MONTAKA

QUARTERLY LETTER

MARCH 2019

UNIT PRICE [1]

$1.0992

FUND COMMENTARY

In the month of March, the Montaka Global Access Fund increased by 0.49 per cent, net of fees. This brings the return for the first calendar quarter of 2019 to 7.75 per cent, net of fees. Since inception, the Fund has returned 20.02 per cent, net of fees, with an average net market exposure of 47 per cent. By comparison, the MSCI World Total Return Index in Australian dollar terms has returned 32.66 per cent over the same period - but with a net market exposure of 100 per cent.

Following a turbulent global equity market downturn in Q4 2018, the markets rebounded strongly in Q1 2019. In our view, the strength during the quarter was driven by (i) a slightly improving global risk environment, driven by the Fed abandoning its monetary tightening bias and the first indications of Chinese stimulus; combined with (ii) global stocks entering the calendar year with valuations that were, broadly speaking, relatively undemanding following the selloff in the prior months. As we have said in the past, lower stocks prices are generally less risky, not more. That is, as stock prices fall, expected future returns generally rise.

Despite strong equity markets during the quarter, there was no shortage of globally significant events that may well have consequences for global investors over the coming months. In the US, the political dysfunction continued. The quarter included President Trump's former personal lawyer (and now convicted felon) testifying under oath to Congress that the President oversaw financial crimes committed by his business prior to taking office. The probability of impeachment significantly increased as a result of this testimony. And yet, by the end of the quarter, most would agree the probability of impeachment had then significantly decreased.

PERFORMANCE ATTRIBUTION[1]* (%)

	March 2019
Long portfolio contribution	1.21
Short portfolio contribution	(0.70)
Change in AUD/USD	(0.02)
Net return	0.49
Since inception[2]	20.02

EXPOSURES (as at 31 March 2019)

	% of NAV
Long exposure	94.6
Less: short exposure	(45.1)
Net market exposure	49.5

POSITION METRICS (as at 31 March 2019)

	Long Portfolio	Short Portfolio
Number of positions	20	25
Largest position size	7.2	3.2
Smallest position size	2.5	0.7
Average position size	4.7	1.8

Note: sizes shown as % of NAV

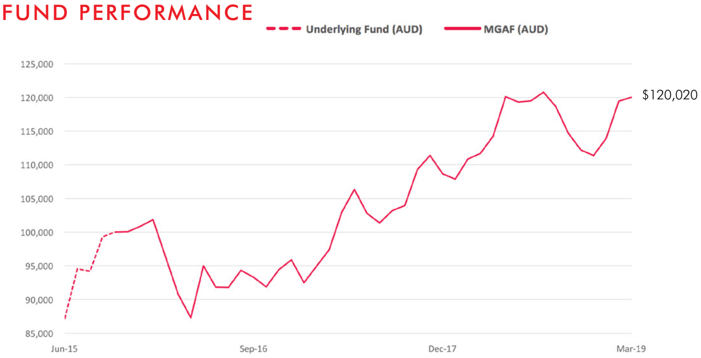
TOP 10 LONG POSITIONS (as at 31 March 2019)

		% of NAV			% of NAV
1	Vivendi	7.2	6	Facebook	5.7
2	Prudential	6.5	7	Insperity	5.4
3	Challenger	6.2	8	Ping An	5.3
4	Alphabet	5.8	9	Microsoft	5.0
5	Lear	5.8	10	Apple	5.0
Total top 10 long positions					57.8

FUND SIZE (NAV) ($M) (as at 31 March 2019)

Montaka Global Fund	185.0
of which: Montaka Global Access Fund	75.1

FUND PERFORMANCE



PERFORMANCE (%)	1M	3M	12M	2 Yr pa	COMPOUNDED ANNUAL RETURN SINCE INCEPTION	SINCE INCEPTION
Fund (AUD)[2]	**0.5**	**7.8**	**7.5**	**11.0**	**5.5**	**20.0**
Underlying Fund (AUD)[4]	0.5	7.8	7.5	11.0	8.9	37.6
Average Net Market Exposure	50	50	46	45	47	47
Global Market (AUD)[2,5]	1.5	11.5	12.4	12.6	8.6	32.7
Average Net Market Exposure[3]	100	100	100	100	100	100

1) The fund is forward priced; you will receive the price struck subsequent to the receipt of your application/ redemption request.
2) Inception: 1 November 2015; Ex-distribution of 1.9994 cents 30/06/2016 and 7.4407 cents 30/06/2018
3) Based on average of month-end net market exposures
4) Montaka Global Fund; inception 1 July 2015
5) MSCI World Net Total Return Index in Australian dollar terms
* all exposures, metrics & positions are derived from the Underlying Fund (Montaka Global Fund)

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The 22-month investigation by Special Counsel Mueller into possible collusion between the Trump campaign and the Russian government, as well as possible obstruction of justice, concluded. No conspiracy beyond a reasonable doubt was found; and on the issue of obstruction, the Special Counsel could not prove beyond a reasonable doubt a crime was committed – though it was disclosed that evidence compiled did not exonerate the President either. While other criminal investigations into President Trump and his associates are continuing, it now appears unlikely there will be any serious attempt by Congress to remove the President before the next general election. In our view, this gives President Trump a clear runway ahead to create the set of conditions most conducive for re-election in November 2020, namely: a strong domestic economy and stock market.

On this front, we still do not have clarity on how the US/China trade dispute will be resolved. We do know, however, that both President Xi and President Trump are feeling domestic pressure to make some kind of deal. In the case of President Trump, he surely has November 2020 in mind and, therefore, needs to time a deal to ensure that the economic benefits of any deal are being felt by domestic voters within the next 20 months. President Xi, on the other hand, faces no such term limit. He does, however, face pressure to reinvigorate domestic economic growth which noticeably slowed in 2018. The Chinese credit data reported for the month of January was extraordinary, at RMB4.6 trillion, suggesting China has already started to stimulate its economy – somewhat of an insurance policy against a prolonged trade negotiation and one that strengthens the hand of Chinese negotiators, in our view.

In Europe, the most globally-significant risk from this part of the world continues to relate to Brexit and how this will ultimately be resolved. The complexity of this problem and the seemingly impossible path to a resolution is enough to make one's head spin. The one positive development during the quarter was the apparent consensus in the UK that a "no deal" Brexit should be avoided. This is an incremental positive, in our view; though even this does not eliminate the chance of a no-deal Brexit altogether.

On the European continent, economic growth clearly deteriorated in 2018. While any effective Chinese stimulus will likely have positive knock-on effects to European growth, we also expect continued monetary stimulus in this region and possibly even new fiscal measures.

Finally, the situation is not dissimilar in Australia. An economy that has clearly been deteriorating will surely benefit from any meaningful Chinese stimulus. Furthermore, the Labor government that is expected by betting markets to take power next month will also likely drive increased government spending – a form of new fiscal stimulus.

From a portfolio perspective, Montaka's solid quarterly performance was driven by (i) the increased net market exposure in the portfolio stemming from our significant buying in Q4 2018; and (ii) strong profits generated on many of our portfolio names – both long and short – during the most recent earnings period. We articulated the motivations for our increased net market exposure in our December 2018 Quarterly Letter. To summarise in one sentence: the combination of lower stock prices – meaning less risky stocks; and an improving risk environment – especially as it pertained to domestic US monetary policies – led us to view the conditions in late 2018 as conducive for increasing portfolio exposure.

In terms of stock performances, notable performers during the quarter included Insperity (NYSE: NSP) in the US; Airbus (Euronext: AIR) in Europe; and Alibaba (NYSE: BABA) and Ping An (HKEx: 2318) in Asia. All of these names increased by nearly 30 per cent during the quarter.

Meanwhile, on the short side, The Kraft Heinz Company (NASDAQ: KHC) declined by nearly 30 per cent during the quarter. We have been short this name for more than a year based on our analysis of the challenges faced by so many branded consumer packaged goods (CPG) businesses; and despite the title of the largest shareholder belonging to Warren Buffett's Berkshire Hathaway.

Speaking of our short side analysis, this quarter we share with you our short thesis on Sports Direct International. In the case study that follows, George Hadjia demonstrates how Sports Direct satisfies all four criteria of Montaka's own short side investment framework.

CASE STUDY: SPORTS DIRECT INTERNATIONAL

Sports Direct International (LSE: SPD) has grown from the humble beginnings of a single store in 1982, to a sprawling sports-goods retailer whose various subsidiaries and investments ring up 3 pence of every £1 of non-food retail spend in the UK[1]. However, despite a history of robust growth, the story of SPD demonstrates an important concept: historical performance may not necessarily be indicative of what will happen in the future.

A brief history

Over the years SPD has been highly-acquisitive, buying many sporting goods brands – Slazenger, Lonsdale, and Everlast, among others – for inclusion in its store offerings. While it has typically been products branded by Nike and Adidas that have driven foot traffic in SPD's stores, the company could sell shoppers its higher-margin own-label goods once they were in a store. This was a successful strategy, particularly when combined with the rapid expansion of SPD's store footprint, which grew from 462 stores in 2007, to 860 in 2018 (both organically and via acquisitions).

However, this own-label brand formula could not be repeated ad infinitum – eventually the top-tier brands that shoppers crave would be crowded out by SPD's house-brands. SPD's merchandising assortment arguably hit "peak own-label" a long time ago. It was estimated that at the time of SPD's IPO in 2007, almost half of the company's UK sales came from own-brand products[2]. This growth strategy of yesteryear was already reaching its limit, and that was even before the impact of the internet started to be truly felt by High Street retailers.

The internet: the ultimate leveller

Relying on a company's past successes to predict the future is foolhardy, and this is doubly true in a new retail paradigm that is seeing retailers' fortunes change immensely due to the internet. While the internet has been a boon for consumers, bringing greater product selection and convenience in the form of quickly delivered goods, it has had a deleterious impact on traditional brick-and-mortar retailers like SPD.

1 Source: GlobalData
2 Source: Peel Hunt; via FT

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The internet has lowered the barriers to entry, with online pure-play retailers such as ASOS, Boohoo.com and Missguided not needing to replicate the expensive brick-and-mortar store distribution networks assembled by incumbents such as SPD.

Furthermore, the internet has opened up cheap and effective channels for customer acquisition, such as Facebook and Instagram. SPD has responded to this burgeoning threat from online retailers in the form of its own online offering.

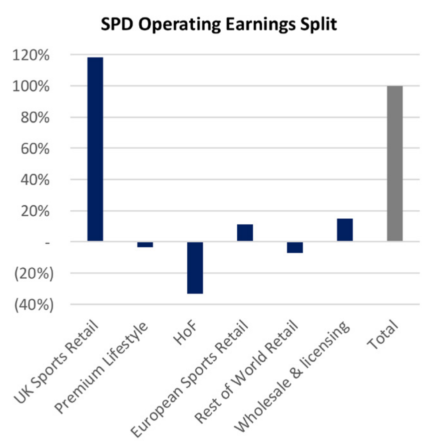
Online revenue comprised 17.4 per cent of the company's total Sports Retail revenue for the year ended 24 April, 2016 – the last time SPD reported these figures. While it might be tempting to conclude that this is simply a different channel, and SPD is still capturing those sales, the additional costs associated with an online order – namely order fulfilment and delivery expenses – make this a fundamentally less-profitable channel for SPD.

Mike Ashley, the CEO of Sports Direct, made the following comment in relation to the company's main Shirebrook warehouse: "You can't easily single-pick products in this warehouse. You lose money on most of your web orders you send out". SPD is not alone. Lord Wolfson, CEO of Next Plc (LSE: NXT), recently wrote: "Last year, every Pound of NEXT business that transferred from Retail to Online cost an additional 6p". For a business such as SPD, that in 2018 had adjusted operating margins of c.5 per cent, there is minimal leeway for these sorts of incremental costs that accompany an online order.

Cracks starting to appear

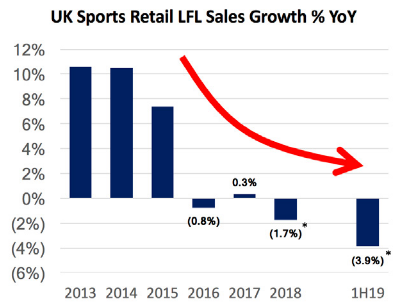
To compound the problem of consumers shifting to channels that are less profitable for SPD, the company's core UK Sports Retail segment, which basically generates the entirety of SPD's total operating earnings, has been in decline for a number of years. It was perhaps telling when the company chose to altogether stop reporting like-for-like (LFL) sales growth numbers in 2018 for its UK Sports Retail segment. This worsening disclosure is unsurprising for a company that has been notoriously opaque. SPD has no head of investor relations and doesn't even host earnings calls – highly irregular for a publicly-listed company of SPD's size.

SPD generates all income from UK sports...



Source: Company Filings

... which has deteriorated in recent years



CEO Mike Ashley described UK November 2018 trading conditions as "unbelievably bad"

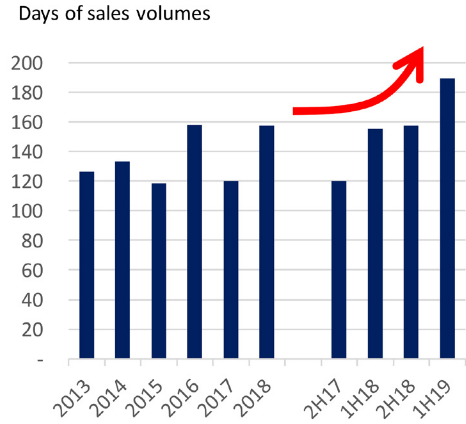
* Refers to UK Sports Retail implied sales density (Company stopped reporting LFL sales for the division in 2018)

Source: Company Filings

In addition to a declining top-line, SPD's inventory position is also worsening, with days of inventory increasing to 190 days as at the end of October 2018, compared with 155 days in the prior year. This signals that it is taking longer for SPD to sell its merchandise, possibly foreshadowing risks to the company's gross margin if at some point it resorts to greater discounting to move the inventory.

SPD: Days of Inventory

Days of sales volumes



Source: Company Filings; MGI

At a time of mounting signs of business deterioration, we have observed a build-up in net debt. When adjusting for off-balance sheet operating leases, SPD's adjusted net debt / underlying EBITDAR has increased to almost 3x. Notably, beginning 1 January 2019, SPD will be required to bring these off-balance sheet leases onto its balance sheet due to a new accounting rule[3], shining a light on the growing underlying leverage in the business.

3 ASU 2016-02, Leases (Topic 842)

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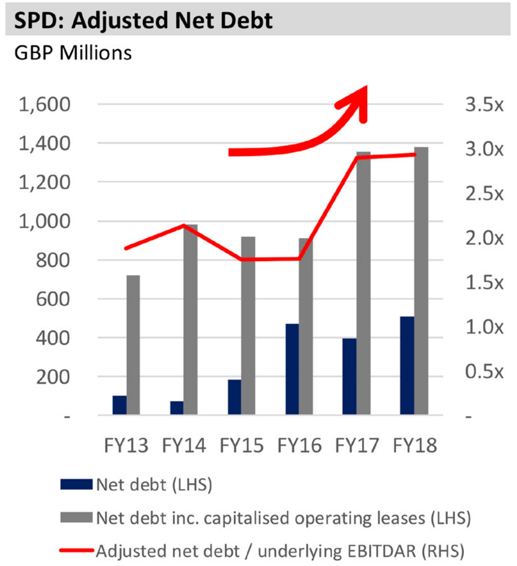


Source: Company Filings; MGI

Perhaps even more alarming is what this debt has been used for – namely acquisitions that have increasingly deviated from the core sporting goods franchise. For example, Ashley has purchased Agent Provocateur (a luxury lingerie company that went into insolvency), a stake in Game Digital (a beleaguered UK video game retailer), and has even mulled bids for HMV (the music and film retailer) and Patisserie Valerie (a café chain). We believe these acquisitions of struggling, and in some cases insolvent, retailers is a case of throwing good money after bad.

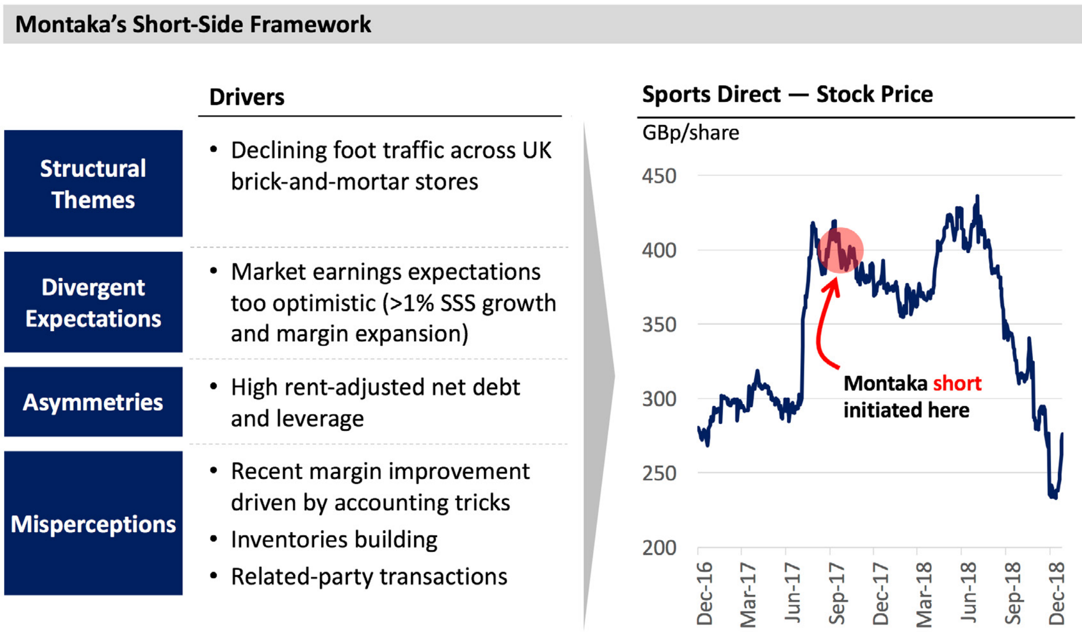
The risks around this strategy are exemplified by the more than 90 per cent decline in the Debenhams share price after SPD built its stake in late 2017.

If you see a cockroach in your kitchen…

While the structural headwinds facing SPD are significant, there have been a number of related-party transactions that strike us as peculiar. Back in 2016, SPD was paying a delivery broker called Barlin Delivery for its services relating to overseas transactions. Barlin was owned by the older brother of Mike Ashley, and this arrangement was not disclosed in SPD's published filings. SPD later cancelled this deal after the UK accountancy watchdog began investigating the arrangement. This is in addition to another arrangement that saw Mike Ashley appoint his daughter's boyfriend, Michael Murray, as the head of a GBP 250m property investment fund, with a consultancy contract structured in a way that could see Murray paid millions of pounds. Murray, 26 years old at the time, was a former nightclub promoter, and had no experience in commercial property development.

As Warren Buffett once mused: "You see a cockroach in your kitchen; as the days go by, you meet his relatives". We believe the questionable transactions could be symptomatic of broader governance shortcomings, with insufficient checks and balances over the actions of Mike Ashley.

We believe SPD remains an attractive short as the current stock price is underappreciating the above-mentioned pressures. Rather, it is implying same store sales growth and margin expansion. While SPD might have grown impressively from a single store in Maidenhead, UK, it did so in an environment that is markedly different to the one it is facing today. We believe it is likely only a matter of time before the market recognises that the strong growth and earnings power of the past is just that. A thing of the past.



Source: MGI; Bloomberg

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With names like Sports Direct International in Montaka's short portfolio, we are able to take advantage of structural headwinds faced by many global businesses, on behalf of our investors. Furthermore, the very existence of Montaka's short portfolio – significant in size at 45.1 per cent of NAV – significantly reduces Montaka's overall net market exposure to 49.5 per cent at month end. It is this relatively lower net market exposure which provides our first line of defence against a potential fall in global equity markets, such as the one experienced in Q4 2018.

That said, we are less bearish today than many others out there in the marketplace. Equity valuations are not excessive in many pockets of the market; and global policymakers have recently commenced stimulative actions which are generally positive for equities. Furthermore, should the US and China agree a meaningful trade deal, this too would surely be positive for many global corporates and equities.

In Montaka's long portfolio, we remain exposed to a number of strong, structural tailwinds that will drive growth in our owned businesses for years and decades to come. For example, we know that over the next 20 years, the global middle-class is going to grow from around 3 billion people, to around 5 billion people – with much of this growth taking place in Asia. Our position in Prudential (LSE: PRU) will benefit enormously from growth in Asian wealth levels and the need for retirement savings and protection products. Similarly, our position in Ping An (HKEx: 2318) will benefit from the structural growth in Chinese wealth levels; and our position in Airbus (Euronext: AIR) from the growing demand for air travel out of the Asian region.

Or take the growth in digital music streaming. This too will be structural in nature for years and decades to come. And no matter which streaming platform around the world drives the growth, they will need to pay royalties to the world's largest music label, Universal Music Group, owned by Vivendi (Euronext: VIV), Montaka's largest holding.

Quarter after quarter, consumer-touching businesses that we analyse all over the world talk about their increasing shift of marketing spend to digital channels. The reason? Significantly higher returns-on-investment through more sophisticated targeting that can be measured in real-time. And the beneficiaries of this increasing spend? Google, owned by Alphabet (NASDAQ: GOOGL), Facebook (NASDAQ: FB), Tencent (HKEx: 700) and Alibaba (NYSE: BABA). All are businesses that Montaka owns.

Montaka investors also have exposure to the structural growth in electric vehicles – the volumes of which will grow at double-digit rates for more than the next decade – through our holdings in Lear (NYSE: LEA) and Rheinmetall (Deutsche: RHM).

And most importantly, we only own stocks for which we believe the growth prospects of the underlying business are being underappreciated by the market today. Only when the market-implied expectations built into a stock's price are too low can we (or anyone else) expect to generate outperformance in the future.

Owning a portfolio of businesses that are positively exposed to these multi-year and multi-decade tailwinds makes sense, in our view. It means that when we encounter periods of global panic – like those scary months in Q4 2018 – we can remain calm and take a longer-term view. Indeed, it is during periods of global panic that we can add to our portfolio names at even lower prices – or even add new names from our "bench" that is both deep and ready to be called upon the moment their respective stock prices make sense.

* * *

In closing, we have had the privilege in recent weeks of connecting with a number of our current and potential future investors across Australia and New Zealand. We really enjoyed hearing what they are focused on and concerned about with respect to their global equity portfolios. We care deeply about continuing our work with our partners to add value in as many different ways possible. We look forward to having similar conversations with those based in the US later in the year. As always, on behalf of the entire Montaka team, I would like to thank you for the trust you have placed in us in preserving and growing your capital.

Sincerely,

Andrew Macken

Chief Investment Officer

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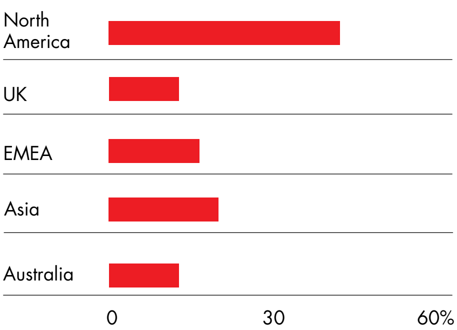
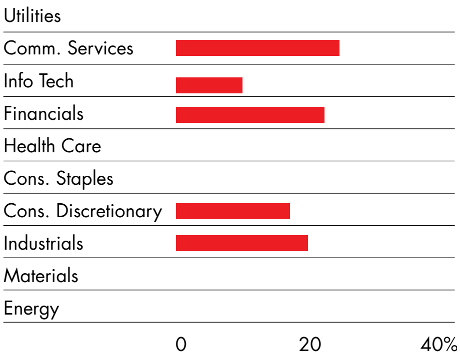
LONG PORTFOLIO (as at 31 March 2019)

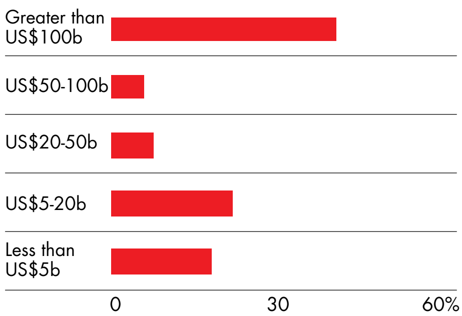
GEOGRAPHIC EXPOSURE (Country of domicile)



INDUSTRY EXPOSURE

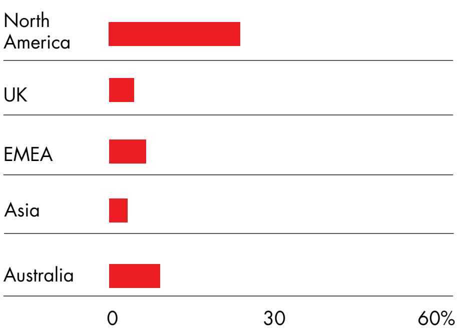


MARKET CAP EXPOSURE

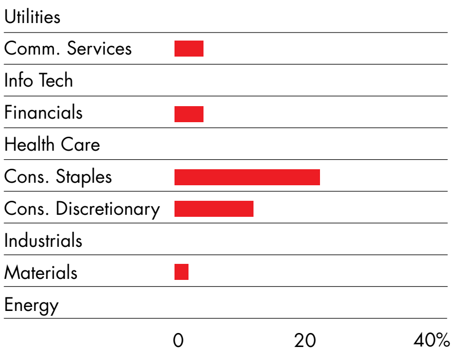


SHORT PORTFOLIO (as at 31 March 2019)

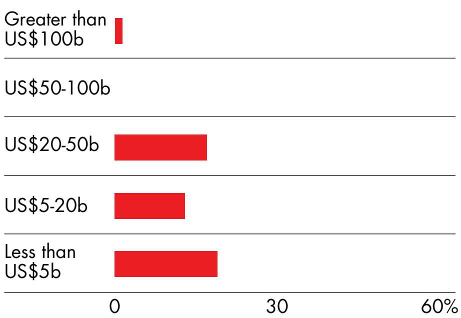
GEOGRAPHIC EXPOSURE (Country of domicile)



INDUSTRY EXPOSURE



MARKET CAP EXPOSURE



Note: exposures shown as % of NAV

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DISCLAIMER

#Fund performance is calculated after fees and costs, including the investment management fee and performance fee. All returns are on a pre-tax basis.

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