MONTAKA GLOBAL ACCESS FUND
QUARTERLY LETTER

MONTAKA

MARCH 2016

UNIT PRICE # $0.9075

FUND COMMENTARY

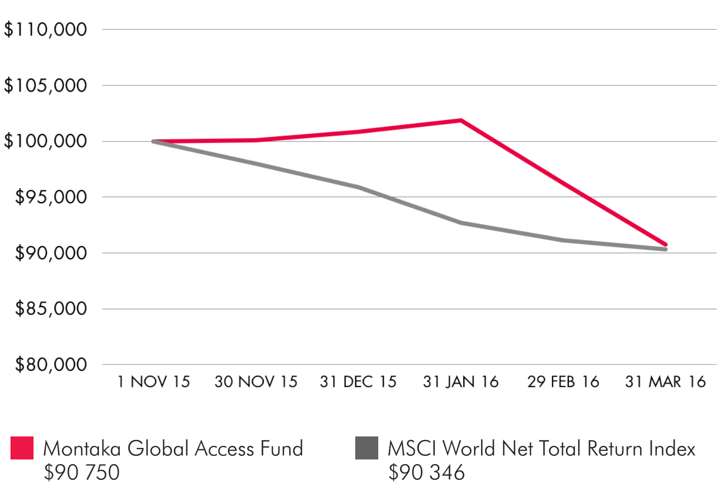
Welcome to the March 2016 Quarterly Letter for the Montaka Global Access Fund. Over the March quarter, the Fund declined by 10.02%, net of fees. Around half of this decline was due to a stronger Australian dollar.

While the Fund was up in US dollar terms for the month of March, a sharp appreciation in the Australian dollar resulted in the Fund reporting a negative monthly return of 5.74%, net of fees.

March closed out yet another eventful quarter for global financial markets. January marked the worst start to a calendar year on record for global equity markets. Following the US Federal Reserve's interest rate rise last December (the first time since 2006), China's currency started to depreciate rapidly - as did its stock market. As has now become the norm, selling restrictions were placed on Chinese investors and China's stock market was even suspended for a period of time to try to stem the price declines.

The decline in China's currency combined with falling foreign currency reserves increased concerns that China would be forced into a larger (and more disruptive) devaluation of its currency. Recall that China operates a largely-pegged exchange rate system meaning that its central bank needs to buy back domestic currency (and sell foreign currency) at the same rate that capital exits the country to avoid the currency from falling naturally. Of course China can typically only sell foreign currency that it owns (and is liquid) and, therefore, the accelerating declines in China's foreign currency reserves suggest that policy makers' ability to support the currency peg is limited. (And if you're thinking about the act of buying back domestic currency as a form of monetary tightening, you would be right. At a time when the People's Bank Of China is trying to ease monetary conditions, you can see the current predicament faced by Chinese policymakers).

FUND PERFORMANCE[1]



1) Inception: 1 November 2015

PERFORMANCE ATTRIBUTION (%)

	March 2016
Long portfolio contribution	7.56
Short portfolio contribution	-6.08
Change in AUD/USD	-7.22
Net return	-5.74
Since inception[1]	-9.25

EXPOSURES* (as at 31 March 2016)

	% of NAV
Long exposure	93.1
Less: short exposure	-43.2
Net market exposure	50.0

POSITION METRICS* (as at 31 March 2016)

	Long Portfolio	Short Portfolio
Number of positions	23	36
Largest position size	6.0	1.9
Smallest position size	2.5	0.5
Average position size	4.0	1.2

Note: sizes shown as % of NAV

TOP 10 LONG POSITIONS* (as at 31 March 2016)

		% of NAV
1	Foot Locker	6.0
2	REA Group	6.0
3	Take-Two Interactive	5.7
4	Playtech	5.5
5	Apple	5.2
6	Challenger	5.1
7	CVS Health	4.9
8	Essilor	4.7
9	Travelers	4.5
10	Insperity	4.5
	Total top 10 long positions	52.1

FUND SIZE (NAV) ($M) (as at 31 March 2016)

Montaka Global Fund	121
of which: Montaka Global Access Fund	48

** all exposures, metrics & positions are derived from the underlying investment fund*
 # The fund is forward priced; you will receive the price struck subsequent to the receipt of your application/ redemption request.

MARCH 2016

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It seems Chinese policymakers were determined not to lose face or control of the currency and stock market. Combined with its National People's Congress to be held in Beijing in March, this required Chinese policymakers to boost confidence in both the economy and financial system. Let's review what we subsequently observed in February which resulted in a sharp reversal of sentiment towards the Chinese economy:

- February's disclosure of Chinese loan growth for the prior month of January was the highest monthly increase we have seen in recent history. It was more than four times the level seen in December and miles above any sensible level of expectation.
- Meanwhile, central bankers from both China and the US went on the offensive. People's Bank of China Governor, Zhou Xiaochuan, said that: "China still has some monetary policy space and multiple policy instruments to address possible downside risks." The PBOC added in a statement that: "There is no basis for sustained depreciation in the currency and stabilizing market expectations on the yuan is critical."
- At around the same time, we saw Federal Reserve official, James Bullard, on live television suggesting that the Fed's December interest rate hike was not necessarily the beginning of a tightening cycle.

And what was the combined effect of these coordinated actions? The US dollar weakened, China's currency strengthened - as did commodity prices, and equity markets soared. Mining companies, whose prospects depend on China's fixed-asset investment-led growth, saw their shares rally hard. Consider that shares in Australian iron ore miner, Fortescue (ASX: FMG), more than doubled over a six week period (Montaka was not short). This makes no fundamental sense, in our view. Global steel consumption (a direct proxy for iron ore demand) is contracting; while iron ore supply continues to grow - and rapidly!

But the sharp improvement in sentiment and prices was not enough for senior Chinese leaders. Controlling the flow of information has also become paramount (and this should be concerning for investors). In late February, the South China Morning Post reported that key financial data relating to purchases of foreign exchange was no longer being disclosed by the People's Bank of China. This coincided with a personal visit to State-run media outlets by President Xi Jinping. According to Xi: "All news media run by the party must work to speak for the party's will and its propositions, and protect the party's authority and unity." The China Daily, the official English-language newspaper, then tied Xi's directives to the regaining of control of the financial system: "It is necessary for the media to restore people's trust in the party, especially as the economy has entered a new normal and suggestions that it is declining and dragging down the global economy have emerged."

China observers will know that President Xi is serious with his intentions. In March, Wujie News published an anonymous letter calling for President Xi Jinping's resignation on the basis of his complete abandonment of a democratic system.

At the writing of this report, 16 Chinese - including a senior manager and senior editor of the media outlet - remain missing in connection with this publication.

The March quarter concluded with meetings by key central banks including the European Central Bank, the Bank of Japan and the Federal Reserve. All meetings resulted in a continuation of (largely expected) highly accommodative monetary conditions. Still, with the US economy gradually improving, it would seem likely that we see further interest rate hikes this year barring any renewed downturn in emerging markets. Interestingly, either scenario is likely bullish for the US dollar, which is why Montaka's portfolio is biased towards high quality US dollar-denominated earnings streams.

The March quarter was a challenging one for Montaka (and, indeed, for many of our peers). Montaka's strategy is one that buys very high quality global businesses cheaply; and sells businesses that are deteriorating and for which market-implied expectations are overly bullish. During the March quarter, however, share prices of high quality businesses increased only modestly relative to low quality businesses - many of which accelerated sharply as a result of a sudden change in sentiment (though not fundamentals).

While this has been a frustrating period, there are a number of positives to take away from this experience. Montaka's risk management processes were put to the test and delivered this period. Our strategy to limit the size of Montaka's short positions helped limit the downside; while our agility to swiftly step aside from many rallying mining stocks did the same.

Many of these stocks are shaping up to be prospective future shorts from which our clients stand to profit. This is a positive silver lining as we emerge from a difficult quarter. And for those who are wondering if China's problems have recently abated, consider the following datapoint contained in the recent 2015 filing of China Minsheng Banking Corp (HKEx: 1988): against loan growth of 13% per annum, growth in poor-quality loans were up by 90% per annum! Credit quality in China's banking system continues to deteriorate at an accelerating rate.

Finally, we encourage our clients not to lose sight of the incredible businesses they own through Montaka's long portfolio. Whether it's the global monopolist in design software, the global leader in eyeglass lenses, the global leader in business-to-business gaming management platforms, the effective owner of Chinese mobile internet traffic, or the owner of one of the most valuable gaming franchises the world has ever seen, Montaka's clients are positioned well to build their wealth as the intrinsic value of these outstanding businesses grows over the coming years.

We continue our educational efforts this quarter with a case study on a Montaka short position: Penn National Gaming.

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CASE STUDY: Penn National Gaming

Investors who are used to buying and selling businesses in the marketplace, instead of stocks, need to be particularly careful when assessing Penn National Gaming (NASDAQ: PENN). On the one hand, here is a geographically-diversified portfolio of US-based gaming and racing facilities. The business is straight-forward to understand: 86% of PENN's 2015 revenue stemmed from slot machines. But in the unique case of PENN, investors need to care less about the underlying business and more about the value that accrues to the company's shareholders as a result of its corporate structure. The short answer, in our view, is: very little.

First about the underlying business: regional gaming. Now, demand for gambling in general is typically fairly stable. But demand for slot machines is likely in long-run structural decline, in our view. Slot machines tend be favoured by older generations and less so by younger generations. Furthermore, we are seeing more and more retirees in the US with insufficient pensions, exacerbated by the low interest rate environment, meaning disposable income for gambling is not what it used to be pre-GFC.

At the same time, competition in the gaming space is only intensifying. Not only is the number of regional gaming facilities expanding; but new forms of gaming, particularly online gaming, are displacing the more traditional forms including slots and racing. PENN says as much in its filings:

"The gaming industry is characterized by an increasingly high degree of competition among a large number of participants, including riverboat casinos, dockside casinos, land-based casinos, video lottery, gaming at taverns in certain states, such as Illinois as well as the potential legalization in Indiana and Pennsylvania, sweepstakes and poker machines not located in casinos, Native American gaming and other forms of gaming in the U.S. Furthermore, competition from internet lotteries, sweepstakes, and other internet wagering services, which allow their customers to wager on a wide variety of sporting events and play Las Vegas-style casino games from home or in non-casino settings, could divert customers from our properties and thus adversely affect our business."

Finally, PENN is negatively exposed to a rapidly consolidating slot machine vendor space. Following such mergers as Bally Technologies with Scientific Games, and GTECH with International Gaming Holdings, PENN's suppliers have only strengthened their bargaining power. PENN even acknowledges a recent trend by which slot machine manufacturers have refused to sell their most popular games, instead requiring a "participation lease" arrangement. Under such an arrangement, the manufacturer is not only paid for the machine but also participates in the net revenue generated by the machine. Again from PENN's filings:

"Generally, a participation lease is substantially more expensive over the long term than the cost to purchase a new machine."

These dynamics have led to PENN generating mediocre returns on shareholders' equity - typically less than 10% per annum, after tax. PENN's underlying business is hardly high quality.

Certainly, the challenges described above have made it difficult for PENN's management to operate. It was perhaps these challenges that led company CEO at the time, Peter Carlino, to explore new and creative options to add value.

Over recent years, the low interest rate environment created a "chase for yield" like nothing we have seen for a very long time. It is not surprising, therefore, that high-distribution-paying tax-advantaged structures, such as real-estate investment trusts (REITs), became in vogue across many industries - even in some that had not typically employed these structures before. The rationale was simple: reduce taxation and take advantage of the very high valuation multiples that were being placed on REITs by the market at the time.

Under Carlino's leadership on November 1, 2013, PENN became the first gaming operator in the US to effect a significant tax-free restructure of substantially all of its real-estate assets into a newly-formed, publicly-traded REIT called Gaming and Leisure Properties (NASDAQ: GLPI). Under the deal, PENN shareholders would receive one share of GLPI for every one share of PENN owned; and PENN would rent the property back from GLPI under a long-term lease agreement. In practical terms, this burdened PENN with a new annual rental expense paid to GLPI to the tune of approximately $400 million. For context, however, PENN's 2012 pre-tax income was only $365 million. GLPI, on the other hand, receives the $400 million as revenue and, with relatively few expenses, pays its shareholders significant distributions.

One might naturally start asking the question: what will be left for PENN shareholders if substantially all future profits are paid to GLPI? Well, the subsequent resignation of Peter Carlino might suggest something about the answer. In connection with the 2013 restructure, Carlino resigned as CEO of PENN (though continues to remain as Chairman) and took up the role of Chairman and CEO of GLPI. Not only this, he had stock and options relating to PENN converted to GLPI. Here is the relevant disclosure:

"Peter M. Carlino and the PMC Delaware Dynasty Trust dated September 25, 2013, a trust for the benefit of Mr. Carlino's children, also received additional shares of GLPI common stock, in exchange for shares of Penn common stock that they transferred to Penn immediately prior to the Spin-Off, and Mr. Carlino exchanged certain options to acquire Penn common stock for options to acquire GLPI common stock having the same aggregate intrinsic value."

It would certainly appear that Carlino is very much betting on GLPI, and not PENN, for the future.

Now, it was always the intention that PENN's obligations to GLPI would be accounted for under the rules of an operating lease. All this means is that investors would see the annual rental expense paid to GLPI and very little else.

MARCH 2016

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This is an effective technique to hide debt off balance sheet. Imagine you owed $400 million per year in interest on a loan. Well, your balance sheet should include a liability for, say, $8 billion. So by opting for the accounting rules associated with an operating lease, the perceived leverage of PENN would be significantly understated.

Last year, PENN's auditors, EY, reconsidered its approval of such accounting treatment. Instead, EY required PENN's obligation to GLPI to be treated under the accounting rules associated with a financing lease. This simply means that PENN needs to show the capitalized value of the lease liability (that would be the $8 billion liability, to use the example above), as well as the value of the leased asset, on its balance sheet.

This requirement created an internal issue, which has subsequently been stated as a material weakness, with respect to preparing an accurate set of financial statements.

"Management identified material weaknesses in our internal control over financing reporting. As a result of these material weaknesses, our principal executive officer and principal financial officer concluded that as of December 31, 2015 the Company's disclosure controls and procedures were not effective to ensure that information required to be disclosed by the Company."

Indeed, since August last year, PENN has been unable to file its financial statements to the market or the Securities Exchange Commission. In November, PENN then received a letter from The Nasdaq Stock Market stating it was in violation of its listing rules. PENN was granted an extension to prepare its financials and meet its compliance requirements.

It took until March this year for the company to file a complete set of annual financial statements from PENN. The company's significant liability to GLPI for the leasing of real property assets is now stated on PENN's balance sheet at $3.6 billion, as shown below. (And yes, PENN's book value of shareholders' equity is negative). But we question if even this is a fair representation of the company's financial position.

PENN: Simplified Balance Sheet (December 31, 2015)	US$m
Cash	237
Net working capital	(280)
Plant & equipment	2,980
Other assets	1,786
Total assets, net of non-interest bearing current liabilties	4,723
Financing obligation to GLPI	3,565
Debt	1,711
Other liabilities	126
Shareholders' equity	(678)
Total funding	4,723

You see, the "estimated" interest rate that was used to convert PENN's annual rental expense stream to a present value of $3.6 billion was 9.7% per annum. The higher this number, the lower the perceived liability. So is a 9.7% interest rate appropriate for PENN? Well, in subsequent disclosure, PENN estimates the average interest rate it will pay on its debt based on the forward interest rate curves (meaning these rates could effectively be locked in today). Out to 2020, the average interest rate on debt is a maximum of 4.7% per annum. Furthermore, we note that PENN's bonds currently trade in the marketplace at yields of 5.9% per annum. So surely 9.7% is too high - meaning $3.6 billion for its GLPI liability is too low.

Now, if we applied an interest rate of, say, 5% per annum to PENN's future annual rental expense stream, then we would arrive at liability with present value around $8 billion. That is, there is an extra $4.4 billion of effective debt that has been omitted from PENN's balance sheet. Under this scenario, PENN's true financial leverage is even higher than what is being shown by its restated balance sheet.

Apart from understating financial leverage, an understatement of debt typically results in an overestimation of value. You see many analysts in the marketplace value a business like PENN on a metric called EBITDAR, which stands for: earnings before interest, tax, depreciation, amortization and rental expense. The analysis typically multiplies EBITDAR by an estimated valuation-multiple, then subtracts from this the value of PENN's net debt and GLPI obligation. Of course, if the GLPI obligation is understated by $4.4 billion, then PENN's equity value will be overstated by $4.4 billion.

Even putting aside the understatement of PENN's debt, let us review what today's shareholders in PENN actually own:

- Claims on $4.7 billion worth of assets that are subordinated to more than $5 billion worth of claims from creditors and GLPI.
- A disclosed commitment to not pay dividends to shareholders for the foreseeable future - consistent with PENN not paying any dividends since its initial public offering in 1994.
- Plans to continue to expand through debt-funded acquisitions and new openings of regional gaming venues - the value to shareholders of which is surely debatable.

And all of this under the chairmanship of Peter Carlino, who is the Chairman, CEO and major shareholder of GLPI. (And PENN even leases its executive offices from an affiliate of Carlino). There are surely some conflicts of interests here.

PENN: Simplified Income Statement (US$m)	2011	2012	2013	2014	2015
Operating income	500	443	(416)	299	515
Rental expense to GLPI	0	0	(70)	(421)	(437)
Other expenses, including interest on debt	(110)	(78)	(140)	(31)	(21)
Profit before tax	389	365	(626)	(153)	57

MARCH 2016

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We make the observation that substantially all of the value of PENN has been hollowed out into GLPI. And we question how much value remains in PENN for shareholders, if any. This case study illustrates how, in some instances, there is so much more for investors to understand than simply the quality of an underlying business. The corporate structure and the priority of claims on assets is of critical importance to understand what is left for shareholders at the end of the day.

Montaka has been short the shares of PENN since its inception.

* * *

We had the privilege, this quarter, to meet many Montaka clients as part of our Australian roadshow. We were struck by two things in particular. First, clients have been exceptionally quick to understand the unique value proposition of Montaka: (i) downside protection due to the Fund's reduced net market exposure; and (ii) greater scope to add value through superior stock selection in both the long portfolio and short portfolio. Second, we were struck by our clients' commitment to the long term. February was a challenging month, for sure. Yet focusing on month to month returns for a fund which invests in equities is not particularly helpful. The process should deliver attractive risk-adjusted returns over multiple years – and we were delighted to discover that our clients already understand this.

Sincerely,

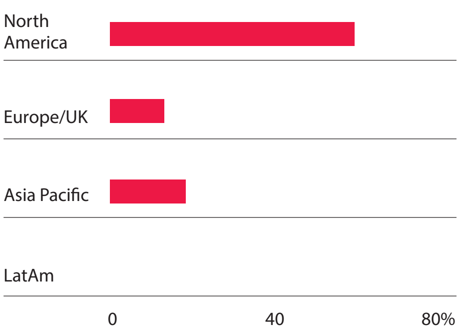
MONTAKA GLOBAL ACCESS FUND
QUARTERLY LETTER

MONTAKA

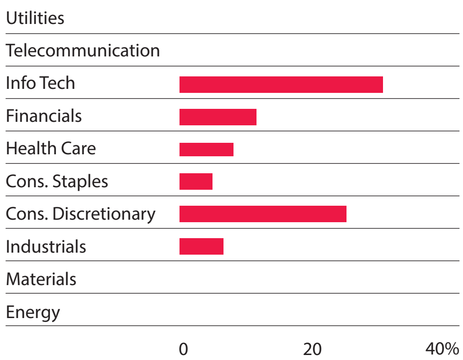
MARCH 2016

LONG PORTFOLIO*

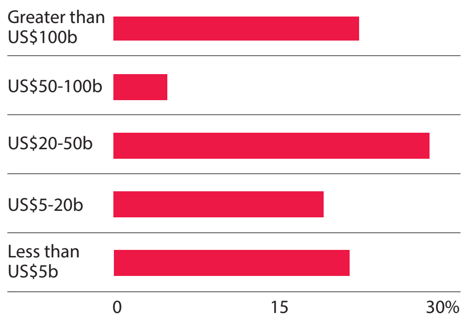
GEOGRAPHIC EXPOSURE
(Country of domicile)



INDUSTRY EXPOSURE

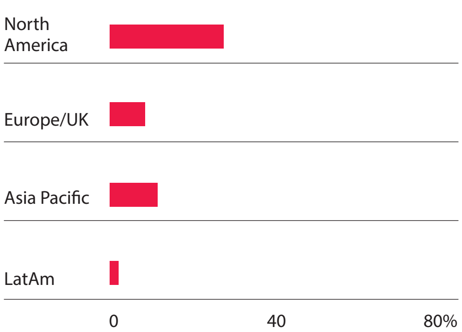


MARKET CAP EXPOSURE

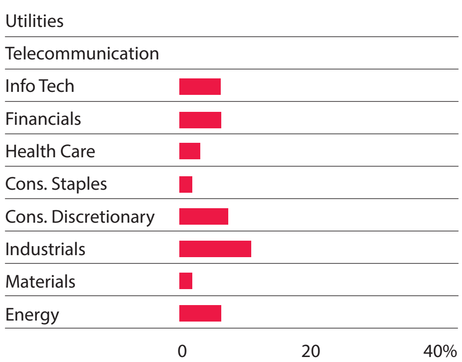


SHORT PORTFOLIO*

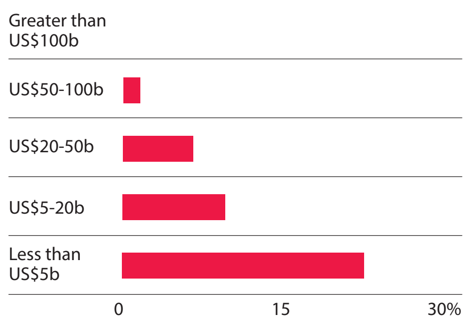
GEOGRAPHIC EXPOSURE
(Country of domicile)



INDUSTRY EXPOSURE



MARKET CAP EXPOSURE



Note: exposures shown as % of NAV

** all exposures, metrics & positions are derived from the underlying investment fund*

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DISCLAIMER