February 2019 – Datt Capital Absolute Return Fund

To our valued investors,

Thank you for entrusting your capital and co-investing with us.

For February the Fund provided a net return of 1.66% for the month.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY19		2.6%	-1.2%	-4.8%	3.53%	-2.07%	6.97%	1.66%					6.00%

Approximate Asset Allocation for the Fund at February month end was:
CRE debt - 48%
Equities - 38%
Cash - 6%
Derivatives – 8%* (liquidation value)

Investment review
Commercial real estate debt
This month we evaluated 5 new opportunities, none were considered investable.

The funds invested in Project D were repaid in January.

Our current real estate debt exposures are:

Name	Location	Type	Maturity	Max LVR/LSR	Interest receivable on investment (per annum)
Project A -Mixed use/Residential infill	Melbourne, Inner East	1st Mortgage Land Facility	August 2020	20%	11% with step up to 16% after 9 months
Project B - Industrial	Melbourne, Inner West	1st Mortgage Land Facility	June 2019	60%	11%
Project C - Residential infill	Melbourne, Inner South	1st Mortgage Land Facility	July 2019	65%	11%

Fixed interest
We continue to monitor a number of fixed income instruments in the distressed and special situation space.

Derivatives
We maintain long volatility positions over the index, with a non-directional bias. We achieved positive returns on a number of equity option positions. Our existing positions will provide good downside protection to the portfolio in case of any market weakness, while not affecting overall performance materially.

Equities
We took a new equity position in Echo Resources in February. Our thesis is outlined below.

Echo Resources

Echo Resources (ASX:EAR) is a gold developer with its operations based in Western Australia. We believe that it provides the best exposure to ASX listed gold development plays, and is compelling value at the current market value of around $100 million. It is our opinion at the current gold price, the company is worth significantly more; especially considering its exceptional project economics, strategic assets and exploration potential.

Echo's key differential advantage against other gold developers, is that it already owns almost all the key infrastructure required to operate a stand-alone gold production operation. The Bronzewing Processing Hub is a 2 million tonne per annum processing plant, currently on care and maintenance, solely owned by Echo with a replacement value of approximately $120 million. Other key infrastructure available to Echo's operations are a 200 person mining camp, an operational airstrip, essential services (water, power, telecommunications) and an established network of haulage and access roads.

Having this infrastructure in place, heavily reduces the upfront capital expenditures ('capex') and time required to bring it's gold resources into production; making the project exceptionally attractive from a financial returns perspective. A Bankable Feasibility Study ('BFS') has been completed, demonstrating that the project requires pre-production capex of around $40 million to bring the project into production in a time frame of only 6 months. This is in contrast with similar projects, requiring between $130-160 million in pre-production capex depending on jurisdiction, and a time frame of 12-18 months to first gold production.

According to the BFS, at a gold price of AUD$1600, the project is projected to earn over it's lifetime of 8.5 years, a base pre-tax IRR of 155% and to payback it's initial capex within 12 months. Assuming a gold price of $1800, we modeled that the project would earn an IRR of around 300% and payback it's inital capex in around 7 months; almost unheard of economics for a commodity project. Taking a discounted equity multiple approach, we modelled that the project would return almost $8 for every $1 of capex spent over its lifetime. EAR's all in sustaining cost ('AISC') for the life of the mine is projected to be around $1270 an ounce however, we expect this figure to fall in the optimised BFS.

These figures account only for EAR's existing resource base; whilst ignoring it's significant exploration successes since the issuance of the BFS and future exploration potential. An optimised BFS is currently underway and due to be released in the March quarter. We anticipate this confirm the robust economics of the Yandal project, and lead very quickly to a Final Investment Decision. We expect there will no issues at all with debt funding the entire capex requirement given the exceptional economics of the project, and the company have iterated that discussions with multiple Tier 1 resource project funders have been undertaken.

We note that the company currently has a 1.7 million ounce mineral resource, with a JORC reserve of 856,000 ounces. We expect, given the recent excellent strikes at Mt Joel, that this figure has the potential to increase substantially. In addition, there is still vast exploration potential for the company at depth, with almost all exploration to date has been done near the surface (<200 metres below ground level). With the project expected to produce around

95,000 oz a year, any further discoveries or resources defined will have the potential to extend the life of the project materially.

EAR's fantastic potential has not gone unnoticed by larger competitors. Northern Star Gold (ASX:NST) have over time taken a stake of approximately 22% of the company; at an implied value over 50% higher than the current market value. NST have appointed an experienced development executive to act as a board nominee. We believe there is a strong possibility that NST may ultimately make a takeover bid for EAR for a number of reasons.

The Yandal project in its current incarnation, is projected to produce around 95,000 ounces per annum. This equates to over 10% of NST projected forward production from its various mines. With NST current capitalised at over $5 billion, this implies a value of around $500 million for EAR once the project is in production; and if the market attributes a multiple similar to NST which is unlikely for the company on a stand-alone basis. If NST were to acquire EAR, this becomes more likely as the acquisition would materially improve NST's company wide production metrics, as well as consolidating a large portion of the area around its flagship Jundee mine and securing the valuable infrastructure and existing gold resources held by EAR. The Bronzewing Processing Hub has a lot of strategic value and when functional will open up a lot of stranded deposits within the area. This asset will still have value at the end of the life of mine as it's likely to be able to generate ongoing income via 3rd party tolling agreements; as well as being able to scale up in size.

EAR also possesses around $65 million of carry forward tax losses that can be recouped before paying tax; which implies profits of around $215 million can be earned (not including depreciation) before becoming liable for tax. This fact makes EAR an attractive candidate for a corporate acquisition. We also note the commonalities between the CEO's of the two companies. Both have studied and worked at different times, at the same educational institutes and the same companies. Both have operational mining backgrounds and we regard the existing EAR team as a good cultural fit for NST so attractive as a bolt-on acquisition.

We note that EAR fulfils almost all of NST's stated acquisition criteria and we note that other transactions in the gold sector in recent times have been for higher prices per ounce of gold equivalent than EAR is currently valued by the market. It is our opinion that EAR shareholders could achieve significant upside at the current price, in a relatively short period of time.

From a portfolio perspective given the brewing geopolitical issues on the horizon, we consider EAR's double exposure to the traditional safe haven assets being gold and the US dollar to be beneficial.

Bellamy's Australia

Bellamy's Australia reported a positive half year result on the 27th of February.

We noted a material increase in the gross margin achieved relative to the previous comparable period. This indicates pricing discipline from our perspective, in spite of a fall in volumes of product sold. The management team wrote down the legacy stock in full this half year, taking a charge of $12 million. The normalised net profit achieved for the half year was circa $16.5 million which was 10% above our own internal projections. We expect Bellamy's to be able to achieve a normalised net profit of between $45-55 million for financial year 2019.

Bellamy's have also significantly overhauled their Chinese market strategy, with the recruitment of a new Chinese Sales Director. As we mentioned in last month's letter, this individual led A2 Milk's successful market entry into China in 2016. Since that time, A2 Milk's stock price has risen over 800% off a fairly low base. This highlights the importance of a successful Chinese market strategy to the fortunes of Australian and New Zealand infant milk producers.

We noted the renewed emphasis on the product side, with the company tailoring it's products to better suit the desires of the Chinese consumer; in particular, the addition of fortifying elements to it's infant milk powder. The marketing team has significantly re-positioned the company's products with a diverse base of brand ambassadors targeting a number of different segments of the market. We also like the fact the company are taking a more controlled approach to it's distribution networks in China. Typically, this would involve a symbiotic partnership with a number of established distributors in the market. We think it's likely Bellamy's have already established relationships with key partners in China, and we expect to see more positive results going forward from this segment.

Finally we expect SAMR certification, needed to sell Chinese label product in the mainland, to be achieved this calendar year. Bellamy's Camperdown production facility already produces SAMR certified infant milk formula for a Chinese, 3rd party brand, so we consider it a low probability that there will be any issues that cannot be resolved.

Afterpay

Afterpay reported some very positive results on the 26th of February.

Afterpay achieved a similar underlying cashflow this half year, as they achieved for the whole financial year last year. Loss metrics were achieved were significantly better than we expected with a 28% reduction in net transaction losses on a pro forma basis. This clearly demonstrates the success of the system in weeding out bad players as the market matures. We also note that in the US, the company have been especially punitive in their assessment of new customers ability to repay which has controlled the higher expected losses from a new market entry.

We were delighted to note that at the time of reporting, Afterpay had managed to increase it's customer base to 3.5 million users. Subsequently, in early March they confirmed their 1 millionth US customer. We estimate an immediately addressable market of approximately 20 million users in the US; so expect the US to be the major growth engine for the company over the next few years. Pleasingly, net transaction margins were maintained despite the very rapid growth in both raw user numbers and total transaction value going through the system.

We anticipate that the company will achieve profitability on a statutory basis in this half year. Excluding one-off share based payments, they would have been very close to breaking even. Given our knowledge on growth companies, the immediate profitability of a company growing in a manner that is fairly unconstrained is the least of our concerns. We would be much more concerned should top line revenue growth slow and/or net transaction losses escalate beyond a reasonable range.

We note that there have been concerns around the company's net transaction margins in the US, due to the high interchange costs associated with credit card payments. We intend on passing on a number of transaction cost mitigants to the management team that may materially reduce the impact of these costs.

We have also recently noted the emergence of a number of rather dubious alternative providers in the BNPL sector; none which enjoy the same structural benefits as Afterpay so we expect many of these companies to die off over time as this becomes apparent. Afterpay is building true brand value with it's best in class service for both customers and merchants, and has been inspiring fear amongst potential competitors in the US and the UK.

Commentary

We remain vigilant regarding a number of geopolitical issues in the upcoming months including Brexit, trade talks between China and the USA and tensions on Indian subcontinent. Our portfolio is positioned accordingly.

We welcome feedback from our Investors with any questions, suggestions, comments or investment ideas.