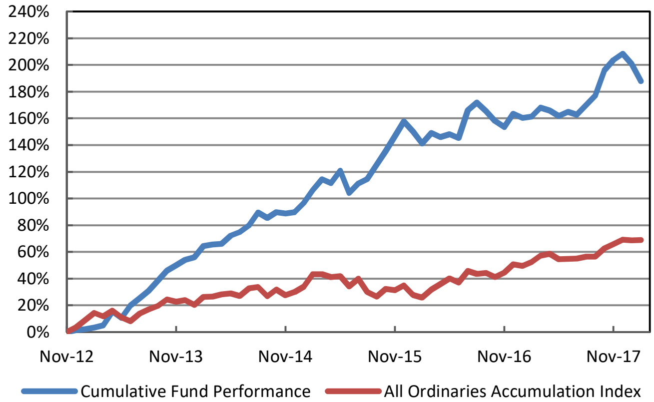
Auscap Long Short Australian Equities Fund Newsletter – March 2018

Welcome

Welcome to the Auscap newsletter, an opportunity for us to report the performance of the Auscap Long Short Australian Equities Fund (Fund) to current and prospective investors. In each publication we will also discuss a subject that we have found interesting in our research and analysis of the market. We hope that you enjoy reading these snippets and encourage any feedback. In this edition we discuss the reporting season and the earnings progress of the companies in which the Fund is invested.

Fund Performance

The Fund returned negative 4.31% net of fees during February 2018. This compares with the All Ordinaries Accumulation Index return of 0.18%. Average gross capital employed by the Fund was 110.6% long and 5.9% short. Average net exposure over the month was 104.7%. Over the month the Fund had on average 26 long positions and 7 short positions. The Fund's biggest stock exposures at month end were spread across the financials, consumer and real estate sectors.



Fund Returns

Period	Auscap	All Ords
February 2018	(4.31%)	0.18%
Financial Year to date	8.68%	9.14%
Calendar Year to date	(6.70%)	(0.15%)
Since inception	187.83%	68.99%

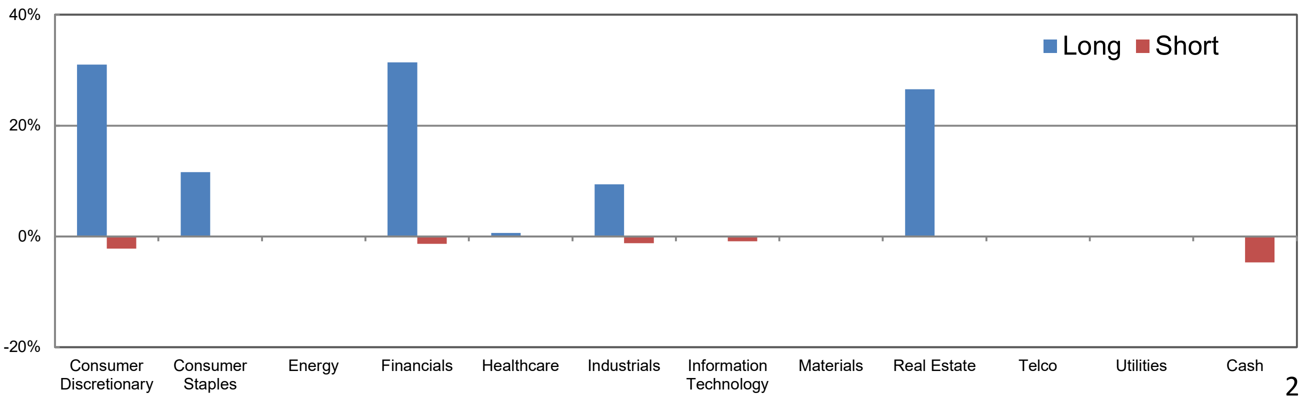
Fund Exposure

February 2018 Average	% NAV	Positions
Gross Long	110.6%	26
Gross Short	5.9%	7
Gross Total	116.5%	33
Net / Beta Adjusted Net	104.7%	72.9%

Fund Monthly Returns

Year	Jul %	Aug %	Sep %	Oct %	Nov %	Dec %	Jan %	Feb %	Mar %	Apr %	May %	Jun %	YTD
FY13						1.35	0.74	1.23	1.46	9.83	(4.05)	8.32	19.72
FY14	4.70	4.28	5.84	5.46	2.86	2.57	1.32	5.32	0.70	0.29	3.82	1.48	46.01
FY15	2.95	5.24	(2.09)	2.25	(0.43)	0.44	3.65	4.90	3.98	(1.36)	4.43	(7.55)	16.81
FY16	3.46	1.64	4.82	4.65	4.69	4.56	(3.01)	(3.54)	3.22	(1.24)	0.96	(1.19)	20.13
FY17	8.48	2.13	(2.37)	(2.72)	(1.83)	4.00	(1.20)	0.42	2.52	(0.81)	(1.53)	1.18	7.97
FY18	(0.77)	2.75	2.53	6.96	2.58	1.56	(2.50)	(4.31)					8.68

Sector Exposure - February 2018



Investing With Conviction: Reporting Season Report Card

The aim of this newsletter is to provide our investors with information and commentary on the Fund's portfolio and the Auscap investment process. Given the time of the year and recent market volatility, it is worthwhile summarising how the companies we own performed across reporting season. By and large, reporting season was relatively benign for the companies in the Fund's portfolio, with the majority reporting results that were in line with our expectations. The companies we own continue to generate strong and growing cash flows and are trading at prices that we find compelling for long term ownership.

By contrast to the respective business performance of the companies owned in the Fund, their stock prices often fluctuate significantly in the short term. We own a concentrated portfolio because we like to own companies that have a number of quality characteristics and are priced attractively. There are not a large number of Australian equities that meet these criteria. The Australian financial market is a well-developed, well-researched and institutional market. The Australian stockmarket is, by and large, an efficient market. The majority of companies are priced appropriately. We want to find stocks that are priced attractively rather than appropriately. This leaves us with a far more concentrated portfolio than the market.

The Fund portfolio typically contains circa 30 to 45 long and short investments. This is for the simple reason that we generally cannot identify more than 30 to 45 genuinely appealing opportunities. Of this group of companies, usually more than 50% of the Fund's exposure will be in ten stocks. These are our ten best investment ideas and they warrant the biggest capital allocation. While a number of factors come into play in sizing positions, the most important is our level of conviction. We are certainly not of the view that there are a hundred great opportunities in the market. One hundred great opportunities would suggest an inefficient market, which would seem unusual in the context of all of the investment banking analysts, institutional fund managers, sophisticated retail investors, private equity participants and advisers that pore over the market each and every day.

While we analyse many opportunities, we generally dismiss over 90% in very short order. We then investigate the remaining 10% or so of companies in more detail, and subsequently discount at least half of these after further analysis. Of the remainder that we investigate thoroughly we find a handful of opportunities that meet all of our criteria. Generically these are high quality businesses with good management, a track record of solid return on invested capital, strong cash generation and low levels of leverage. We spend the majority of our time focused on these companies as well as those already in our portfolio. We want to understand these companies in significant detail, which takes considerable time. Occasionally we find a company that has the right attributes trading at a price we find attractive. In these instances we want to understand *why* a particular company is trading at a price that appears attractive. Sometimes further analysis indicates a business with structural challenges and deteriorating earnings, the typical "value-trap" that we try very hard to avoid. But at other times an opportunity arises because the market is focused elsewhere and it is easy to dismiss a sector or company because of a macroeconomic, sectoral or thematic concern, whether warranted or not.

When non-company specific issues are heavily impacting pricing in a sector, we go looking for the proverbial baby that has been thrown out with the bathwater. The current low level of interest in real estate trusts due to rising bond yields is potentially an interesting example. Many of the real estate trusts we own trade at a discount to the net tangible asset value of their property portfolio, despite also owning profitable funds management and/or development businesses that are implicitly being valued at zero. At the time of writing, the real estate trusts in our portfolio on average yield over 7%, have gearing of 27% (net debt to total assets), have weighted average lease expiries of circa 6 years and are primarily office and retail assets in major metropolitan areas. Our conservative expectation is that they should continue to grow earnings at 3-5% per annum over the medium term. Some of these vehicles have additional optionality in their portfolios where management should be able to add value through active management. Given the low level of earnings volatility they should exhibit over time, we are pleased with the prospective total return characteristics they present.

Owning a concentrated portfolio will invariably lead to periods of both upside and downside volatility in the performance of the Fund. In recent months, performance has been impacted by declining share prices of some of the stocks owned in the portfolio. There are a number of factors at play. Some stocks have simply retraced part of a previous strong upward move that led to solid performance in the second half of 2017. Some of our real estate and infrastructure exposures have been subjected to a sell-off in so-called "yield" related sectors as a result of a rise in government bond yields around the world. And some stocks have fallen despite reporting results that were better than our expectations.

We do not own companies because of global "themes", we do not try to predict macroeconomic events and position the portfolio accordingly and we do not try to time our investments to manage monthly performance. We are aware of all of these factors, but our focus is always on the underlying businesses we own. As we outlined in the February newsletter, of greater importance is what is happening to earnings over the medium to long term. This is our focus. Stock price volatility that is not a response to volatility in company earnings is an opportunity for the patient investor. There have been very few changes to the portfolio in recent months. The average duration of stocks held in the portfolio is approximately two years. The recent decline in the share price of some of the companies we own has provided us with an opportunity to selectively add to some of our exposures. We are enthusiastic about our current investments and look forward to continuing to search over time for compelling value-based opportunities for our investors.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to the website www.auscapam.com and follow the registration link on the home page. Interested investors can download a copy of the PDS at www.auscapam.com/auscap-fund/pds. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

Auscap Asset Management Limited

ACN 158 929 143 AFSL 428014
Lvl 30, 9 Castlereagh St, Sydney
Email: info@auscapam.com
Web: www.auscapam.com

Service Providers

Prime Brokerage: Citi Global Markets
Administration: Link Fund Solutions
Tax & Audit: Ernst & Young
Legal: Norton Rose Fulbright