Auscap Newsletter

Auscap Long Short Australian Equities Fund

Auscap Global Equities Fund

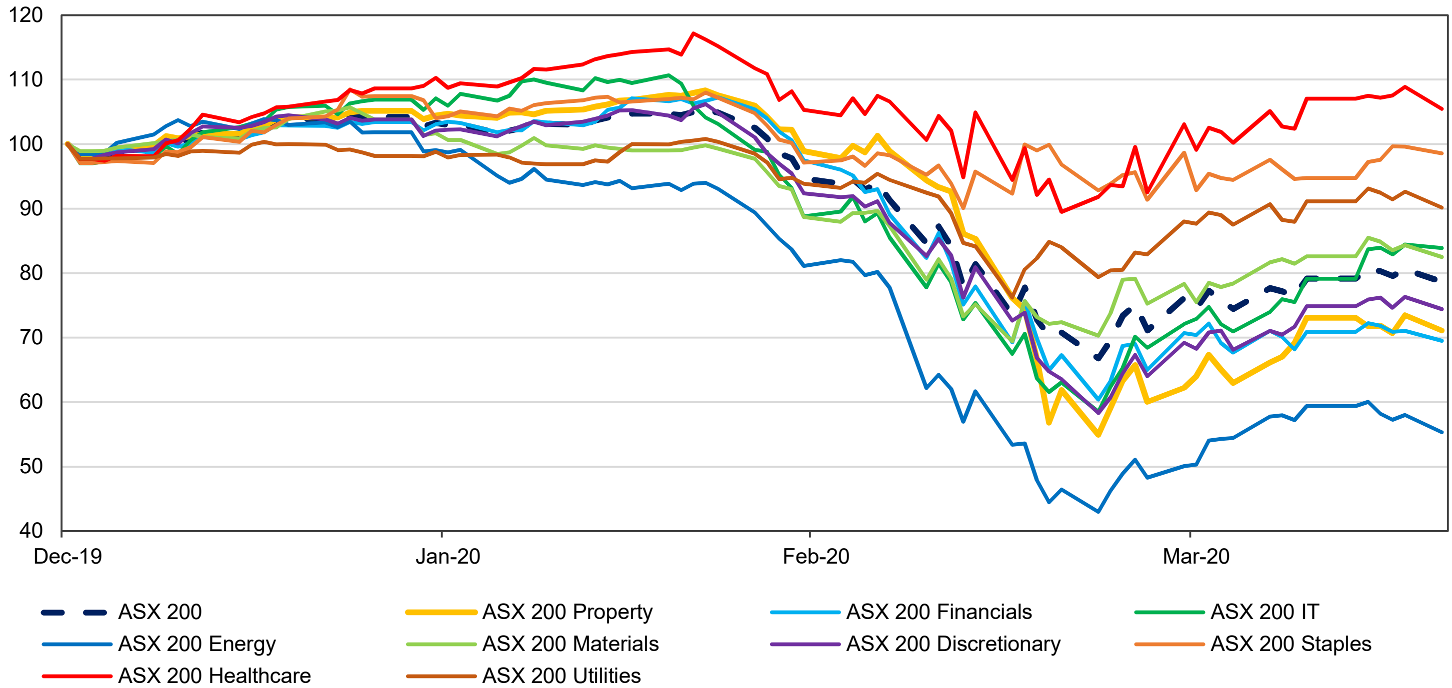
APRIL 2020

AUSCAP ASSET MANAGEMENT

Real Estate Ructions

COVID-19 has led to significant falls in global equity markets, with the ASX 200 dropping 37% off its February high on a peak to trough basis. Sectors with relatively defensive earnings streams (Healthcare, Consumer Staples & Utilities) have generally outperformed, while economically sensitive stocks such as those within the Energy, Financials and Consumer Discretionary sectors have been hit particularly hard. Despite typically being seen as having defensive characteristics, the Real Estate Investment Trust (REIT) sector has also materially lagged the index. This newsletter covers a few of the reasons for the REIT underperformance and where we have been finding opportunities in the sector.

YTD ASX 200 Index Performance (rebased to 100)



Source: FactSet, Auscap

Reasons For Underperformance

A large component of the recent REIT underperformance relates to near term sector-specific headwinds and uncertainty. In the short term, lost rent and elevated tenant support will reduce cash generation available to shareholders. Over the longer term, there is risk around the extent to which: rental agreements may be unfavourably re-negotiated; select tenants may become insolvent; a shift to online shopping may accelerate; and office demand may be impacted from a structural shift to working from home. These factors have the potential to drive lower rental income and negative revaluations of property values, potentially requiring some REITs to raise additional equity from shareholders.

We are cognisant that some of the market's concerns may play out to a degree. Negative revaluations are a possibility, and capital raisings could in some circumstances be required. By way of example, in April GPT revalued two of its wholesale trusts. These revaluations resulted in a 2% decline in the value of the office assets and an 11% decline in the value of the shopping centre assets, the result of independent valuers moderating their forecasts to take COVID-19 into account.

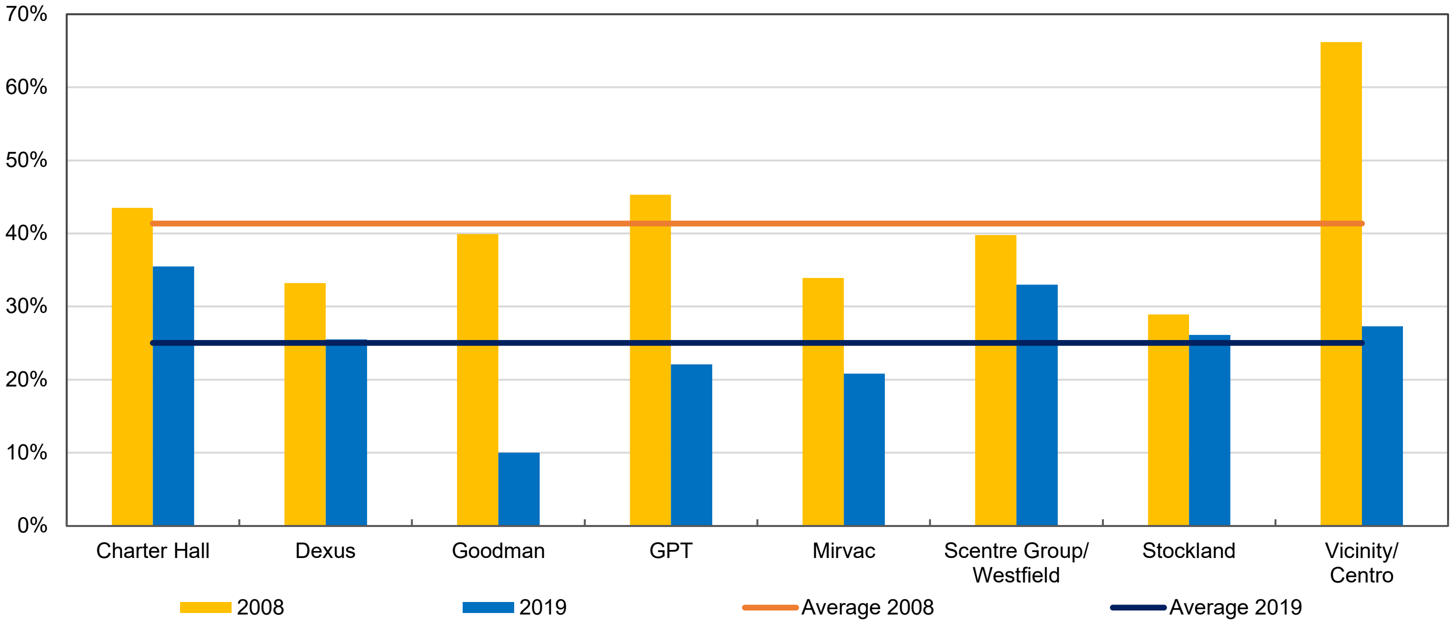
While these concerns are valid, the sharp sell-off across the sector has been indiscriminate and has, we think, resulted in pockets of excellent value. As long-term oriented investors, we think about how the situation may evolve in 12 to 18 months' time and beyond. With this in mind, the best time to buy high quality assets is often when their share prices are reflecting bleak short-term outlooks, whilst the enduring attractive characteristics are being largely ignored.

Lessons From The Global Financial Crisis

The REIT sector was a significant underperformer during the Global Financial Crisis (GFC) as a result of high gearing levels going into the slowdown which led to dilutive recapitalisations and caused the sector to fall by more than 70%. We suspect scarred by the experience, some investors have decided to sell the sector early, fearing a repeat of this period. As a generalisation, many REIT investors are comparatively conservative and typically place a high premium on certainty. In a time of crisis where near-term dividends are at risk, even if REITs have defensive characteristics, some investors will flee to cash.

We would also note that the balance sheets across the REIT sector are in much better shape than they were going into the GFC and most have considerable surplus liquidity. Management teams have learnt the lessons from the past, with average gearing levels for the S&P/ASX 300 A-REIT Index at approximately 25% compared with 40% in 2007, the lowest gearing level for the sector since the 1990s. Debt expiry profiles have also been extended and financing sources have been diversified, suggesting much lower short-term refinancing risk. Lower interest rates have also reduced the costs associated with the leverage they carry.

ASX100 A-REIT Gearing



Source: Iress, Auscap

We are focused on companies with high quality assets, strong balance sheets, sufficient liquidity to survive the crisis, a distinct customer proposition, long-term track records and compelling valuations. We are confident that the REITs the Auscap Long Short Australian Equities Fund (Fund) owns demonstrate these characteristics.

Why Are REITs An Attractive Investment?

Given this backdrop, it is worth reiterating why we are attracted to REITs. Rent is the key revenue stream for REITs and, as an essential cost for most businesses, is highly recurring in nature. Passive REITs, which focus on rent collection and do little active development or external funds management activity, tend to trade near the independent valuation of their assets. Actively managed REITs, which have additional earnings streams, frequently trade above book value to account for the additional value generated by their active management teams. The Fund owns a combination of passive and active REITs with the valuation characteristics summarised below. We view the returns on offer as very attractive, with highly pessimistic outcomes being implied by the current share prices of the Fund's holdings.

ASX REIT Holdings	Historical Yield	Discount to NTA	Occupancy	Gearing
Auscap Fund Weighted Average	10.5%	42.7%	94.4%	26.9%

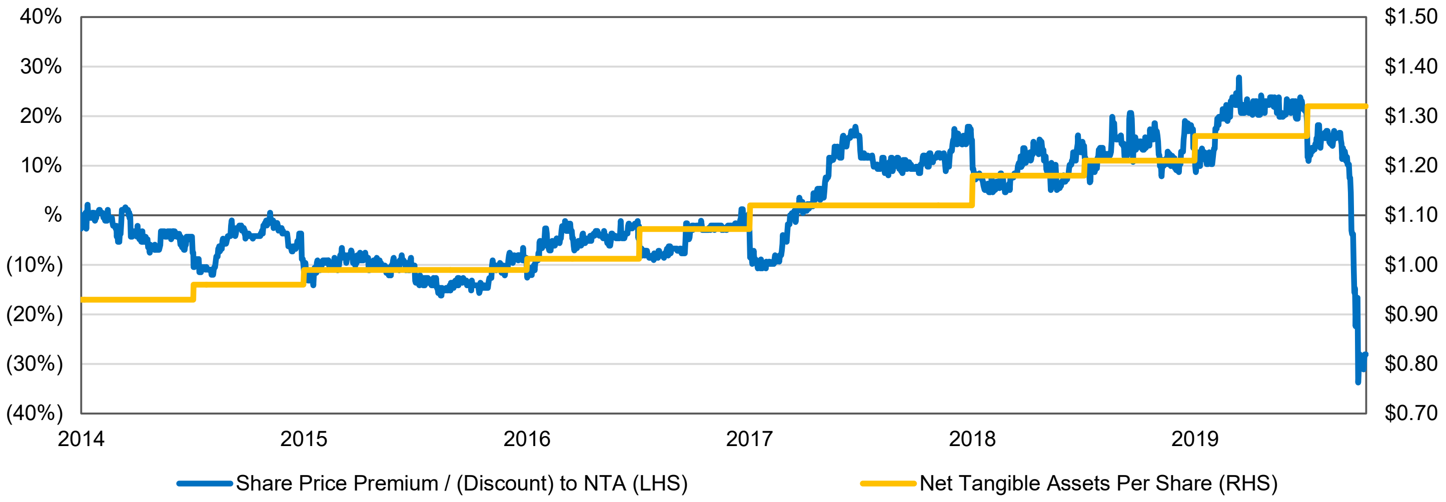
Source: Auscap, Iress

Whilst these metrics are attractive, we are also of the view that valuations generally understate the qualitative characteristics of the Fund's REITs that give them unique competitive advantages which underpin their solid rental growth outlooks. Below are three examples of stocks held in the Fund with characteristics that we find compelling.

GDI Property Group

GDI Property Group (GDI) is a fully integrated, internally managed property and funds management group with capabilities in ownership, management, refurbishment, leasing and syndication of properties. Its largest exposure is to the Perth office market and its largest tenants are the West Australian Government and the Australian Federal Government. GDI is on track to pay an FY20 distribution yield of 7.5%. It also currently has significant development opportunities in Perth to grow its NTA over time. GDI has a history of opportunistic behaviour in periods of market dislocation. With a current loan to value ratio of only 9%, it is well placed to take advantage of any opportunities that might arise due to COVID-19. GDI's Managing Director, Steve Gillard, is a substantial shareholder.

GDI Net Tangible Assets Per Share and Share Price Premium / (Discount)

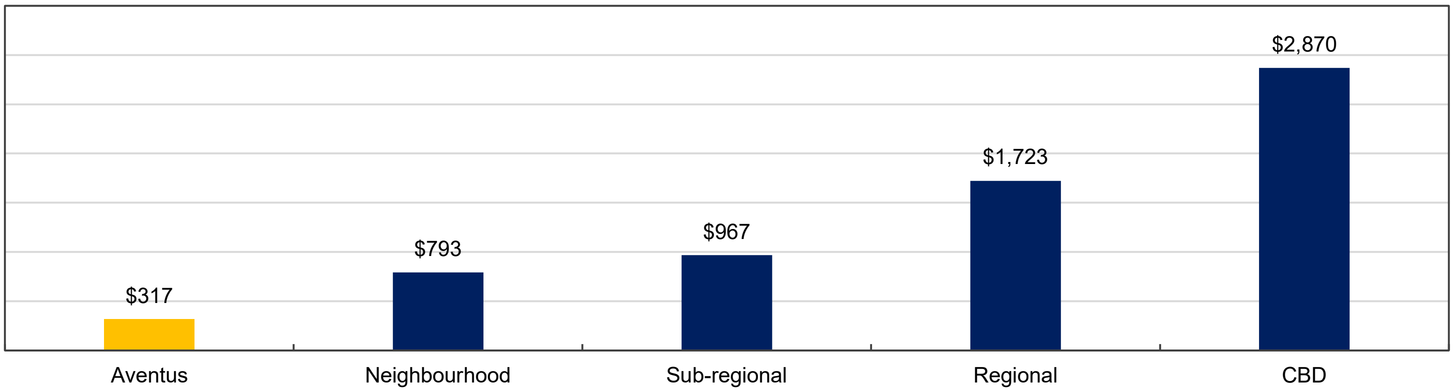


Source: FactSet, Auscap

Aventus Property Group

Aventus Property Group owns a diversified portfolio of 20 high quality large format retail centres, representing 22% of the category in the Australian market. All leases include annual rent escalations, 76% of which are fixed, typically at 3-5% per annum. Crucially, Aventus charges an average gross rent of $317 per sqm, which is materially lower than the majority of other large scale retail centres. This low comparative rent has allowed Aventus to maintain high occupancy, currently 98.6%, for over a decade whilst also providing a long runway of rental growth. Aventus is well placed to capitalise on any health-related trend towards large scale open air retail centres where consumers can drive to within close proximity of the retailer they intend to visit. Aventus trades at a 33% discount to NTA and a historical distribution yield of 11.2%.

Average Gross Rent / Sqm

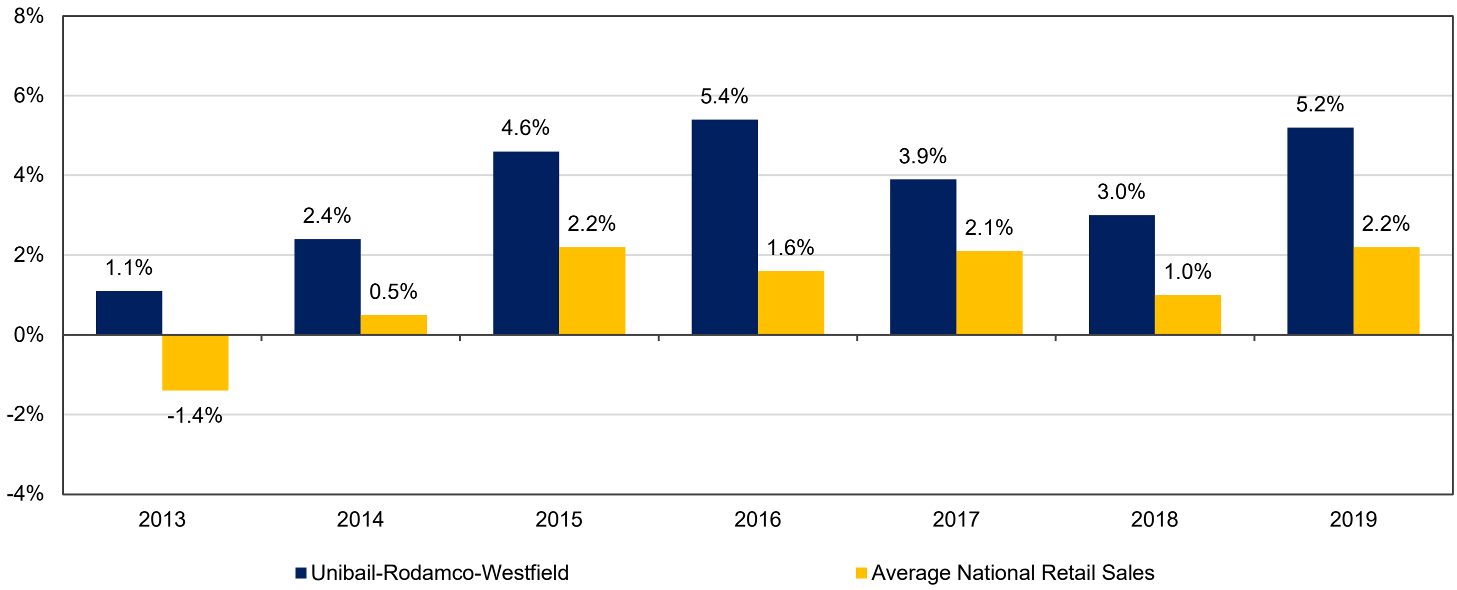


Source: Aventus, JLL Research, Auscap

Unibail-Rodamco-Westfield

Unibail-Rodamco-Westfield (Unibail) is one of the world's largest REITs, holding what we believe to be one of the world's highest quality retail portfolios. Unibail owns 19 of Europe's top 30 retail assets by footfall and 79% of its assets have been refurbished since 2009. Unibail's liquidity position is strong and it has a significantly diversified tenant base. Unibail is experiencing acute short-term challenges, with many of its flagship assets substantially closed at present. However, trading at a 77% discount to NTA, Unibail's upside from a resumption to normal trading could be significant given the material devaluation already implied by the current share price.

Unibail Tenant Sales Growth (%)



Source: Unibail-Rodamco-Westfield, Auscap

We acknowledge that there are legitimate market concerns in relation to the current and future operating performance of many REITs. However, the widespread falls and ongoing uncertainty have created opportunities. Auscap remains positive on the outlook for our REIT holdings. They trade at an average historical distribution yield exceeding 10% and significant discounts to their respective net tangible asset values. They hold sufficient liquidity to survive the COVID-19 crisis and display some enduring competitive advantages that should hold them in good stead to emerge from the current period of uncertainty in a strong position.

We released a detailed letter to investors in the Auscap Long Short Australian Equities Fund in April. If you are a unitholder and did not receive this please email investors@auscapam.com.

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
March 2020	(47.3)%	(20.9)%
Financial Year To Date	(46.8)%	(21.2)%
Since Inception	44.4%	54.0%
Annualised Returns	5.1%	6.1%

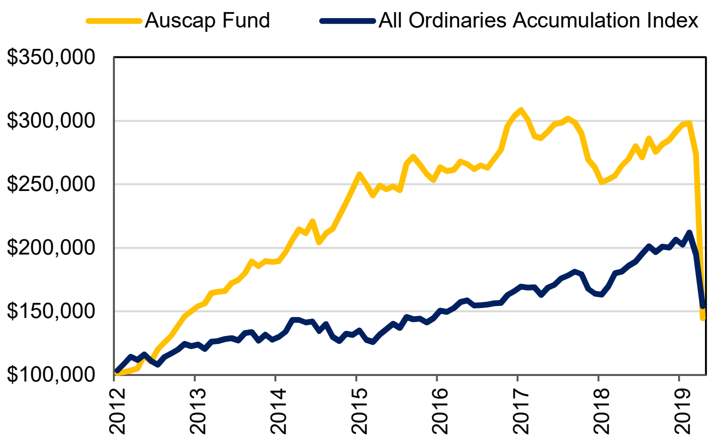
Fund Exposures

March 2020 Average	% NAV	Positions
Gross Long	143.5%	29
Gross Short	21.3%	6
Gross Total	164.8%	34
Net / Beta Adjusted Net	122.2%	118.6%

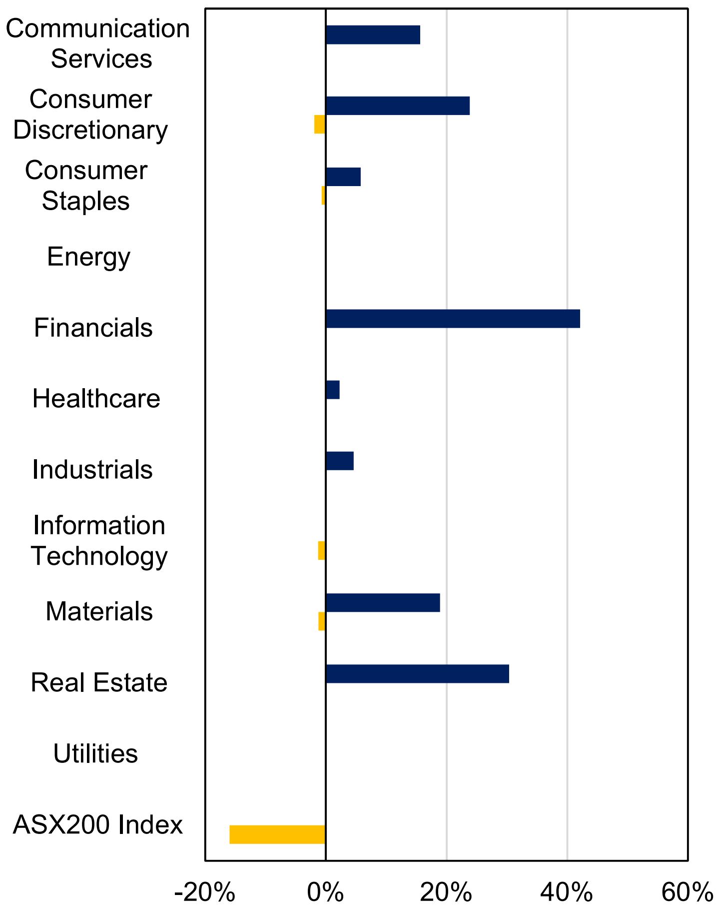
Portfolio Commentary

The Fund returned negative 47.3% net of fees during March 2020. This compares with the All Ordinaries Accumulation Index return of negative 20.9%. Average gross capital employed by the Fund was 143.5% long and 21.3% short. Average net exposure over the month was 122.2%. Over the month the Fund had on average 29 long positions and 6 short positions. The Fund's biggest exposures over the month were spread across the financials, real estate, consumer discretionary, materials and communication services sectors.

Fund Performance*



Sector Exposure - March 2020



Fund Financial Year Returns*

FY13	19.7%	FY18	12.7%
FY14	46.0%	FY19	(9.2)%
FY15	16.8%	FY20 (YTD)	(46.8)%
FY16	20.1%	CY19	18.1%
FY17	8.0%	CY20 (YTD)	(51.4)%

Top 10 Investments^

Adelaide Brighton	Nick Scali
AP Eagers	Nine Entertainment
GDI Property Group	Super Retail Group
Macquarie Group	Unibail-Rodamco-Westfield
Mineral Resources	Virgin Money UK

** 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 31 March 2020.

Auscap Global Equities Fund

Fund Performance*

Period	Auscap	MSCI^
March 2020	(46.4)%	(13.6)%
Financial Year To Date	(50.9)%	(16.8)%
Since Inception (Nov 19)	(50.9)%	(16.8)%

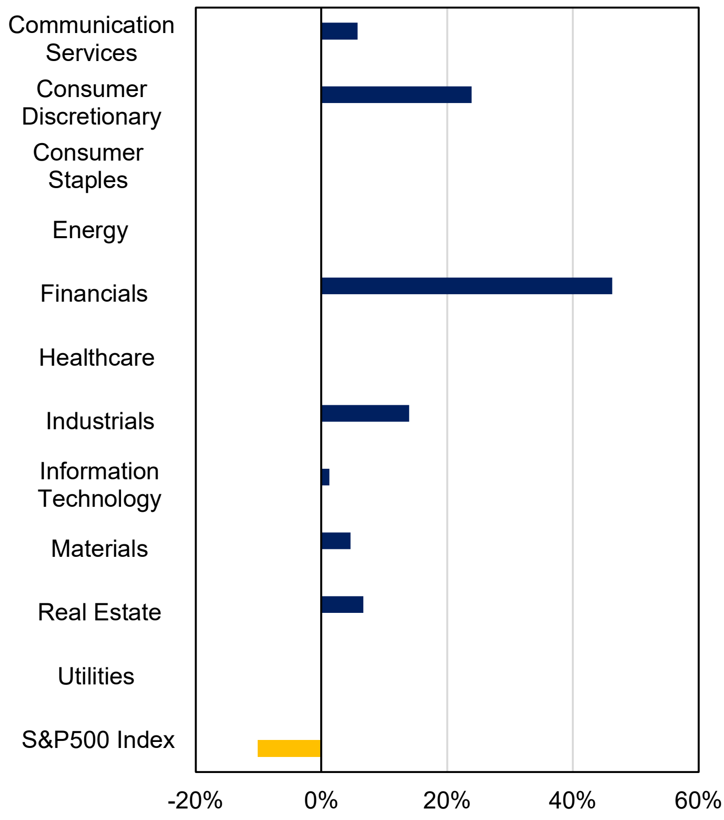
Fund Exposures

March 2020	% NAV	Positions
Gross Long	128.1%	31
Gross Short	8.9%	2
Gross Total	137.0%	22
Net / Beta Adjusted Net	119.2%	134.6%

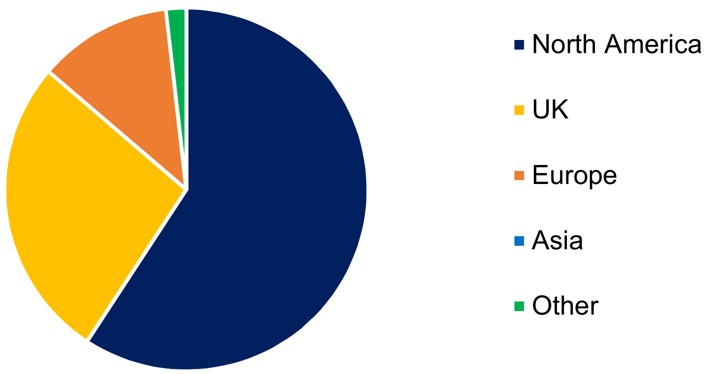
Portfolio Commentary

The Fund returned negative 46.4% net of fees during March 2020. This compares with the MSCI World 100% Hedged to AUD Index return of negative 13.6%. Average gross capital employed by the Fund was 128.1% long and 8.9% short. Average net exposure over the month was 119.2%. Over the month the Fund had on average 31 long positions and 2 short positions. The Fund's biggest exposures at month end were in the financials, industrials, consumer discretionary and information technology.

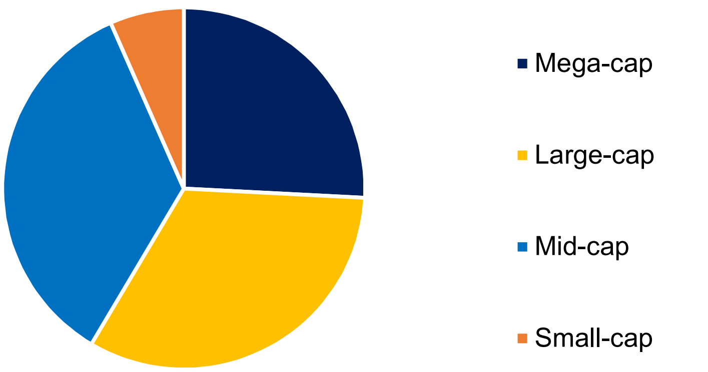
Sector Exposure - 31 March 2020



Exposure by Region



Exposure by Company Size



Top 10 Investments+

Alphabet	Macquarie Infrastructure
American Express	Morgan Stanley
Capri Holdings	PVH
Citigroup	Santander Group
Intercontinental Exchange IN	Unibail-Rodamco-Westfield

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^ MSCI World 100% Hedged to AUD Index.
+ Top 10 long investments in alphabetical order as at 31 March 2020.

Disclaimer

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