Auscap Newsletter

Auscap Long Short Australian Equities Fund

DECEMBER 2020

AUSCAP ASSET MANAGEMENT

A Portfolio Of Performers, Laggards And Opportunities

It has been an extraordinary year. Despite the sell-off in February and March, the Auscap Long Short Australian Equities Fund (**Fund**) was up 5.3% for the calendar year as of 30 November 2020. This compares to the All Ordinaries Accumulation Index which is up 1.8% over this period. This being the case and with COVID-19 vaccine rollouts potentially on the horizon, we thought it was an appropriate time to reflect on the current positioning of the portfolio.

We think about the portfolio as currently being comprised of three reasonably distinct groups of companies:

- **Strong performers**: Stocks that have rallied strongly from their lows and contributed most to the Fund's recovery;
- **Laggards**: Those whose stock prices are still well down on where they were pre-crisis and often have not rallied significantly from their lows, despite a material improvement in operating conditions; and
- **New opportunities**: New additions to the portfolio, where we have capitalised on the sell-off to invest in high quality businesses that we have always liked and have found opportunities to invest in at attractive prices.

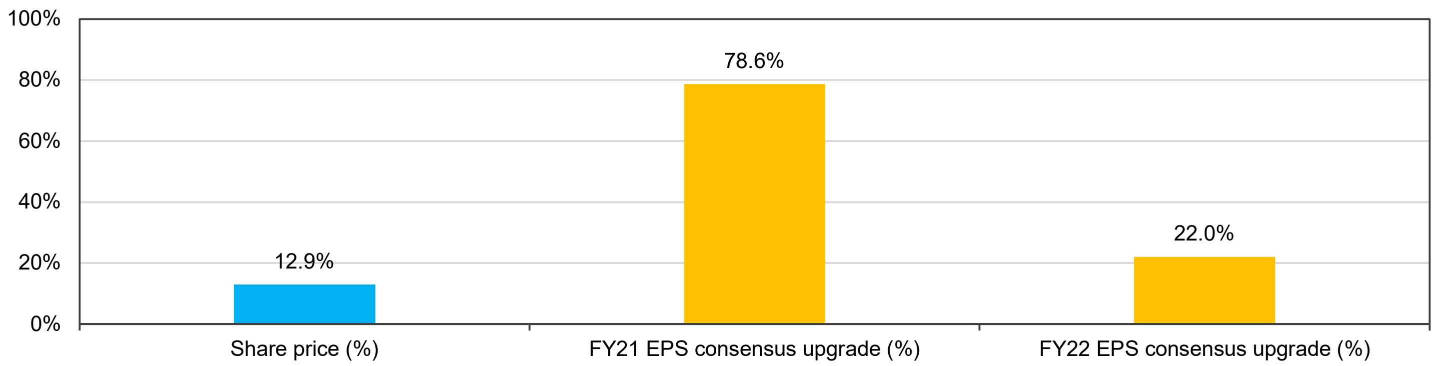
This newsletter discusses the outlook for each of these three portfolio buckets.

Strong Performers

There are a number of investments that have rallied strongly from their lows and contributed most to the recovery in the Fund, yet our enthusiasm for these stocks remains. Many of these companies were the businesses that Auscap was buying most aggressively in late March and early April. While their share prices are up considerably since then, in most cases their earnings are up even more.

One example is Nick Scali, a business with one of the highest return on equity ratios on the ASX. Nick Scali is currently experiencing an extraordinarily strong trading environment, aided by fiscal stimulus and a reallocation of consumer spending towards the home. Whilst these tailwinds are likely to subside, we are confident that Nick Scali's outlook is positive, driven by growth in online sales, a significant store rollout plan, category expansion, an improved housing backdrop, higher consumer confidence and potential acquisition opportunities. Despite this strong trading environment and positive outlook, Nick Scali's share price is currently only 13% higher than pre-COVID levels. After accounting for Nick Scali's property ownership and current year cash generation, Auscap estimates that Nick Scali is currently trading on a price to earnings multiple of less than 10 times forecast earnings in FY22.

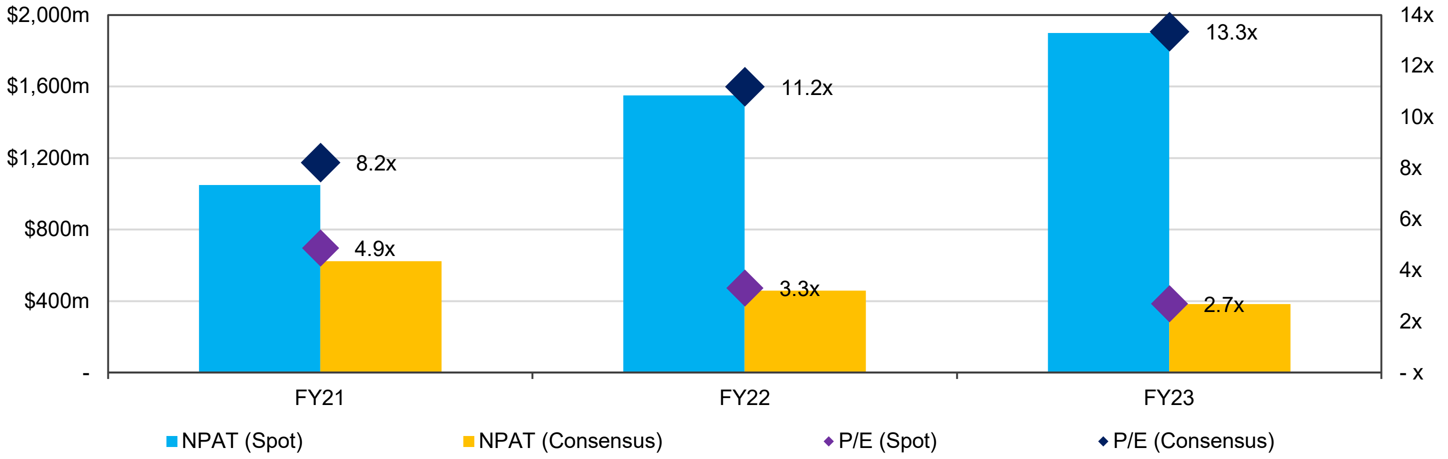
Nick Scali Share Price and EPS Outlook - Current vs 21 February 2020 (%)



Source: FactSet, Auscap

Another strong performer is Mineral Resources, which is up over 80% since February. Auscap discussed the attractiveness of Mineral Resources and its significant growth potential in our September 2019 newsletter. Since then, Mineral Resources has continued to expand aggressively. At Mineral Resources' November Annual General Meeting, CEO Chris Ellison outlined plans for significant iron-ore production growth, whilst noting "*we believe without any doubt that over the next two and a half to three years, we're going to double the entire MinRes business. That's doubling in revenue, doubling probably in the number of people we employ, the tonnes we shift, and more importantly, doubling the bottom line*." In addition to its exciting organic growth opportunities, Mineral Resources is leveraged to the currently buoyant iron ore price. We estimate that at the spot iron ore price Mineral Resources is trading on a price to earnings multiple of less than 5 times.

Mineral Resources NPAT (LHS) and P/E (RHS)



Source: FactSet, Macquarie, Auscap

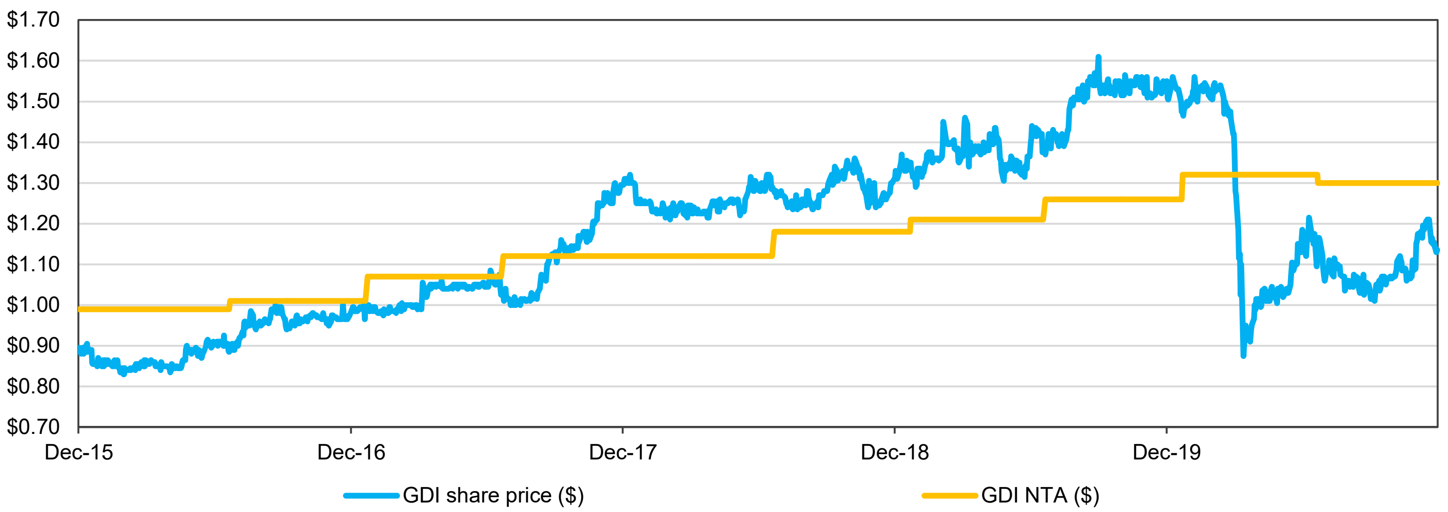
We have a number of investments in this position, where the share price strength has been more than matched by improved financial performance. So we remain excited about the valuation and growth outlook of our "strong performers" basket of companies.

Laggards

The second group of companies are those whose stock prices are still well down on where they were pre-crisis and have not seen significant rallies over the last 6 months. This is despite their operating environment being considerably more positive than in March, with many experiencing a strong rebound in business activity.

An example is GDI Property Group, a real estate owner and fund manager with significant exposure to the Perth office market. Due to the impact of COVID-19 on office occupancy, GDI provided modest rent relief ($1.5m for FY20) to select tenants and its NTA decreased by 1.5% to $1.30 at 30 June 2020, a valuation which attributes little value to its funds management activities and significant development opportunities. However, GDI is currently trading 26% below pre-COVID levels and at a double-digit discount to its net tangible assets, despite multiple data points suggesting the West Australian economy is performing strongly. We think that over time the market will realise that the operating environment that GDI is exposed to has improved, and the discount is not warranted. This is similar to a number of exposures in the Fund. Despite signs of renewed investor interest in some of the laggards during November, we continue to view valuations as attractive across this group of businesses.

GDI Share Price vs NTA ($)



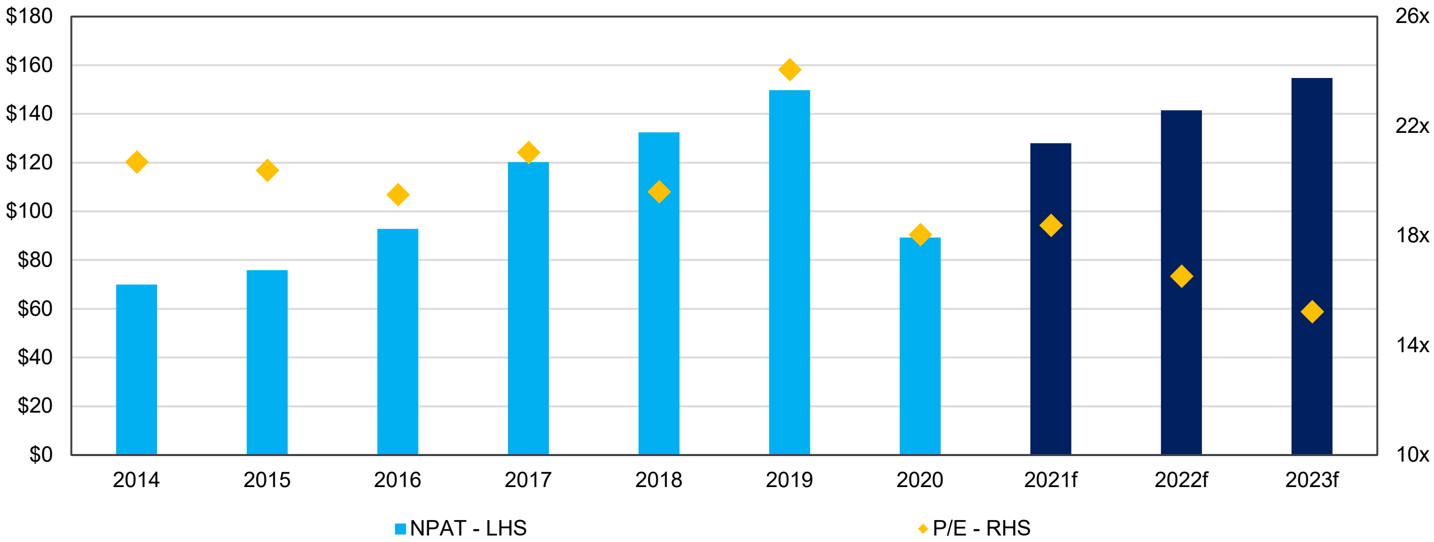
Source: IRESS, Company Disclosures, Auscap

New Opportunities

The third group of companies are new investments that we have made, capitalising on the sell-off to invest in great businesses that we have always liked at prices we find attractive. One example is NIB Holdings.

NIB's share price fell considerably as a result of COVID-19. NIB's main business, health insurance across Australia and New Zealand, has proved largely resilient to COVID-19. However, in response to APRA guidance, NIB took a material COVID-19 provision for these businesses due to the potential for a large catch up in claims in coming months. Time will tell to what extent this provision is required. NIB also has two smaller divisions that were heavily impacted by COVID-19. One is an international inbound health insurance business covering international students and workers. The other is NIB Travel Insurance. Profit for these two divisions dropped from $42m in FY19 to a combined $3m in FY20. NIB is currently trading on an FY22 P/E multiple of approximately 16.5x, which compares favourably to its historical average multiple and does not account for an eventual recovery in NIB's COVID-exposed businesses. We anticipate that its earnings should improve as the impact of the pandemic on global activity recedes.

NIB NPAT vs P/E



Source: FactSet, Auscap

We will continue to monitor the economic data and developments in relation to the Fund's portfolio closely, but we are encouraged by the forward indicators. The Fund's current exposures we believe compare favourably to the broader market. They are high quality businesses with forecast earnings growth in excess of the market, trading with attractive valuation metrics.

We thank our investors for their support over 2020 and wish all of our readers a happy, safe and relaxing festive season.

Auscap Asset Management

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
November 2020	20.3%	10.2%
Financial Year To Date	43.9%	13.8%
Since Inception	212.6%	112.4%
Annualised Returns	15.3%	9.9%

Fund Exposures

November 2020 Average	% NAV	Positions
Gross Long	130.4%	53
Gross Short	9.4%	2
Gross Total	139.8%	55
Net / Beta Adjusted Net	121.0%	145.0%

Portfolio Commentary

The Fund returned 20.3% net of fees during November 2020. This compares with the All Ordinaries Accumulation Index return of 10.2%. Average gross capital employed by the Fund was 130.4% long and 9.4% short. Average net exposure over the month was 121.0%. Over the month the Fund had on average 53 long positions and 2 short positions. The Fund's biggest exposures over the month were spread across the consumer discretionary, real estate, financials, materials and communication services sectors.

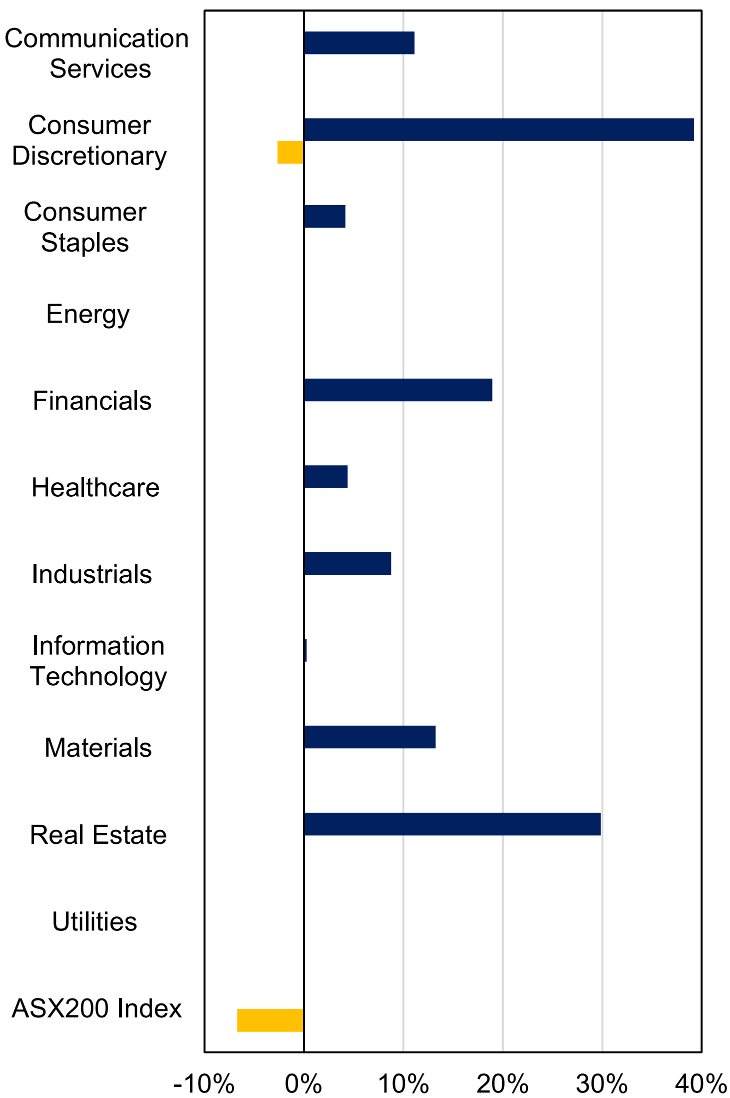
Top 10 Investments^

Aventus Group	Nick Scali
Eagers Automotive	NZME
GDI Property Group	Super Retail Group
Mineral Resources	Unibail-Rodamco-Westfield
Motorcycle Holdings	Virgin Money UK PLC

Fund Financial Year Returns*

FY13	19.7%	FY18	12.7%
FY14	46.0%	FY19	(9.2)%
FY15	16.8%	FY20	(19.9)%
FY16	20.1%	FY21	43.9%
FY17	8.0%		

Sector Exposure - November 2020



** Performance figures are calculated for the lead series net of all fees and expenses assuming the reinvestment of all distributions. Past performance is not a reliable indicator of future performance.*
^ Top 10 long investments in alphabetical order as at 30 November 2020.

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