AVENIR
CAPITAL

30 October, 2017

Dear Partner:

The Avenir Value Fund (the "Fund") returned 2.6% during the September 2017 quarter compared to the MSCI ACWI index (in AUD) return of 2.8%. More than 100% of our quarterly return came in the month of September when the Fund was up 4.4%. For 2017 year-to-date, the Fund has returned -0.4% compared to the index which is up 8.2%.

The quarter saw global equity markets continue their relentless move upwards shrugging off ongoing geopolitical tensions, the near term prospect of higher interest rates and global central bank tightening, a host of natural disasters and ever higher valuations. The upward move by most indices serves to highlight the resilience and strength of what is the second longest equity bull market in financial history.

Many investors appear increasingly comfortable putting capital to work behind the "synchronised global growth" thesis that is holding sway over markets. And, while there is always plenty of noise to potentially upset markets, there is nothing imminent that can be pointed to as the catalyst that will bring the party to an end. Additionally, while the activity of investors does suggest a certain degree of complacency, there is not the feeling of euphoria or the completely reckless behavior (with a few exceptions) that suggests we are in the midst of a bubble. Equity markets are, without question, high by historical standard but investors still, by and large, express an element of caution in their approach even if their actions somewhat run counter to that.

So, what to do in an environment where assets prices in general feel elevated and high by historical standards but we are not surrounded by the widespread euphoria that typically represents the final stage of a bull market and there is no obvious canary in the coal mine?

Well, we continue to do what we have always done which is to diligently and patiently look for those investment opportunities in which we can buy a partial ownership stake in a quality and growing business when we can do so at what we believe to be a material discount to underlying value. If we find one, we invest, and if we don't find one, we don't invest.

While this sounds simple, it is not always easy because we are continuously being offered new opportunities by the market. Furthermore, when we own a company, our conviction in that position is relentlessly being tested by the market. Either, because the price declines below our purchase price or because time goes by and the market refuses to agree with us and acknowledge the value that we believe is there.

A central component of our investment approach, however, is to have the necessary conviction to see the journey through even when we are tested (which is different from stubborn pigheadedness when the underlying facts change or we realise we got something wrong). One of the dangers of the public market is that the ease of buying and selling can lead to an intellectual laziness when investing because the investor knows that they can always change their mind and later sell what they are just about to buy. Investing with the knowledge that you can just swap an investment out if something better comes along can lead to an acceptance of middling investments rather than waiting for the truly compelling one to arrive. It can also lead to a portfolio full of risky investments made under the misapprehension that if some of the 'potential bad things' that might happen actually happen, the investor can then just sell as if the market will not have already passed judgement by then in a material and permanent mark down in value.

We have worked hard to ensure that the liquidity of the public market is our friend rather than our enemy. Our approach is to consider not just the opportunity set we face today but the opportunity set we may be presented with in three months, six months or a years-time. We prefer that our mindset is oriented to considering investments with a longer time horizon and with more of a sense of permanence about the decision to build the right level of conviction in our investments. Much as one is likely to differently weight the importance of certain factors when considering someone's suitability as a husband or wife rather than as a boyfriend or girlfriend, so too is an investor likely to differently weight various factors when considering an investment through a long-term, fundamentally oriented lens rather than a short-term, momentum-driven lens. This approach makes for a very high bar for new investments to make it into the portfolio but we believe leads to a much safer, more robust and ultimately, more profitable portfolio in the long-term.

We are very comfortable with the current portfolio we currently hold which we believe represents a quality group of competitively well placed companies with strong growth prospects and which we own at undemanding prices. The ratio of the current market price to our assessment of the underlying value of the companies we currently own is approximately 65%. This implies a greater than 50% upside in the portfolio from current prices to get to our view of underlying company value.

Select Portfolio Updates:

Adairs (ADH:ASX) was our largest gainer increasing by 78% during the quarter and by 170% from the low hit in mid-June 2017. The share price of Adair's was pushed down to what we regarded as excessive levels by a combination of negative trading updates, general retail equity market weakness due to the fear of Amazon's entry to the Australian market and then, we suspect, by tax-loss driven selling as we approached 30 June 2017. At share prices that got as low as $0.56 per share the value opportunity proved too great and we substantially increased our position at an average price in the low $0.60's.

At those prices, and bearing in mind that just prior to our additional purchases, management had reaffirmed their forecast for the year ended 30 June 2017 (even though the full year results had not yet been released) we were paying roughly 4x FY2017E EBIT[1] and less than 5x FY2017E P/E[2].

During the September quarter, Adair's released several trading updates that were progressively better including improving same store sales performance. On this count, fiscal 2017 was a year of two halves for Adairs with the first half delivering same store sales declines of 4% while the second half showed an increase in same store sales of 1%. Importantly, the trends improved in the fourth quarter FY2017 (June quarter) with same store sales growing 3.8% over the same period in the prior year. This momentum has continued into the first part of fiscal 2018 with same store sales growth of 13% for the first eight weeks of the new fiscal year. Based on recent trading guidance and the outlook for fiscal 2018, Adairs has returned to strong growth and our initial investment thesis appears to be back on track following some mid-year jitters.

Our second biggest gainer was our position in the warrants of **General Motors** (GM:NYSE) which increased by 29% during the quarter. While GM delivered another very solid quarterly operational and financial performance, the big driver of the share price move was largely a shift in sentiment.

The market begin to view GM through a different lens and appeared finally willing to give the company more credit for the dramatic change in focus by current management to profit and return on capital goals rather than the volume and scale goals of previous management teams. There was also a willingness to consider that the most important economic driver for GM is the truck/pickup segment of its business which is arguably less cyclical, less competitive and less threatened by the movement towards autonomous vehicles than the sedan business. Additionally, the narrative shifted to consider the possibility that due to GM being the first company to use mass-production methods to build autonomous vehicles, its ownership of Cruise Automation, the successful launch of the Chevrolet Bolt electric vehicle during the quarter, its

[1] EBIT = earnings before interest and tax.
[2] P/E = price to earnings ratio.

Maven City car-sharing service and its long-existing connected car capabilities through OnStar, that GM may actually be well positioned to win in "Auto 2.0" and have substantial long-term earnings potential in data, autonomous driving and electric vehicles.

The market has begun to consider the possibility that GM could, in fact, be the winner in an electric, autonomous and data/connected world thereby earning even greater income than currently and doing so in a manner that could lead to multiple expansion due to the 'better quality' of that greater earnings power.

GM still plans on returning $7 billion cash to shareholders during 2017 including the repurchase of $5 billion worth of shares or 8.5% of the market capitalization as at 30 September 2017.

BBX Capital (BBX:NYSE) was another solid contributor for the quarter with BBX representing one of the larger positions in the Fund and the share price increasing 12% to end the quarter at $7.37 per share. While this already represents a healthy 115% gain on our investment we still feel the company is undervalued and have been encouraging management to take steps to better inform and educate the market as to the underlying value in the business. During the quarter, the company announced that it had confidentially submitted a draft registration statement with the Securities Exchange Commission in relation to a potential IPO of its Bluegreen vacation ownership business. We highly support this action and feel that an IPO of the main operating business will help to shed light on the value of this asset which, by itself, is worth substantially more than the entire current market capitalisation of the company.

One of our biggest decliners during the quarter was **Spirit Airlines** (SAVE:NASDAQ) with the share price dropping 35% to end the quarter at $33.41 per share. Spirit has been facing strong price competition from legacy carriers along with dealing with the impact of numerous natural disasters, such as hurricanes, in some of its key markets and an ongoing compensation dispute with its pilots. Declining profitability has led some to question the sustainability of its business model in a world in which the large, legacy carriers have adopted selective "basic economy" fare structures in order to stem the market share gains made by ultra-low cost carriers (ULCC's) such as Spirit.

We believe that the ULCC business model is still very much intact and that having a 35% cost advantage over your competitors is a powerful weapon that will ultimately allow Spirit to resume its rapid and profitable growth. Even in these times of heightened price competition, Spirit grew revenue in the first half of 2017 by 12.5% with operating income margins of 19% and a 17% return on equity. At the quarter end price of $33.41, Spirit trades at a P/E ratio of 9x our estimated earnings in 2019. At 14x 2019 earnings (the company's long-term average multiple) Spirit is worth over $50 per share and we believe the company has multi-year, double-digit earnings growth ahead of it.

Tecnoglass (TGLS:NASDAQ) also declined materially (28%) during the quarter after management surprised investors by downgrading 2017 earnings expectations. The company has grown revenue at a compound annual rate of 24% per annum over the past four years and EBIT by 50% per annum over the same period. During this time, the company has occasionally seen periods where some business is pushed back into the following year leading to a pause in earnings growth before growth resumes strongly the following year. We expect to see the same pattern in 2018 with some of the business previously expected in 2017 being deferred to 2018.

Management has reacted well to the revenue deferral by taking the opportunity to focus on cost management, after a period of strong growth, and reducing headcount by 10%. We think this will prove to be a timely reminder for management to maintain a tight focus on costs and will be beneficial over the longer term. Despite the above, Tecnoglass still maintains a strong cost advantage delivering a 24% operating margin (before the recent cost reductions) while the rest of the industry operates at approximately 17% operating margin levels.

The company is continuing to take steps to diversify its geographic revenue stream which is creating some short term hiccups but is a measure of which we strongly approve for the longer term strength of the company. At the quarter end price of $6.73 per share, Tecnoglass is trading at a 10% free cash flow yield, based on our revised expectations for 2017 earnings, and we believe earnings could grow by more than 20% per annum over the next two years.

We added one new position, **HCA Healthcare, Inc** (HCA:NYSE), to the portfolio this quarter. HCA is a hospital business in the United States, operating 172 hospitals, 44,000 beds and 119 freestanding surgery centres. The company trades at a historically cheap multiple of 7.5x EV/EBITDA. This is largely due to market noise in the United States around the repeal of the Affordable Care Act, better known as 'Obamacare'. We believe the worst case scenario of a full-repeal is more than priced in to HCA.

We are buying the company at a 10% free cash flow yield and we believe cash earnings per share can grow at double digit rates driven by an aggressive capital allocation policy primarily focused on share buybacks. Since an IPO in 2011, HCA has generated $11.2bn free cash flow. Over the same period HCA has repurchased $9.9bn of shares (reducing share count by 21%), paid $3.2bn in special dividends and made $4.4bn worth of acquisitions. At the same time the company has reduced debt/EBITDA from 4.7x to 3.8x today.

While the noise (and tweets) around healthcare regulation is ongoing, HCA has continued the strategic M&A that the company was founded on. The hospital industry currently provides HCA ample opportunity for such M&A with the two largest peers heavily indebted, at an average debt/EBITDA of 7.8x[3], and undertaking forced asset sales. HCA has a long track record of significantly increasing the operating profitability of hospitals it acquires.

The industry structure also provides protection against regulatory or reimbursement risk. 80% of hospitals in the US are non-profit & government owned. The majority of these hospitals operate at very low to negative margins - only keeping the lights on through subsidies from the government. Additionally, hospitals are the largest employer in the congressional districts of 75% of the members of the U.S. House of Representatives. Self-interested politicians are reluctant to engage in bad politics by voting for legislation that could cause local hospital closures thereby negatively affecting a large population of their voters. These industry dynamics provide protection from regulatory and reimbursement risk for the most efficient hospital operators, such as HCA.

Avenir Global Fund - New Retail Class

The new retail class of units in the Avenir Global Fund was launched on 25 August 2017 which allows retail investors to invest directly into the Fund. This class of units has made a strong start and is up 10.6% in the two months since launch.

Daily Unit Prices Available Online

Unit prices for the Fund are now calculated daily and both current and historical unit prices for both the original wholesale class which was launched on 1st August 2011 (*Avenir Global Fund – Class I*) and the new retail class which was launched on 25th August 2017 (*Avenir Global Fund*) can be accessed here.

Transition Update

Further to the letter sent to investors in July 2017 following the transition of administrative and registry services to Fidante Partners, please find below some additional information regarding accessing and updating your account information.

Quarterly statements: Fidante provide transaction and periodic statements on a quarterly basis. These are mailed to all investors post quarter-end and include details of all transactions on your account including any distributions.

[3] Two largest public competitors are Tenet Healthcare (Debt/EBITDA: 7.3x) and Community Health Systems (Debt/EBITDA: 8.3x)

Access to information (Investor Online): You should now have received your login details (user ID and password) to Investor Online. This is an online service which provides you with secure access to your investment information, including balances, transaction history and historical correspondence. All information post 1 July 2017 will be available in your Investor Online account and can be accessed through the *Investor Login* section at www.fidante.com. In addition to this, all historical statements and information regarding your account is available on request through our Contact Centre. If you have not received your Investor Online login details, or if you have a specific request for information please contact our Investor Services team on **13 51 53**.

Third party authority to access information: If you would like to make a third party authority for individuals such as advisors and accountants to access information on your account please complete a third party authority letter and return to the address provided below. You can request a copy of this letter by calling the Contact Centre on 13 51 53. Your privacy is of utmost importance to us, we therefore require the **original signed form** to be returned to action this request.

Up to date information: It is important that we have up to date information on file for your account. Your personal information can be viewed on Investor Online, alternatively this can be confirmed on request through the Contact Centre. To keep your investments safe we have strict protocols around updating information. Contact information such as phone numbers, email addresses and residential/postal addresses can be updated over the phone through the Contact Centre. You will require your account information and be asked to complete an ID verification process. To update information on your account relating to transactions or information access requests, such as updating bank account details and submitting transaction requests requires original signed forms to be completed and returned. These forms are available via the forms section of the Fidante website at https://www.fidante.com/forms.

The contact details for Fidante are outlined below:

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We appreciate the confidence and trust you have placed in us. That trust allows us to make sound, long-term investment decisions that help to reduce risk and immeasurably improve our chances of achieving superior long-term returns.

“Conviction is worthless unless it is converted into conduct.”

- Thomas Carlyle

Best Regards,

Adrian Warner

Managing Director