Auscap Long Short Australian Equities Fund

OCTOBER 2021

AUSCAP ASSET MANAGEMENT LIMITED

Does China's Property Market Present Grand Risks?

The residential real estate market has been a significant driver of China's economic growth over the last two decades. Now authorities are trying to rein in the amount of leverage used by all developers, initially focused on larger companies. Evergrande, China's second largest property developer and previously a poster child for the phenomenal growth in the sector now poses the greatest risk. The questions are, to what extent should investors be concerned about its potential collapse and what implications, if any, are there for the Australian and global economies?

Who is Evergrande?

Evergrande is a very significant Chinese property developer with some 1.5m dwellings under development[1], spread across 778 projects in 223 cities[2], in a country that produces approximately 15m new dwellings a year[3]. Property development is an enormous driver of economic growth within China. Barclays recently estimated that if Evergrande's development activity fell 50%, it would reduce development by 4% across the country and potentially cause a 10% contraction in the property market.[4]

Evergrande employs 200,000 people directly and reportedly creates 3.8m jobs per annum[5]. The problem is that it has approximately US$300 billion of liabilities, $170bn of which are due within 12 months, with only one tenth of that amount in cash on hand[6]. To put that into context, US$300bn was approximately the net debt of the Australian Federal Government prior to the COVID-19 pandemic and is equivalent to 2% of China's GDP. These obligations are so large that many consider the business to be systemically important, and it appears to be on the verge of defaulting on its obligations. Press reports indicate that Evergrande has missed bond payments, is late in paying employees and has not paid due invoices from suppliers and other creditors.[7]

What precipitated Evergrande's issues?

So how did we get here and why is Evergrande at risk of default? In August 2020, the Chinese Government announced the "3 red lines policy". The policy created 3 measures that are used to assess the rate of allowable growth in debt for property developers. These are:

1. a liability to asset ratio of less than 70%;
2. a net gearing ratio of less than 100%; and
3. a cash to short term debt ratio of more than 100%.

If developers fail to meet 1, 2 or all 3 measures, then the regulator can cap their debt growth at 10%, 5% and 0% respectively. If all three lines are passed, the limit on debt growth is 15%. Policy makers have given major developers until mid-2023 to meet all three measures. The policy is expected to be applied to the largest developers initially, before expanding to cover smaller players in the sector.

Evergrande failed all 3 tests when they were introduced in August 2020. Following this, Evergrande commenced a nationwide sales program in September 2020 offering 30% off all properties. On 9 June 2021 regulators reportedly instructed major lenders to conduct fresh stress debts on their exposure to Evergrande. On 22 June 2021, several large banks started restricting credit to Evergrande. On 21 July 2021 Standard Chartered and HSBC were reportedly declining loans to buyers of properties from Evergrande. And on 17 August 2021, the Chairman of the onshore real estate group resigned. Two days later executives were summoned by the regulator and instructed to reduce debt levels, with reported group liabilities hitting 1.97 trillion yuan, or approximately US$300bn, on 31 August 2021. Many suppliers have claimed to be owed money by Evergrande and some, such as listed piping supplier Yonngao which is reportedly owed RMB 478m (US$74m), have stopped deliveries[8]. Further exacerbating Evergrande's problems, on 3 September 2021, the company announced that contracted sales for August had dropped 26% year on year to RMB 38bn[9] (US$5.9bn).

[1] https://www.aljazeera.com/economy/2021/9/23/china-tells-evergrande-to-avoid-near-term-dollar-bond-defaults
[2] https://www.afr.com/world/asia/evergrande-is-hostage-to-beijing-s-property-pain-threshold-20210921-p58tfr
[3] https://www.economist.com/finance-and-economics/2021/01/25/can-chinas-long-property-boom-hold
[4] https://www.afr.com/chanticleer/evergrande-s-burning-question-20210922-p58tuc
[5] https://www.cnbc.com/2021/09/17/china-developer-evergrande-debt-crisis-bond-default-and-investor-risks.html
[6] https://www.afr.com/world/asia/how-evergrande-could-become-another-lehman-brothers-20210921-p58teu
[7] https://www.ft.com/content/88dcb535-3945-4138-b394-dda82292b638
[8] https://www.businesstimes.com.sg/real-estate/fall-from-grace-evergrandes-debt-journey-since-chinas-three-red-lines-policy
[9] https://www.businesstimes.com.sg/real-estate/evergrande-property-sales-drop-26-as-china-market-cools

It seems increasingly likely that at some point Evergrande will cease to exist in its current form. Government officials have reportedly told Evergrande to finish their existing developments and to repay individual investors[10]. However, the market is taking a dim view of the likely return of capital to bond holders. The listed Evergrande US dollar denominated bonds trade between 20c and 25c in the dollar. Trading in Evergrande's shares has been suspended after a fall of 80% calendar year to date, such that the company now has a market capitalisation of just US$5bn.

Is Evergrande an isolated case?

Evergrande is not the only property developer under scrutiny. According to UBS, the largest 50 developers in China accounted for 60% of property development activity in 2019[11]. S&P suggested that only 6.3% of their rated property developers could pass all 3 lines on the initial analysis. Of the country's 66 major developers, nearly half passed all 3 lines at the end of 2020, up from just 14 six months earlier[12]. Only 4 of the developers failed all 3 tests, of which Evergrande was the largest. Evergrande and Guangzhou R&F Properties were the only two major developers to not show improvement between June 2020 and December 2020.

In one sense this might seem like good news. Unfortunately there are two words of caution. The first is that we do not know how much window dressing was done to make the balance sheets of many of the developers look better than normal at year end. The second is that the tests are not particularly onerous. Anything close to a 70% liability to asset ratio would be considered extremely high in Australia. So we need to be aware of the anchoring bias created by the thresholds outlined. Whilst the majority of developers being below a liability to asset ratio of 70% might be an improvement on a year ago, that certainly does not mean that they are all in a robust financial position.

In the last few weeks Fantasia Holdings Group, a property developer of high end apartments and urban renewal projects, failed to repay a bond that came due at the start of October 2021[13]. This happened only weeks after reporting that its operating performance was good, that it had sufficient working capital and no liquidity issue. Sinac Holdings Group also reportedly missed two interest payments on its bonds. Sunshine 100 China Holdings defaulted on its notes in August and Xinyuan Real Estate Co and Central China Real Estate both have bonds due within a month and are being watched closely.

Could Evergrande trigger a financial crisis like the GFC?

The question on many investors' minds is whether these defaults are capable of triggering a banking crisis. Is this sequence of events and the potential collapse of Evergrande akin to China having its "Lehman Brothers moment"?

While Evergrande reportedly owes money to 171 domestic banks and 121 other financial firms[14], it appears unlikely that there will be a liquidity crisis in the same vein as the one many economies experienced during the Global Financial Crisis ("GFC"). China's banking system is internally funded rather than relying on international investors and is centrally controlled, with the Chinese Government a major shareholder in the largest financial institutions, capable and willing to provide extra liquidity to the financial system during periods of stress. The Evergrande issue appears to be a consequence of deliberate action by the Government to rein in property developer debt and reduce the risk of moral hazard. The fact that any default is potentially driven by Government policy leaves many commentators assured that the Government has measured the impact on financial market stability and concluded that the system will cope with any fallout from property developer defaults.

We would tend to agree with analysis that suggests the probability of a financial crisis bearing close resemblance to the GFC happening on the watch of any sophisticated Government is unlikely. However, this argument only allays concerns around China experiencing a *banking* crisis as a result of bad debts and lack of liquidity in the system. Put simply, it means that China is unlikely to experience exactly what many other countries experienced during the GFC. Invariably though, the next crisis will not look like the last one. Policy makers learn from past mistakes that occur domestically or internationally, particularly in the interconnected world we live in today. So the question we would prefer to ask is whether these defaults could trigger a different type of crisis. This is a question without a straightforward answer.

[10] https://www.abc.net.au/news/2021-09-26/markets-rally-as-evergrande-nears-default/100491376
[11] https://www.ubs.com/global/en/asset-management/insights/china/2021/china-three-red-lines.html
[12] https://www.bloomberg.com/news/articles/2021-04-12/evergrande-fails-china-s-three-red-lines-test-as-peers-improve
[13] https://www.bloomberg.com/news/articles/2021-10-06/a-surprise-default-in-china-worsens-evergrande-contagion-fears
[14] https://www.bbc.com/news/business-58579833

If not a banking crisis, then what is the concern?

While the banking system might have sufficient Government support to withstand property developer defaults, we are more concerned with the potential impact on the residential property market in China, which Kenneth Rogoff and Yuanchen Yang estimate constitutes a remarkable 29% of GDP[15]. The banks are only one of many stakeholders required to keep property development contributing positively to GDP growth. Bondholders, wealth management product investors, suppliers, employees, contractors, and most importantly, *willing property buyers* are all required to keep the property development sector growing.

Whilst the banks are funders of property development, investors and home buyers are also heavy financiers of the residential property development industry. There are currently millions of investors and home buyers likely to be anxiously waiting to see whether their off the plan housing development will become a finished product. The psychological impact on property investors and home buyers from the publicity around Evergrande's issues is yet to be understood but could be significant. Such non-settlement risk has not been experienced by Chinese buyers on this scale before. If individuals reduce their propensity to purchase property in the future, then developers may struggle to get the necessary finance to continue their developments while staying inside the 3 red line policy requirements.

Non-repayment, or even just the *risk* of non-repayment, of wealth management products ("WMPs") by a developer as large as Evergrande could have repercussions for future developers trying to raise funds this way. The Reserve Bank of Australia noted in a 2015 Bulletin that there had been no verified reports of bank WMP issuers ever not repaying investors. It is easy to see how Chinese retail investors may have assumed that the entire asset class was implicitly guaranteed. More than 80,000 people bought Evergrande WMPs that raised over US$15.4bn over the past 5 years, with some US$6.1bn of these investments still outstanding.

The bond market is another source of capital for a company like Evergrande. Non-payment of loans across multiple developers lessens the availability of capital and could materially increase its cost. Earlier in 2021 the Government cracked down on banks and wealth managers using money invested in cash management products from buying long term debt or bonds rated below AA+, with an estimated US$510bn of the products currently invested in assets that have or will soon become non-compliant[16].

Finally, suppliers and contractors extend credit when they conduct work prior to receiving payment for the work. If they do not get paid promptly, they may either reduce their exposure to such work or demand more onerous terms around payment for services rendered. In relation to Evergrande, there are reports that some suppliers and contractors have not been paid for work already done.

To us, the immediate risk is not to the Chinese banking system but to the broad funding of residential development. If any of the aforementioned channels break down, sector funding capacity will be impacted. The potential impact on GDP could be very substantial.

Are there potential flow on implications?

A slowdown in residential development will potentially have flow on consequences for the broader Chinese economy. China's local governments generate 30-40% of their revenue through land sales to developers[17]. A reduction in land sales would therefore require local governments to either increase debt or reduce expenditure.

The impact on the broader property market, in particular in relation to pricing, is unclear. Property developers might try to sell development properties at marked down prices to clear inventory and generate cash, as Evergrande has tried to do. This creates risk to the broader property market and could lead to a problematic negative feedback loop. It has been estimated that there are already more than 65 million empty apartments across China[18]. In a country where population growth is running at the slowest rate on record at less than 0.5% per annum, there is no natural tailwind of population growth or immigration to absorb surplus supply.

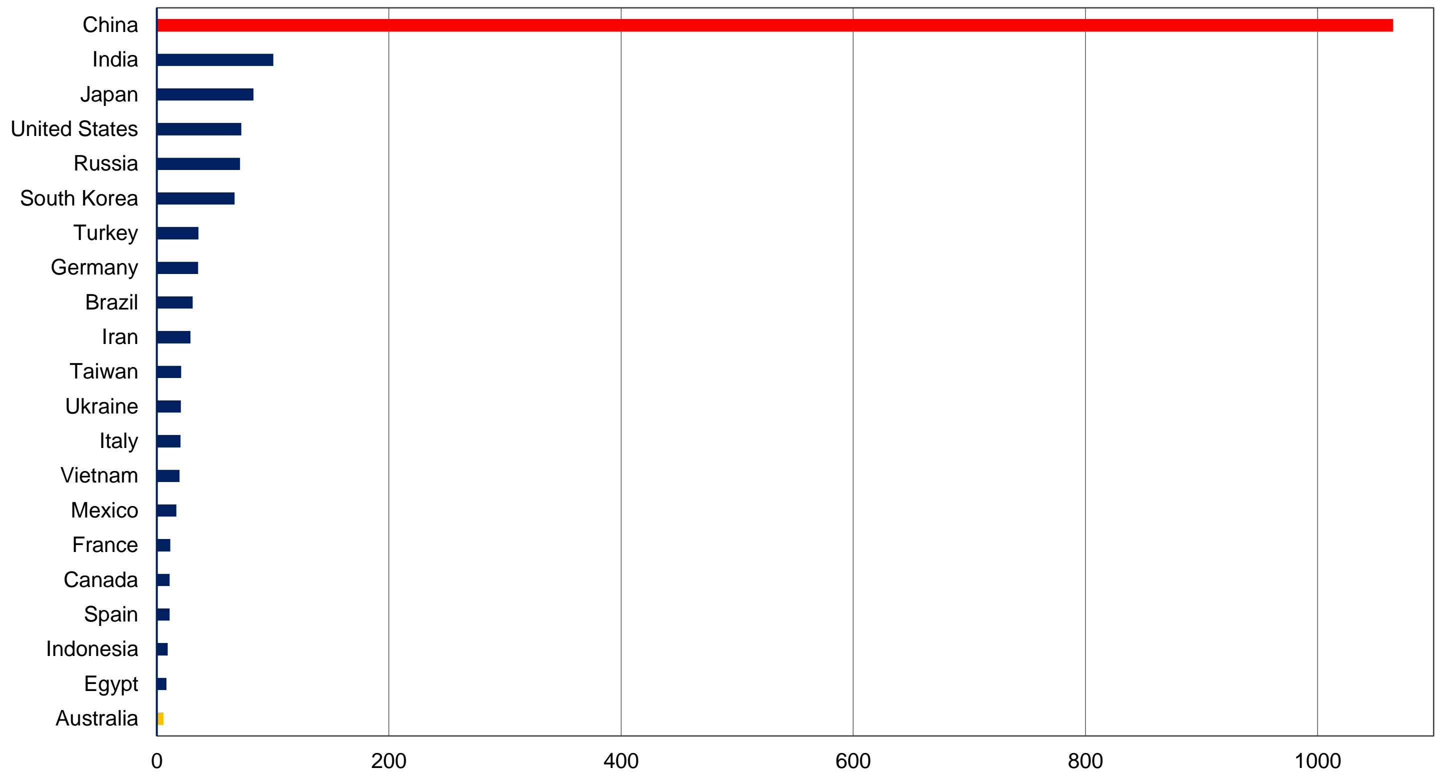
[15] Kenneth Rogoff & Yuanchen Yang, "Has China's Housing Production Peaked?", China and the World Economy 21 (1): 1-31
[16] https://www.smh.com.au/business/banking-and-finance/china-escalates-crackdown-on-us1-trillion-market-20210616-p581g7.html
[17] https://www.abc.net.au/news/2021-09-26/markets-rally-as-evergrande-nears-default/100491376
[18] https://www.abc.net.au/news/2021-09-21/china-property-bust-evergrande/100472190

Residential property prices are also substantially elevated by modern standards. Rogoff and Yang state that the property price to income ratios in Beijing, Shanghai, and Shenzen exceed a multiple of 40, compared to 22 in London and 12 in New York. It was recently pointed out that "*prices in Tier 1 cities have risen more than six-fold since 2002, compared with the increase in Ireland of 100 per cent and Spain of 230 per cent in their respective housing booms*."[19] Across China the average property price to income ratio is currently 27.9x. This compares to Japan at 11.6x, India at 10.8x, the United Kingdom at 9.5x, Australia at 7.3x and the United States at 4.0x[20]. In short, a reduction in property development would likely have second and third order consequences that would negatively affect economic growth within China and therefore globally, given China's position as the world's second largest economy.

What risk does this present to Australia and the world?

The look through risk to demand for products that go into residential construction, including some of Australia's largest exports such as iron ore and coking coal, could be very material. China produced 56.5% of the world's steel in 2020[21]. If China's demand for steel goes backwards, the combined growth in consumption in the rest of the world is unlikely to be enough to offset the decline.

2020 Steel Production By Country (mt)



Source: World Steel Association, Auscap

Any reduction in bulk commodity demand from China will have an impact on global commodity prices and volumes, negatively affecting Australia's terms of trade and Government receipts. There are also potential flow on implications for employment and consumption to consider. We remain cognisant of potential risks emanating from China as a result of the deleveraging process that is currently being undertaken in relation to domestic property developers. While there is a reasonable probability that the Chinese Government successfully navigates this issue, there is certainly a non-zero probability attached to the risk that there are material flow on consequences that negatively impact China's economic growth. While we remain positively disposed to domestic and global economic growth as the world emerges from the COVID-19 pandemic, an awareness of the potential implications of any fallout from a significant slowdown in the property sector in China helps us to map our approach to investing while these risks are present.

[19] https://www.afr.com/companies/financial-services/what-happens-when-beijing-s-housing-bubble-bursts-20210919-p58svw
[20] https://www.numbeo.com/property-investment/rankings_by_country.jsp
[21] https://www.worldsteel.org/media-centre/press-releases/2021/Global-crude-steel-output-decreases-by-0.9--in-2020.html

Driving Earnings Higher

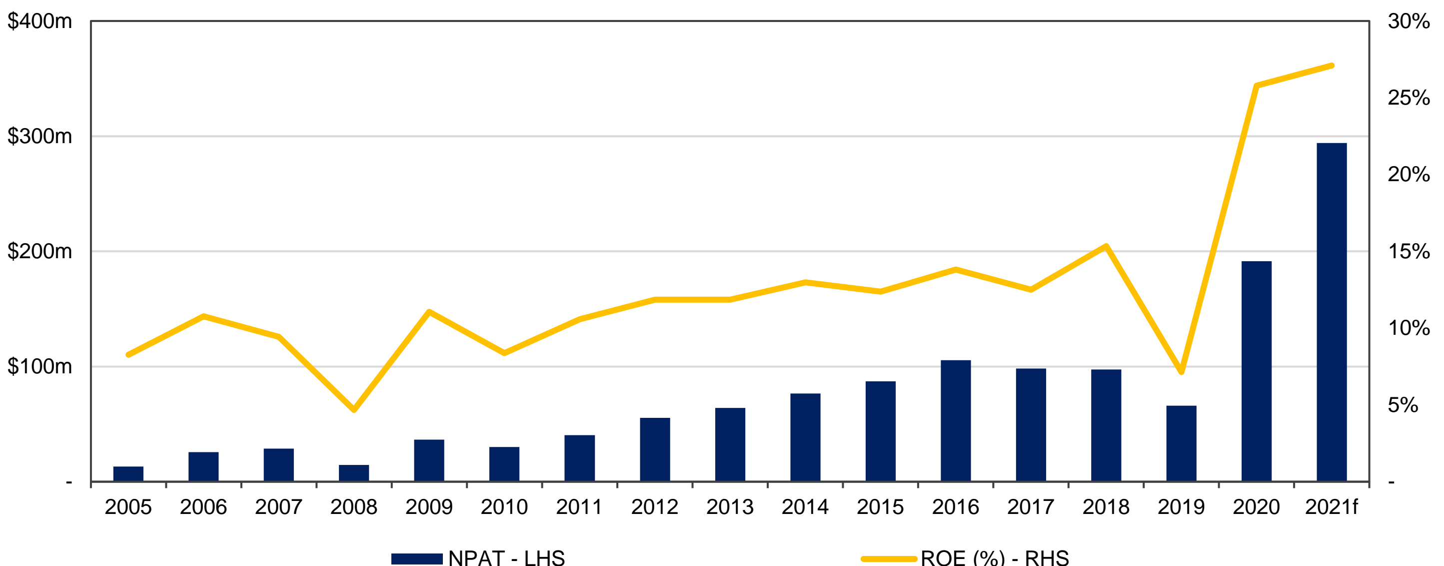
Our views on Eagers Automotive discussed below are based on factual information available to us at the date of publication of this newsletter. Our views and market conditions as expressed below may change. There is a risk that Eagers Automotive will not perform as expected, which could have an adverse impact on the Fund. The below information is not general advice, personal advice or a recommendation to be relied upon when making an investment or other decision. While all reasonable care has been taken to ensure that the information below is complete and correct, no representation or warranty is given as to the accuracy of any of the information provided.

Eagers Automotive ("Eagers") is Australia's largest automotive dealership group. Listed in 1957, it has grown to more than $9bn of annual revenue, 7,300 employees and 11% of the Australian new vehicle market. In FY20, it generated 57% of its revenue from new vehicle sales, 24% from used vehicle sales and most of the balance from parts and services. Eagers represents most major Automotive Original Equipment Manufacturers ("OEMs"), including the top 15 brands by volume. Similar to many other retailers, Eagers had a strong FY20, with profit before tax jumping to $209m from $100m in FY19. So is Eagers just another COVID beneficiary, soon to face declining earnings as conditions normalise? Once you pop the hood, it becomes clear that there is far more under the bonnet. This newsletter discusses Auscap's investment thesis for Eagers.

Business quality

Eagers has a history of strong financial returns. Based on FactSet consensus for FY21, Eagers is on track to compound revenue at a 14% CAGR and net profit at a 21% CAGR since 2005. This has been achieved with an average return on equity of 12% over the last decade. As of 30 June 2021, Eagers Automotive had just $31m of net corporate debt, down from $316m in FY19, leaving it well placed to fund future growth initiatives. Whilst Eagers has funded some of its acquisitions by issuing shares, it has not raised equity from existing shareholders since 2006.

Eagers Automotive Financial History



Source: Company Disclosures, FactSet, Auscap. FY19 $209.2m non-cash impairment associated with AHG merger normalised.

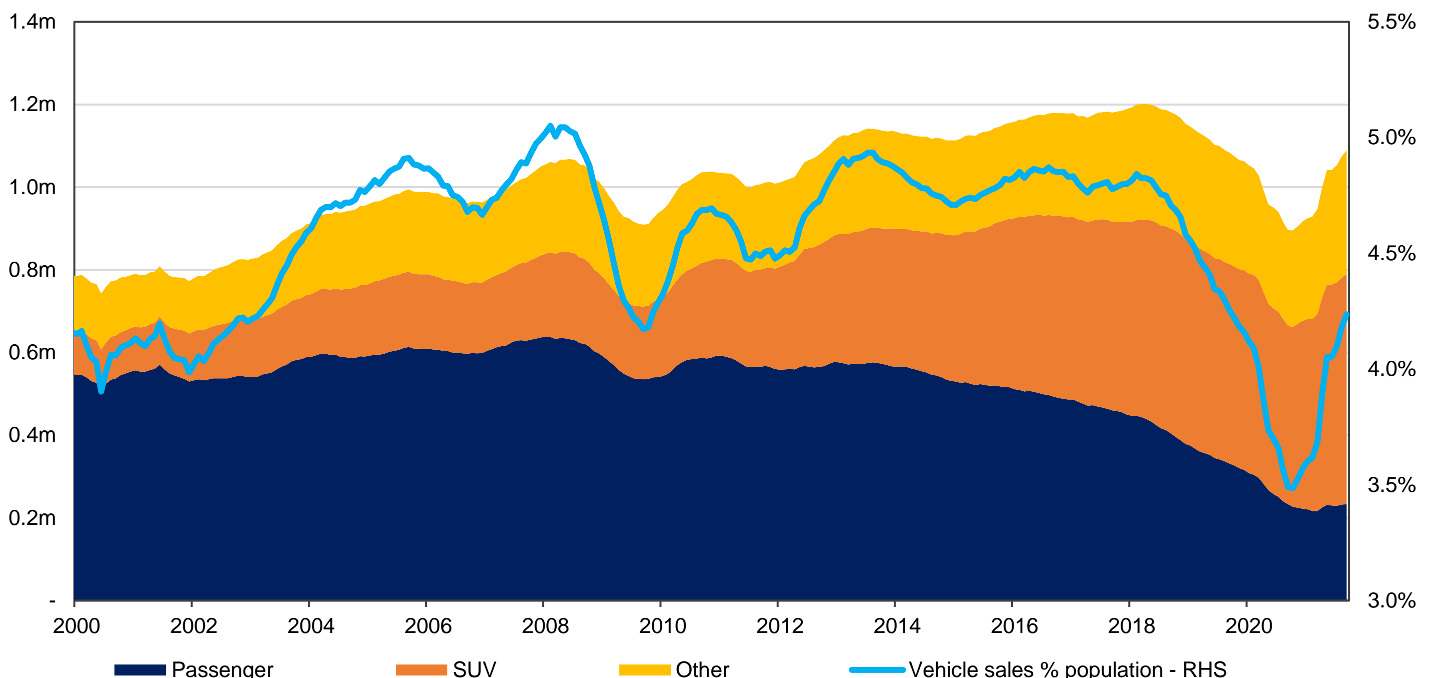
The outperformance of Eagers starts at the top. Successful automotive entrepreneur Nick Politis has sat on the board since 2000 and now owns 27% of the company, which is currently worth approximately $1 billion. Newly appointed CEO Keith Thornton has been with the business since 2002 and has accumulated $4 million of shares since joining the business. Keith's remuneration incentives are based on long-term earnings targets with FY20 set as the base year for growth. When Keith was appointed CEO, highly regarded outgoing-CEO Martin Ward, who also has skin in the game with ownership of 1% of the business, purchased an additional $500,000 of shares on-market and remains within the business. Nick Politis also purchased $1.2 million of shares on market at that time. We are encouraged by such a vote of confidence in Keith as the new CEO. The alignment of interests with shareholders has underpinned the long-term thinking within the business that has generated strong financial returns over many years.

Growth options

Cyclical turnaround

Australian vehicle sales have been depressed since 2018, primarily driven by a large credit contraction, falling property prices from 2017 to 2019 and COVID-19. But in November 2020, after 31 consecutive months of declining sales, vehicle sales finally turned the corner, driven by the strong consumer environment. Whilst this recent strength is encouraging, Australian vehicle sales are still only annualising 1.1 million units, the same level as 2008 and at a similar level on a per capita basis to the depths of the Global Financial Crisis. Australia's car parc is aging, with the Australian Bureau of Statistics ("ABS") estimating that the average Australian vehicle is now 10.6 years old. This suggests the medium-term outlook for new vehicle demand remains favourable.

Australian New Vehicle Sales (rolling 12 months)

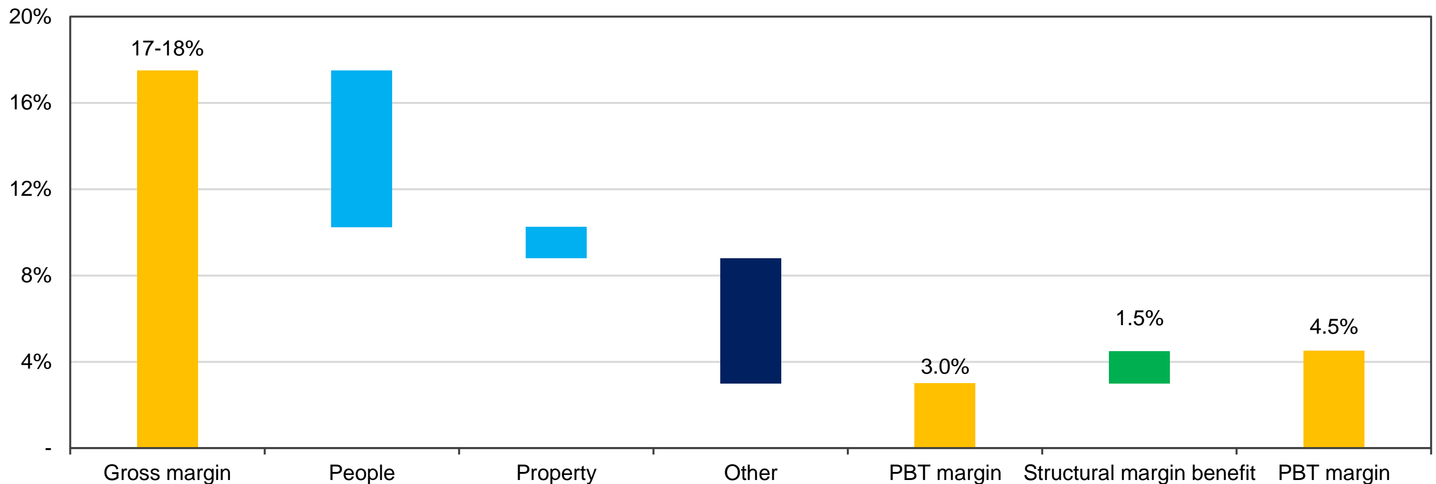


Source: FCAI, ABS, Auscap

Operating margin expansion

Automotive dealerships have historically operated on thin margins. In recent years, Eagers has achieved a group-wide gross margin of 17–18%, translating to an average Profit Before Tax ("PBT") margin of 3%. This means that small changes to the cost base can have a large impact on the bottom line. Eagers has flagged this margin optimisation opportunity as a key strategic priority. Most of Eagers' operating costs consist of property expenses and people costs. As the automotive industry continues to evolve and grow in sophistication, Eagers believes less "glass boxes" will be needed. This creates a significant opportunity, as property consolidation and scale allows Eagers to improve its operating efficiency. A first step of Eagers' cost-out plan was achieving $36m of synergies following its 2019 merger with Automotive Holdings Group (AHG). Stage 2 was $100m of annualised cost savings following the COVID-19 pandemic. These two initiatives, according to management, have lifted Eagers' sustainable PBT margin to 4.5%, up 50% on pre-COVID levels, even allowing for the unwind of the margin benefit gained from current strong industry conditions. While the proof will be evidenced once current tight supply pressures ease, management have a strong track record of delivering on their plans.

Illustrative Eagers Economics



Source: Company disclosures, Auscap

Eagers' ex-CEO Martin Ward is currently working exclusively on optimising the property portfolio to further improve margins. This involves consolidating existing dealerships into fewer and more strategic locations with an improved funding structure. In Brisbane Eagers is embarking on an ambitious project to consolidate its large Brisbane dealership presence into a flagship Auto Mall site near the Brisbane Airport, integrated with a 2.3 kilometre Mark Skaife-designed racetrack. This will be a one-stop-shop for purchasing new and used cars, accompanied by concept display stores in shopping centres adjacent to service centres. The expected synergies of the project are significant, with shared parts and service capabilities on site, optimised staff costs and an attractive long-term rental deal. When benchmarked to US peers, Eagers' 4.5% PBT margin appears sustainable. If Eagers achieves further success with its cost out opportunities, significant profit growth could follow.

Market share growth

Eagers has grown from 3.7% of Australian new vehicle sales in 2010 to 11.1% in 2020. The industry remains highly fragmented and dominated by privately owned dealership groups. The consistent industry feedback is that multiple independent dealership groups are currently considering succession planning, are conscious of the looming market evolution and view the recent improvement in industry conditions as a sensible catalyst to sell their businesses. We believe Eagers has considerable scope to increase its market share over the longer term. Eagers has $661m of liquidity currently available, which provides substantial firepower for accretive acquisitions. Importantly, Eagers' success in property optimisation, finance and insurance (F&I) penetration and used vehicle growth is difficult for smaller independent dealerships to replicate. This means that the earnings potential of a prospective acquisition grows materially once Eagers has the keys. Eagers can therefore pay a price that a vendor finds acceptable, whilst still creating significant shareholder value.

Used Cars (EasyAuto123)

Each year, roughly three times more used cars transact relative to new vehicles across Australia. Whilst the used car market is large, the sales process is widely disliked by consumers. Consumers lose considerable value when they trade in a car, whilst feedback suggests a general aversion to haggling on price and concerns around a vehicle's true condition when purchasing from a private seller. A large market with unhappy consumers creates a significant opportunity for disruption. Having closely watched developments in the US market, EasyAuto123 ("EasyAuto") is Eagers' solution for the Australian market. The EasyAuto proposition is simple:

- a wide selection of quality-verified used vehicles browsable online or at large one-stop-shops;
- a fixed price on vehicles (no haggling) with a best price guarantee (if you find a cheaper price they will beat it) and a 7 day money-back guarantee; and
- for trade-ins, reasonable prices, a valuation within minutes and payment within 24 hours.

Whilst this model's consumer appeal is obvious, do the economics work? Eagers actually plans to generate more than $1,000 *less* gross profit per vehicle in EasyAuto than they would through their dealer network. However, the EasyAuto cost base is very different to a dealership network, due to its scalable business model. EasyAuto's cost base is largely fixed, meaning there is significant scope to fractionalise costs as the business grows.

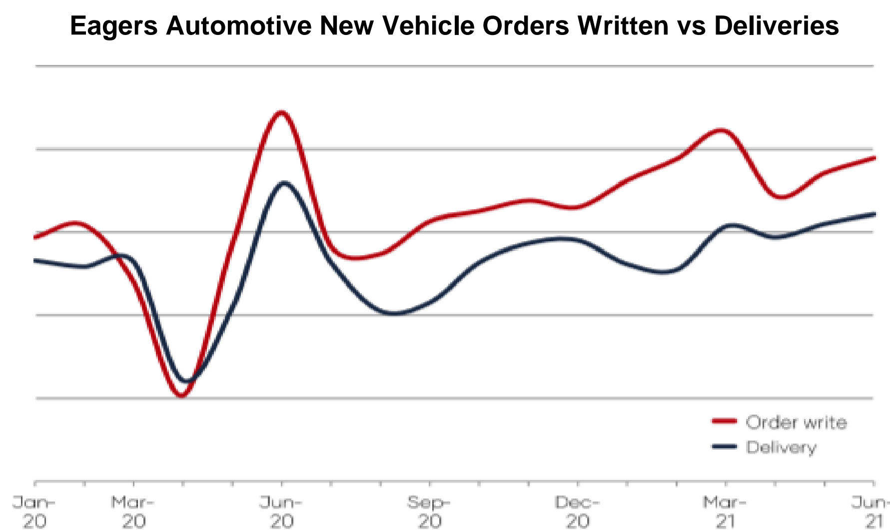
EasyAuto was inherited by Eagers as part of the 2019 AHG merger as a loss-making concept. It is now profitable and is annualising 13,256 used vehicle sales a year, despite limited marketing to date. Eagers has set an initial target of 50,000 annualised used vehicle sales as a first step for EasyAuto, which would represent a used vehicle market share of 1.3%, a fraction of Eagers' new vehicle market share of 11%. In addition to the profit potential, EasyAuto is also highly strategic, creating a powerful position for Eagers within used vehicles and improving Eagers' importance to OEMs. Few research analysts covering Eagers currently reference EasyAuto in their valuation, but it is easy to see why management view it as a huge opportunity to create shareholder value.

Risks

Unsustainable trading conditions

The automotive market is currently experiencing very strong trading conditions that Eagers is no doubt benefitting from. New vehicle gross margins across the industry have improved materially post-COVID, as strong demand conditions and disruption to global supply chains have removed the need for dealers to discount cars. While these conditions will ease at some point, feedback suggests it is unlikely to occur any time soon. Supply bottlenecks and growing demand are creating good visibility for dealers and manufacturers. We expect these conditions will last well into 2022 and potentially beyond. Since the initial COVID-19 outbreak, Eagers has sold more cars than it has delivered in *every* single month (shown below). This means that Eagers' order bank is continuing to grow. Even after the disruption of recent lockdowns, Eagers has said that its geographical weighting to Western Australia and Queensland has resulted in this trend continuing into July and August.

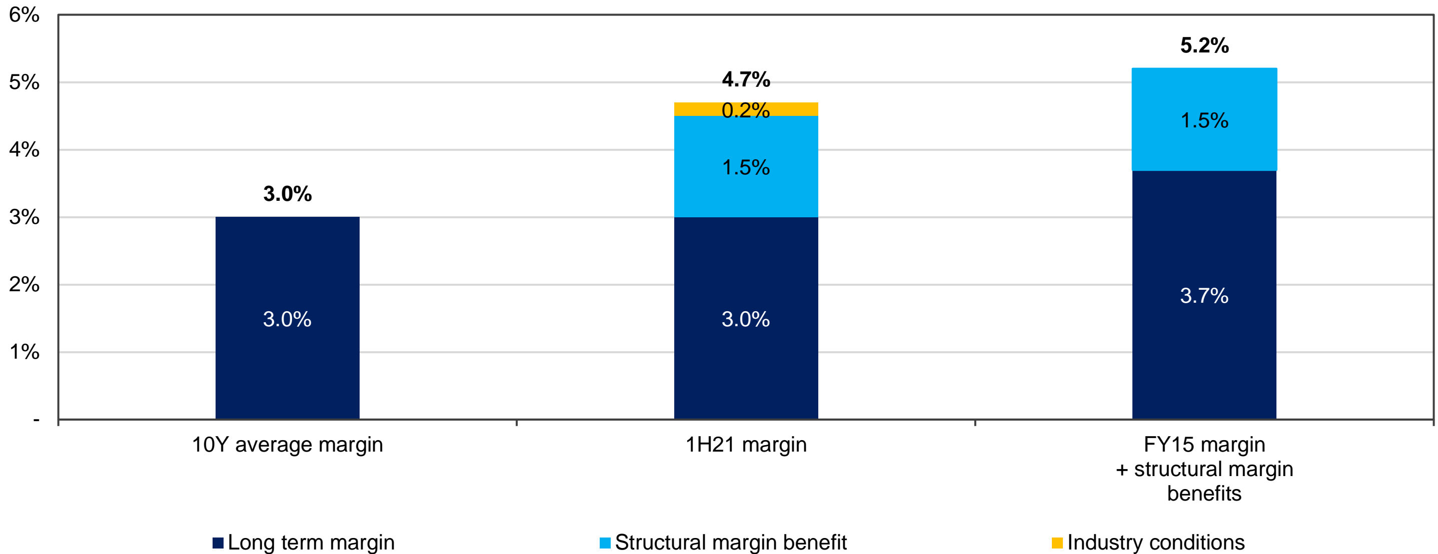
Eagers Automotive New Vehicle Orders Written vs Deliveries



Source: Company disclosures

Further, a large portion of new vehicle revenue historically came from incentives paid by OEMs for meeting sales targets. The current industry dynamics have led to a reduction in the size of these incentives. Another high margin component of new vehicle revenue has been the sale of F&I products. Market penetration of these products has dropped recently as OEMs have temporarily pulled back on finance campaigns, long delivery lead times have reduced the need for point-of-sale financing and consumer wealth effects have reduced demand. Eagers estimates that current industry dynamics have boosted its PBT margin by just 20bps, or 7%, relative to its long-term average and still below the gross margin Eagers was achieving in FY15. This 20bps of margin expansion will eventually disappear, but in addition to the opportunities for margin improvements outlined above Eagers has also called out a material opportunity to increase its F&I penetration over the medium term, which may well more than offset this margin contraction over time.

Eagers PBT Margin



Source: Company disclosures, Auscap

Disruptive threats

The second risk to Australian dealerships is more existential. Could OEMs cut dealers out of the selling process by selling vehicles directly to consumers with a fixed price omni-channel model? With Tesla already pursuing this model, the shift to electric vehicles, which currently have lower margins for OEMs relative to internal combustion engine vehicles, could be a catalyst for such a change. Honda has recently begun the process of experimenting with an "agency model", with Mercedes planning to follow in 2022. Under this model dealers do not own any vehicles, do not have the flexibility to negotiate a price and are paid a set fee per vehicle sold.

While these developments need to be monitored carefully, there are a few things worth noting. Within the last month all twelve of the largest OEMs in Australia, representing 80% of vehicles sold, have reaffirmed their commitment to their current selling model to automotive industry publication *Drive*. On further analysis this is perhaps not surprising. A new vehicle sale often involves a used vehicle trade in, financing, and a parts and service commitment. OEMs are ill-equipped to manage a used car trade-in process and they generate significant profit from F&I and aftermarket services without having to manage daily operations, so they are not incentivised to disrupt this. To date, any shifts to agency models have led to a consolidation of servicing and parts responsibilities, often at attractive margins, into the hands of the largest dealership groups, effectively offsetting any reduction in new vehicle gross margins. We would expect Eagers, as the largest player in the domestic market, to benefit from such a consolidation, but we will continue to closely monitor any developments and risks on this front.

Summary

Eagers is a high-quality business with an enviable financial track record, a strong balance sheet and significant insider alignment. We expect Eagers to achieve a strong profit result this year, with many of the sector tailwinds continuing well in 2022. After accounting for the value of its property portfolio, we estimate Eagers is currently trading on a Price to Earnings multiple of approximately 12x. Given the significant scope for long term profit growth through improved sustainable margin expansion, growth initiatives including EasyAuto and both organic and inorganic growth, we remain positive about our ownership of this high-quality business.

Auscap Asset Management

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
September 2021	(3.4%)	(1.5%)
Financial Year To Date	7.7%	3.7%
Since Inception	323.3%	141.5%
Annualised Returns	17.7%	10.5%

Fund Exposures

September 2021 Avg.	% NAV	Positions
Gross Long	94.7%	41
Gross Short	0.0%	0
Gross Total	94.7%	41
Net / Beta Adjusted Net	94.7%	113.2%

Portfolio Commentary

The Fund returned negative 3.4% net of fees during September 2021. This compares with the All Ordinaries Accumulation Index return of negative 1.5%. The Fund's largest exposures over the month were spread across the consumer discretionary, real estate, communication services, financials and materials sectors.

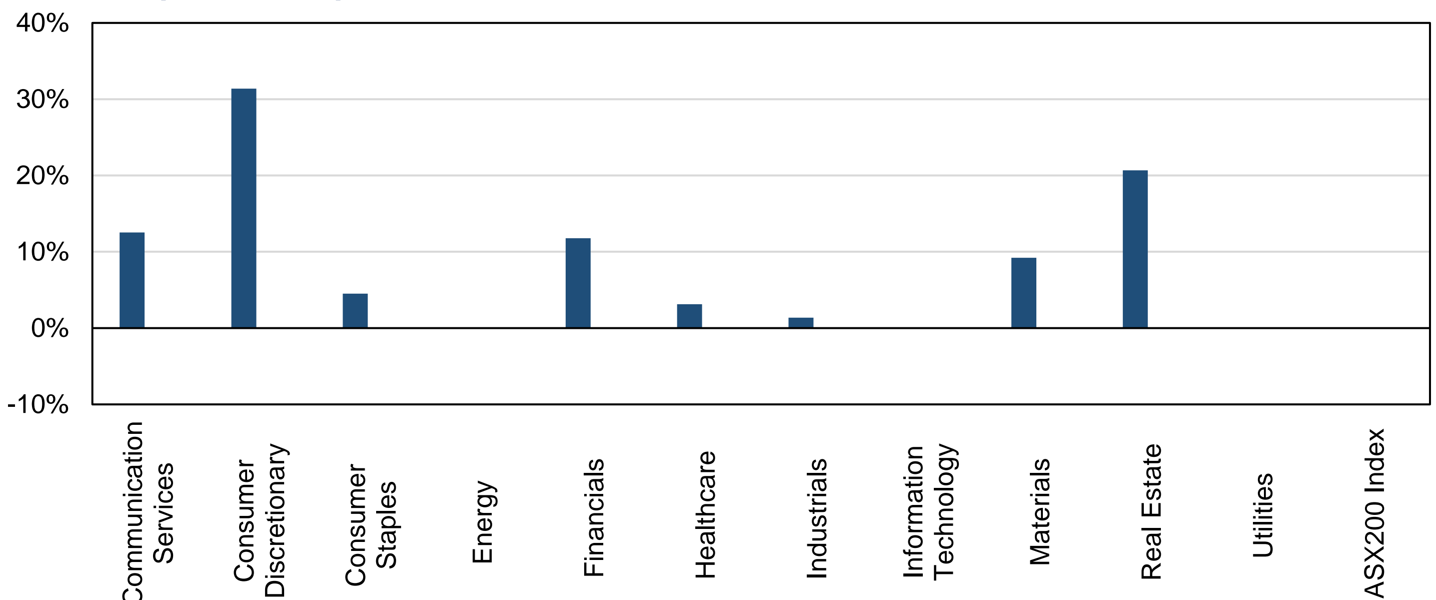
Fund Calendar Year Returns*

CY13	51.9%	CY18	(18.5%)
CY14	23.2%	CY19	18.1%
CY15	36.0%	CY20	10.6%
CY16	2.2%	CY21	29.0%
CY17	17.1%		

Top 20 Investments^

Aventus	Macquarie Group
Blackmores	Mineral Resources
Carsales.com	Motorcycle Holdings
Charter Hall Retail REIT	News Corporation
Eagers Automotive	NIB Holdings
GDI Property Group	Nick Scali
Home Consortium	NZME
Jumbo Interactive	Unibail-Rodamco-Westfield
Lovisa	Virgin Money UK
MA Financial Group	Virtus Health

Sector Exposure - September 2021



*Performance figures are calculated for the Monthly Class net of all fees and expenses and assume the reinvestment of all distributions. Note, as at 1 January 2021, the Series Class was consolidated into the Monthly Class. Past performance is not a reliable indicator of future performance.
^ Top 20 long investments in alphabetical order as at 30 September 2021.

Newsletter – October 2021

Auscap Asset Management

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