AVENIR
CAPITAL

26th April, 2018

Dear Partner:

The Avenir Global Fund – Class I units (the "Class I Fund") declined 1.3%, net of fees, during the March 2018 quarter. The retail class of the Avenir Global Fund ("Avenir Global Fund") also declined 1.3%, net of fees, for the quarter and has increased 11.4%, net of fees, since inception on 25 August 2017. The MSCI ACWI index (in AUD) returned 1.0% for the March 2018 quarter while the S&P 500 returned negative 0.8%[1].

What a difference a quarter makes. In our prior letter, we referred to the increasing complacency we saw in global financial markets during 2017 and the pockets of increasingly imprudent behavior. This continued unabated into January with the S&P 500 up almost 6%, marking a record 15th consecutive month of gains for the index.

Then, February saw a dramatic shift with the S&P 500 falling 10% in nine trading days, one of the fastest market corrections on record. Markets clawed back half of that loss in the latter part of February ending the month down 3.9% before falling again in March to be back near the recent lows.

In our previous letter we also spoke of the dramatic increase in the value of cryptocurrencies during 2017 as being illustrative of increasingly reckless investor sentiment. Well known cryptocurrencies such as Bitcoin increased 13x during 2017, while others, such as Ripple and NEM, increased 36x and 29x respectively. What has happened since then? Every major cryptocurrency is down in 2018 with an average return of -58%[2].

While the volatility has been quite dramatic, major developed market equities ended the quarter just shy of where they began. Where they go from here is unclear in the near term. Investors face conflicting forces such as strong global economic growth and, in the U.S., tax legislation assisted strong earnings growth, offset by uncertainty over the rate of increase in interest rates, geopolitical concerns such as trade tensions between the U.S. and China, potential U.S. conflict with Russia over Syria, and the impact of Brexit in the UK. Against this backdrop and with valuations still, in our view, elevated, it is not clear if investors will become increasingly skittish or brush off these latest concerns and allow the markets to surge upwards again.

In this environment we continue to tread cautiously and only invest in companies which we are confident have stable underlying value and only when we can do so with a material margin of safety to reduce risk and maximise our potential long-term return. Heightened volatility works to our advantage as it creates opportunities to own high quality businesses, at prices below underlying value, that may not otherwise reflect the necessary margin of safety to qualify for investment. Our pipeline of ideas is full and we ended the quarter with a cash weighting of 14% allowing us firepower to act when we find the next qualifying investment.

[1] Past performance is not a reliable indicator of future performance. Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

[2] Twitter; 2 April 2018: @charliebilello – Pension Partners.

**Select Portfolio Updates:**

The Fund made two new investments in the first quarter of 2018, **Synchrony Financial** (SYF:NYSE) and **Dart Group** (DTG:London).

Synchrony is the leader in the private label credit card business in the United States with 38% market share followed by Citi with 28% and Alliance Data Systems third with 12%. We initially explored Alliance Data Systems as a potential investment candidate but our research into the industry revealed Synchrony to be the more competitively advantaged operator and we could buy Synchrony at a similar valuation to Alliance so we turned our attention there.

Synchrony was separated from General Electric, via an initial public offering, in late 2014 and now, over three years later, is a seasoned stand-alone public company. The company partners with leading retail brands such as Lowe's, Walmart and Amazon and some of these client relationships are more than 40 years old. The company recently acquired Paypal's U.S. consumer credit receivables portfolio as part of a transaction which saw the extension of Synchrony's co-branded consumer credit card programme with PayPal, and Synchrony becoming the exclusive issuer of the PayPal Credit online consumer financing programme. This makes Synchrony the exclusive issuer of PayPal credit in the U.S., building on its 13-year relationship with PayPal.

Synchrony generates a great deal of free cash flow and earns high cash returns on capital. Management is well aligned with an economic stake in over 1 million shares that were issued as part of the separation from GE. A high return on capital, the ability to generate free cash flow and a management team that are economically aligned with shareholders are some of the attributes we look for in qualifying investments.

The private label credit card market is a growing industry as more retailers seek ways to stand out in an increasingly competitive retail space. Private label credit cards not only help provide financing for customers to purchase goods and services, but allow retailers to offer loyalty rewards and gather important shopping pattern data that can help them better compete with the rise of online retailers such as Amazon.

Synchrony has some added attractions. Firstly, as part of the IPO, the company was required to hold additional capital for some time and was restricted in its ability to return excess capital to shareholders. That is now starting to change and the company bought back $1.5 billion worth of its share in 2017 reducing the number of shares outstanding by almost 6%. Synchrony currently has common equity tier 1 capital equal to 16% of its total risk weighted assets compared to its peers with closer to 10-12%. This excess capital provides plenty of dry powder to grow its book of business without requiring additional capital or to buy back shares. As an example of the scale of this opportunity, if Synchrony reduced its tier 1 equity capital to 12%, it would free up $3.2 billion of capital which would allow the company to buy back 13% of the company's shares outstanding at the quarter end price of $33.54 per share. This would increase earnings per share from the reported 2017 figure of $2.42 to $2.87 and increase return on equity from 13.6% to 17.5%. Given the company currently trades at 10x our expected EPS for 2018 we think buying its own shares would be a worthwhile exercise and we expect to see management pursue significant share buybacks during the next few years.

Synchrony also has a sound funding base with 73% of total funding requirements being provided by its own growing deposit customers. The company is also a full tax payer and will benefit from recent U.S. tax legislation that will reduce Synchrony's income tax rate materially.

Dart Group is a UK based travel and leisure operator that operates a fast-growing, low-cost airline called Jet2 and, more interestingly, a packaged holiday operator known as Jet2Holidays. Dart has grown revenue by 150% over the past 5-years, entirely organically, while operating income has grown 270% over the same period. The company is run by founder and 38% shareholder, Philip Meeson, who, while somewhat taciturn in relation to public communication, is doing a fine job of profitably growing the business.

The packaged holiday industry is growing steadily in the UK and Dart, which has been growing much faster than the market, is now the second largest operator. The company recently expanded into two new regions, Gatwick and Birmingham, and while costs have already increased to prepare for this growth, the increased revenue and earnings that should follow have not yet been delivered. The increased presence out of Gatwick and Birmingham not only materially expands the company's addressable market but should also increase the already strong consumer brand power of the Jet2Holiday business, further improving the competitive position of the company. While the share price had recently increased before our interest, the underlying value of the company had grown much faster than the price so that we were still able to buy with an adequate margin of safety.

Sadly, we had only acquired half of our desired position when the company released what, from our point of view, was an unfortunately timed trading update that made the earnings growth we had foreseen much clearer to the market. The share price reacted quickly increasing 30% from our purchase price and eroding part of our margin of safety before we had established our full position.

Our biggest detractor for the quarter was **Clear Media** (0100:HK) which declined in price by 23%. We added substantially to our position during the quarter. The fall was, in part, due to the impending bankruptcy of iHeartMedia, the ultimate owner of a 50.4% stake in Clear Media. We do not see the bankruptcy of iHeartMedia negatively affecting the operations of Clear Media in any way and, in fact, iHeartMedia's travails may act as a catalyst of sorts as any iHeartMedia corporate restructuring may see Clear Media being put up for sale which we see as a very positive potential outcome. Clear Media has net cash on the balance sheet and recently reported very solid trading performance for the second half and full year 2017.

Less positively, Clear Media also announced, at the beginning of the quarter, that two of its employees had misappropriated US$12 million dollars from the company. The company has conducted a full forensic investigation with the input of independent accounting and legal firms along with representation from its majority shareholder, and believe that the bulk of the misappropriation occurred as long ago as 2010. A criminal investigation of the two employees is underway and the company's auditor was not able to give an unqualified audit report for the 2017 fiscal year while the investigation is underway. This resulted in the suspension of trading of the company by the Hong Kong Stock Exchange on 3rd April 2018. We believe this is an isolated incident and, while unfortunate, does not have a material impact on the underlying value of Clear Media. The company has undertaken a full and thorough investigation of the misappropriation of funds and we believe the Hong Kong Stock Exchange will reinstate trading before long.

Clear Media is competitively entrenched in its market and continues to deliver steady growth in earnings and cash flow. More than 50% of the company's revenue now comes from Chinese technology heavyweights such as Alibaba and Tencent, along with a range of other e-commerce and technology companies. These fast growing companies have displaced previous major customer groups such as auto, food and beverage companies, providing an arguably higher quality and less cyclical customer base. Clear Media's quarter end price of HK$6.00 per share yields a multiple of less than 5x our expected 2018 operating income and, with net cash equal to 10% of the current market capitalization and solid annual free cash flow generation, the company is well positioned to continue its solid earnings growth. While we purchased our position several years ago at HK$7.51 per share (compared to the current $6.00 share price), we have received HK$1.84 in cash dividends during our ownership, equal to 25% of our average purchase price. We believe Clear Media is worth well over two times the current price.

**General Motors** (GM:NYSE) was our second biggest detractor for the quarter with the share price declining 13% giving back some of the gains from the prior quarter. We think GM's value continues to grow, as management makes sensible decisions based on a focus on cash flow and return on capital rather than the historical mantra of sales at all costs, despite the inability of the share price to get much traction. During 2017, analyst's consensus estimates for GM 2017 earnings per share went from $5.76 at the beginning of the year to $6.30 at year end; GM ultimately earned $6.62 per share in 2017. Similarly, at the start of 2018, consensus 2018 earnings per share expectations for GM were $5.80 per share whereas the company recently guided 2018 EPS to be similar to 2017 eps ($6.62 per share) with 2019 even higher. Despite these continual revisions upwards, the share price fell during the quarter and now trades at less than 6x current year earnings. GM continues to record strong sales of pickup trucks, which is by far the company's biggest profit driver, and with the U.S. likely to embark on a record infrastructure expenditure program under President Trump, medium term prospects for GM's industry leading truck business appear good. We expect the company to return roughly 10% of its market capitalization to shareholders in 2018 in the form of dividends and share buybacks, much as it did in 2017.

**Nexstar** (NXST:NASDAQ) was our third biggest detractor falling 15% during the quarter to $66.50 per share following its 26% gain the previous quarter. Nexstar reported solid December quarter results with effective cost control and better than expected EBITDA and free cash flow. The company also guided to strong retransmission margins in the future giving support to our expectations for retransmission profit growth. We expect the company to generate roughly $13.50 per share in average annual free cash flow over 2018/19 (we use a two-year average to adjust for political and non-political year cyclicality) meaning the company ended the quarter trading at less than 5x estimated free cash flow per share. Assuming a 10% free cash flow yield, Nexstar is worth well over $100 per share.

Our biggest gainer for the quarter was **Tecnoglass** (TGLS:NASDAQ) which was our largest decliner in calendar 2017 and recovered a good chunk of its 2017 decline by increasing 29% during the March quarter to $9.45 per share. We added to our position on the price weakness during 2017 and lowered our average price considerably as a result.

**BBX Capital** (BBX:NYSE) continued its strong performance for us rising 16% from $7.97 to $9.21 per share during the quarter and has now increased 50% over the past 12 months. During the quarter, the company's main operating asset, the publicly listed Bluegreen Vacations (BXG:NYSE) reported solid financial results for 2017 with EBITDA up 8%. The share price of BBX is still well below underlying value despite the share price having increased over 200% since the beginning of 2016. Based on its 90% ownership of Bluegreen Vacations, along with various other real estate assets, BBX Capital is worth $14 per share, 50% higher than the quarter end price of $9.21.

**HCA Healthcare** (HCA:NYSE) was our third biggest contributor for the quarter (+10%) as the company reported a very strong finish to 2017. The company is very competitively entrenched, generates strong free cash flow, is investing aggressively for future growth and to continuously improve its competitive position, and will benefit enormously from the recently enacted changes to tax legislation in the U.S. HCA will benefit more than most companies from the recently reduced US corporate income tax rate as 80% of its competitors are not-for-profit, and so will not receive any direct benefit from tax cuts, and its major for-profit competitors are financially distressed and so do not generate much profit to be taxed in the first place. Consequently, HCA is in the enviable position where it should be able to retain the bulk of its tax cuts (which will increase annual free cash flow by some $500 million per year or 15%) while many companies are likely to see their tax savings competed away over time. We purchased HCA in the third quarter of 2017 at a mid-US$70 share price representing 7.5x EBITDA and a better than 10% free cash flow yield. It is worth noting that, as we finalise this letter, a local private equity firm has submitted an unsolicited takeover proposal to Healthscope (HSO:ASX), the number two private hospital operator in Australia, at a price that implies an enterprise value of over 14x EBITDA. This is despite HCA generating EBITDA margins well in-excess of Healthscope and the Australian industry leader, Ramsey Healthcare, which trades at ~12x EBITDA.

We expect HCA to achieve double digit increases in annual cash earnings per share driven by a combination of largely organic revenue growth (supplemented by some acquisitions) and share buybacks. During 2017, HCA bought back $2.05 billion of its own shares, equal to 7% of shares outstanding, and still has $1.8 billion remaining in its current share purchase authorization. We expect the shareholder return focused management team to continue to retire the company's own shares at the current attractive valuation level.

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Despite current market volatility, we have confidence in the underlying stability of value in the companies in our portfolio and believe they are competitively well-positioned in their markets. They are also priced at attractive absolute levels with prices well below our estimates of underlying value offering us what we believe to be a sufficient margin of safety.

The ratio of the current market price to our assessment of the underlying value of the companies we currently own is approximately 65%.

Recent market volatility may be short lived and equity markets continue to rise strongly in the near term, or, it may be an indicator that the prolonged period of easy money in the equity markets is nearing an end and attractive returns may be harder to come by over the next five or more years. We believe, however, that our value-oriented and concentrated investment approach will continue to generate good investment outcomes for our investors over time, and the team at Avenir remain energised and focused in our search for the next great investment.

*"Opportunity is missed by most people because it is dressed in overalls and looks like work."*

***- Thomas A. Edison***

Best Regards,

Adrian Warner

Managing Director