AVENIR
CAPITAL

30th April 2019

Dear Partner:

The Avenir Global Fund (the "Fund") delivered a 9.9% (net of fees) return for the March 2019 quarter.[1] In comparison, the MSCI ACWI index (in AUD) increased by 11.2% over the same period. Over the year up until 31 March 2019, the Fund has delivered 12.3% (net of fees) compared to the MSCI ACWI index which returned 10.8%.[1]

The market's gain in the March quarter largely offset the sharp decline in the market in the last quarter of 2018. For some reason, the "quarter" has been set upon as the ideal unit of time for fund managers to report on their performance and on the many, no doubt exciting, developments that are taking place at the companies they hold within their portfolio during that quarter. Why that is the case is not entirely clear but one obvious downside of that practice results from the tendency to extrapolate short term results into the future as a guide to a manager's expected long term performance.

The last two quarters, however, and, indeed, the last 15 months, show how it might be more sensible to see a quarter's investment result principally as noise and of limited value as a reflection of the skill of an investment team in identifying and capitalising on high quality investment opportunities. Anyone who tried to extrapolate any of the past five quarters results for the market, or for an individual fund manager, might by now be left confused and despondent. In spite of a lot of noise and movement during the intervening period, most major indices now stand within a few percentage points of where they were at the beginning of 2018.

The reality is that change at individual companies, generally, is not measured over quarters but over years. Equally, investment managers that follow a strategy based on thinking like long-term owners of businesses, rather than short term speculators who guess which way flashing numbers on a screen are going to move, will be much more interested in results over a multi-year period than the most recent quarter which is, generally, nothing more than random chance. We are certainly much more satisfied with the 16% per annum portfolio return (gross) that we have generated since inception of the Fund (2011) than we are the 11% portfolio return (gross) generated in the last quarter[2], even though the latter would annualise to a 45% (gross) rate (if the quarter's performance could be sustained over the year, which we think is not likely).

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[1] Performance figures refer to the Avenir Global Fund – Class A launched on 25 August 2017. For full performance figures please see our website at www.avenircapital.com.au. 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] Performance figures refer to the Avenir Global Fund. Class I was launched on 1 August 2011and Class A was launched on 25 August 2017. Past performance is not a reliable indicator of future performance. Returns are calculated before fees have been deducted for the relevant unit class and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

The underlying value of a concentrated portfolio of carefully chosen companies that have attractive economic characteristics and durable competitive advantages, simply does not go through wild swings over a quarter. And for investment managers like Avenir, that run concentrated portfolios of such companies, there are not exciting developments at each of the companies we own every quarter. What can happen, however, is the steady compounding of the underlying value of those companies and the portfolio overall. What also happens, over time, is the closing of the gap between the discounted price we paid to acquire our share of the companies we own and the underlying value of those companies, adding further to long-term returns.

Our private equity heritage encourages us to view every investment we make as if we are buying the whole company. This helps to keep our focus on the quality of the underlying business, its long-term prospects and the price we are being asked to pay, rather than trying to speculate as to what the market or individual company prices may do over the short-term. Movements in asset prices in the short-term generally reflect changes in the required return of investors, driven by change in short-term sentiment, rather than change in the free cash flow generating prospects of those assets over the long-term.

This, in turn, creates the opportunity for investors who have an investment-process that forces them to control their short-term impulses and focus on the underlying fundamentals of individual companies and on identifying opportunities to acquire mispriced companies. It is easier to find companies where expectations are low, free cash flow generation and return on capital is high or improving, the company benefits from an entrenched competitive advantage, and management are aligned with shareholders and are capable allocators of capital, than it is to predict market movements (that is, the change in other investors' sentiment) over the short-term.

Select Portfolio Updates:

Our biggest gainer for the quarter was **Nexstar Media Group** (NASDAQ:NXST) which increased by 38% to US$108.37 per share during the quarter and has now increased 155% from our initial purchase price of US$42.50 in March 2016. We first acquired Nexstar on the back of its announced acquisition of Media General Group. The management team of Nexstar, led by long-term CEO Perry Sook, has delivered tremendous value to shareholders over time through an acquisition driven strategy in which they have demonstrated an ability to fully integrate acquired businesses, extract real synergies and drive shareholder value. Based on our calculations, pro forma for the Media General acquisition, Nexstar was going to earn ~US$10 per share in free cash flow which meant that we were paying slightly over 4x free cash flow at our initial purchase price of US$42.50 per share. Since that time, free cash flow has increased to US$13.40 per share, a 35% increase. 2018 represented the seventh consecutive year of record financial performance for the company and, with 70% of the company's retransmission consent agreements up for renewal in 2019, we believe this strong organic financial growth should continue.

In December 2018, Nexstar announced a definitive agreement to acquire Tribune Media for US$6.4 billion in an all-cash financed transaction. This transaction will make Nexstar the largest local broadcast company in the United States with 216 stations in 118 markets and reaching 39% of the

U.S. population[2]. The company will serve 18 of the nation's top 25 markets and 37 of the top 50 markets. While this acquisition still needs to receive regulatory approval, based on management's guidance and giving management credit for achieving the targeted synergies, pro forma for the acquisition, we expect that Nexstar will be generating US$19.50 per share of free cash flow. The quarter end share price of US$108.70, represents a multiple of only 5.5x this growing free cash flow.

Our second biggest contributor was **Synchrony Financial** (NYSE:SYF) which increased by 36% during the quarter to US$31.90 per share. The quarter's increase gets the share price back to the same level it was in early October 2018 before it fell by 25% to end the December 2018 quarter at US$23.46 per share. At the end of the December quarter, Synchrony was trading at the very attractive price of 6x P/E despite having excess capital on the balance sheet and earning a 19% return on its equity. We added 20% to our Synchrony position on the back of the December quarter drawdown so we have benefitted from the round trip which saw the share price go from $32 per share to $23 per share and now back to the $32 per share level.

During the March quarter, Synchrony finalized the closing of the Walmart relationship by announcing the sale of the Walmart receivable portfolio to Capital One, the new relationship partner to Walmart. The ending of this long-term customer relationship was not good news and was an important contributor to the recent share price decline, but it highlights the importance of ensuring that a margin of safety exists in the purchase price of any investment we make. While the share price suffered some turbulence on that back of the announcement that Synchrony was losing Walmart as a customer, the share price has quickly returned to the pre-announcement price, illustrating the margin of safety that existed in our initial purchase price. The company has also taken effective corrective action by selling the Walmart receivable portfolio and we expect the company will use at least some of the $2 billion of capital released later this year by this action to buy back shares, should the share price remain at attractive levels.

During the March quarter, Synchrony also renewed some other important customer contracts including Sam's Club (owned by Walmart), Amazon, Google, Qurate Retail Group, QVC and Zulilly among others. The company also won new business such as a new co-brand program with eBay, building on its existing customer relationship. At the quarter end price of US$31.90, Synchrony trades at a P/E multiple of 7.2x estimated 2019 net income which would seem to be an attractive price for a company that has grown earnings per share by a cumulative 38% over the past two years and generates a 19% return on its equity despite having excess capital that can be released to drive shareholder value either by investing in the business or by buying back shares at the current low price.

Our two largest detractors for the quarter were our Korean holdings, **KT Corporation (KOSE:A030200)** and **KB Financial (KOSE:A105560)**, which both drifted down by 12% during the quarter. Both companies are extraordinarily cheap but without obvious catalysts in the near term, what you might call "classic value". We believe that KT's price is held down by fears of excessive upcoming capital expenditure to build out a 5G network, along with subdued pricing of its mobile phone plans due to the heavy hand of the Korean regulator who persists in meddling with the market price setting

[2] Assuming the U.S. Federal Communications Commission UHF discount.

mechanism to score political points with the Korean people. The combined effect of these concerns leads to a company that is trading at roughly 2.2x EV-to-EBITDA[3] or 9x price to net income. Even more extraordinary, KT is trading at a 20% free cash flow yield which seems to be a level that cannot persist for too long despite the lack of obvious catalyst. We met with the management of KT Corporation during the quarter and, while they still keep some of their plans close to their chest, there are signs of optimism that the market's concern over the degree of 5G capital expenditure is misplaced and, if the market skittishness over expected capex subsides, that alone may be enough to relieve some of the pressure on the share price. We take comfort in the 20% free cash flow yield, the bulk of which we believe should fall to shareholders even if we assume an element of wastage of this free cash flow by management.

KB Financial reported reasonably dour 2018 results during the quarter, with most of the negative news emanating from the non-bank securities and non-life insurance businesses. The banking business was stable but net interest margins are proving particularly stubborn to expansion at just under 2%. Net income for the year was down 7.7%, although up about 2.2% if certain non-recurring expenses are excluded. Loan growth was strong at 10% and credit costs remained very low. Return on equity has been growing over the past several years, but recently seems to have stalled at just under 10%. Overall, earnings are stable but not showing meaningful upwards momentum. The main appeal of KB is its price, which has drifted down from KRW61,000 a year ago to sit at KRW41,800 at quarter end, hovering at 5.5x P/E and 0.5x tangible equity, despite the company earning a 10% return on equity. KT and KB are amongst the lowest priced companies that exist, and it will not take much in the way of a shift in sentiment to move their share prices meaningfully higher.

We are delighted to announce that Alexander Chin has joined the investment team at Avenir Capital as an Investment Associate. Alex has been a passionate investor since an early age and has been investing his entire professional career in both Australia and overseas markets. Alex's most recent role was at Peters MacGregor, a global, concentrated, value-oriented investment firm. Immediately prior to that, Alex was with Schroders and, before that, Sirius Funds Management. Alex brings a wealth of global investing experience and is a very welcome addition to the Avenir team.

Avenir has been a long-time shareholder of General Motors and the investment has delivered nice returns for the Fund. We still think GM is very mispriced and that the current market price does not fully reflect the benefits of the cultural transformation that has taken place at the company since its bankruptcy in 2009. Our current thinking on GM, as outlined by Avenir Investment Associate Christine Jurzenski, was featured earlier this month in Barron's magazine, which can be seen here.

[3] Enterprise value (equity plus net debt) divided by earnings before interest, tax, depreciation and amortisation.

We have confidence in the underlying value in the companies in our portfolio and believe they are competitively well-positioned in their markets. We believe they are priced at attractive absolute levels with prices well below our estimates of underlying value offering us what we believe to be an attractive margin of safety.

We believe that our value-oriented and concentrated investment approach will continue to generate good investment outcomes for our investors over time, regardless of overall market performance, and the team at Avenir remain energised and focused in our search for the next great investment.

"Never allow your short-term temperament to affect your long-term decisions."

- Moutasem Algharati

Best Regards,

Adrian Warner
Managing Director