/payment providers. The group represents a stark contrast to the aforementioned new-age companies who ostensibly provide some sort of credit disguised as annuity[21]:

| | Synchrony Financial | Capital One Financial | Discover Financial Services | Alliance Data Systems |
|---|---|---|---|---|
| FY 2020 mean consensus EPS | 4.68 | 12.1 | 9.56 | 20.64 |
| Price | 35.52 | 90.16 | 80.1 | 147.94 |
| Multiple | 7.59 | 7.45 | 8.38 | 7.17 |

It should be noted that the consensus numbers above assume differential and varied assumptions on share buy-backs to our own. Additionally, the opportunity for industry consolidation or further divestments by ADS remains a live one making prevailing valuation metrics very attractive.

**Conclusion**

With S&P500 trading at ~17.7x "back-ended" 2019 earnings, we see many risks, notably in further degradation of current earnings estimates, low volatility given the attendant wide ranging political and leverage risks, allied to a very optimistic looking set of oil/energy reliant 2020 estimates (+11% growth).

In our view, it's simply not a time to be heavily "long" equities as an asset class, with the obvious caveat that there are always selective neglected, long opportunities, to offset some of the more mania-type thinking which still prevails.

**Andrew Brown & Marc Lerner**

**For further information:**

Andrew Brown
**Executive Director**
(02) 9380 9001 / 0418 215 255

[21] Data sourced from Refinitiv; prices as at 11 July 2019

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## STATISTICAL APPENDIX: QUARTER & FYTD TO 30 JUNE 2019

### 1. Monthly performance, exposure and NAV

| | Investment return[22] | Cost imposition[23] | Net Return[24] | R12 Return | NAV/share pre tax (c) | Gross Exposure[25] | Net Exposure[26] |
|---|---|---|---|---|---|---|---|
| 30 Jun 17 | | | | 46.6% | 35.5 | 276% | -6% |
| 30 Jun 18 | | | | -18.8% | 29.0 | 278% | 81% |
| | | | | **R12 return** | | | |
| 31 Jul 18 | -3.8% | -0.3% | -4.1% | -22.5% | 27.8 | 276% | 63% |
| 31 Aug 18 | -6.4% | -0.4% | -6.8% | -23.7% | 26.2 | 285% | 48% |
| 30 Sep 18 | 0.9% | -0.2% | 0.7% | -25.0% | 26.4 | 287% | 42% |
| 31 Oct 18 | -0.8% | -0.2% | -1.0% | -19.8% | 26.2 | 217% | 145% |
| 30 Nov 18 | -0.2% | -0.2% | -0.4% | -12.1% | 26.0 | 233% | 152% |
| 31 Dec 18 | -10.3% | -0.2% | -10.4% | -14.5% | 23.2 | 243% | 185% |
| 31 Jan 19 | 9.1% | -0.3% | 8.8% | 2.6% | 25.2 | 256% | 138% |
| 28 Feb 19 | -1.7% | -0.4% | -2.1% | -12.9% | 24.7 | 313% | 90% |
| 31 Mar 19 | -3.3% | -0.5% | -3.9% | -18.1% | 23.7 | 359% | 48% |
| 30 Apr 19 | 1.7% | -0.6% | 1.1% | -20.2% | 24.0 | 386% | 43% |
| 31 May 19 | 0.4% | -0.5% | -0.1% | -19.4% | 24.0 | 382% | 24% |
| 30 Jun 19 | -9.4% | -0.4% | -9.8% | -25.8% | 21.6 | 395% | 0% |

### 2. Equity exposure as at 30 June 2019[27] (as % month end pre tax shareholders funds):

| | AUSTRALIA | | OVERSEAS | | TOTAL | |
|---|---|---|---|---|---|---|
| | percent | exposures | percent | exposures | percent | exposures |
| **LONG** | 80.3% | 19 | 117.2% | 33 | 197.5% | 52 |
| **SHORT** | (17.5%) | 7 | (22.7%) | 6 | (40.2%) | 13 |
| **INDEX** | (60.1%) | - | (97.0%) | - | (157.1%) | |
| **TOTAL** | 2.7% | 26 | (2.5%) | 39 | 0.2% | 65 |

22 Change in market value of all investments – cash and derivatives – after interest charges, dividends receivable, dividends and fees paid away divided by opening period net asset value and time weighted for equity raisings
23 All accrued expenses for company administration (eg. listing fees, audit, registry) divided by opening period net asset value and time weighted for equity raisings
24 Calculated as 2 (above) minus 3 (above)
25 Calculated as total gross exposures being nominal exposure of all long and short positions (cash and derivative) divided by end month pre tax net asset value – assumes index ∂ of 1
26 Calculated as total net exposures being nominal exposure of all long minus short positions (cash and derivative) divided by end month pre tax net asset value – assumes index ∂ of 1
27 Figures may not sum due to rounding

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