28 April, 2017

Dear Partner:

The Avenir Value Fund (the "Fund") increased 1.5%, net of all fees and expenses, in the March 2017 quarter. Underlying equity investments increased 5.6% in value offset by negative currency effects of 4.1%. Over the past twelve months, the fund has returned 30.6%. By comparison, the ASX All Ordinaries increased 4.5% in the quarter and 19.5% over the past twelve months and the MSCI World Total Return index returned 6.9% for the quarter and 16.1% over the past twelve months.

During the quarter we moved into our new office space at Level 2, 5 Martin Place in Sydney. The process of transitioning our operations and infrastructure to Fidante has begun in earnest. We have been very impressed by the hard work and thoroughness displayed by the entire Fidante and Challenger team and thank them for their efforts to date. There is more to do and we are greatly looking forward to the completion of the transition. Sometimes, you do not know what you are missing until you find it but the depth of resources now available to us and the quality of the operational infrastructure on which we will now rest is extraordinary.

What has not changed is our investing philosophy and process. We continue to generate superior returns by understanding the sustainability of business models and taking a long term investment horizon over which the benefits of high barriers to entry can play out. We also have expertise in business valuation and focus on those ideas in which we are able to buy advantaged businesses at prices we believe represent a material discount to their intrinsic value. Finally, we run a concentrated portfolio and only allocate capital to those ideas which present the most favourable balance of risk and return characteristics. While this forces us to make capital allocation choices that are not always easy and to sometimes forego worthwhile opportunities, this selectivity provides a powerful driver of returns and risk mitigation.

All the money is going *here* and *here*, so where is the opportunity?

Our approach runs counter to much of the money management industry which tends to drift towards index replication over time. The forces pushing in this direction are powerful as it is simply easier and less stressful to run money in this manner and there is comfort in being safely in the crowd no matter what the results. This move to passive investing is only gaining momentum as the current bull market passed its 8-year anniversary during the recent quarter, making it the second ever longest-lived bull market (since the one that lasted from 11 October, 1990 to 24 March, 2000). The call for the benefits of passive, or index investing, grows very loud during the latter years of bull markets.

In the last three calendar years, according to a recent New York Times[1] article, investors sank $823 billion into the index fund giant, Vanguard. The staggering nature of that sum is highlighted by the fact that the more than 4,000 *other* mutual funds in the US only pulled in a net $97 billion during the same period. Vanguard is now required to pour more than $2 billion per day into the equity markets, the vast bulk of which goes into the leading companies in the S&P 500, names such as Apple, Microsoft, Facebook and Amazon. That is 20 times the amount that Vanguard was investing on a daily basis in 2009 according to the New York Times.

The key point to remember here, apart from simply the staggering sums involved, is that there is no stock picking or, dare we say it, 'investing' involved. This approach has worked well during one of the longest bull

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markets in history, but how it ends we can't be sure. For a period, it is self-fulfilling as the largest companies get the bulk of the inflows and so their price goes up so they get more of the inflows and repeat. It is not clear how this 'index bubble' ends, as it is never clear when or how any bubble will end, but one can't help but feel that at some point the tide will turn and the effect in the opposite direction may be just as strong.

We believe that the move towards passive investing makes the markets less, rather than more, efficient and creates wonderful opportunities for alpha generation via active and selective stock picking. Furthermore, a good portion of the money that is not going towards passive index investing is going towards data-driven or quantitative, fast-money investing activities. Bank of America Merrill Lynch (BAML) recently published a paper entitled "The most contrarian theme: long-term, fundamental investing"[2], arguing that one of today's greatest market inefficiencies stems from the scarcity of capital devoted toward long-term, fundamental investing.

BAML note that the rise of short-term investment strategies which rely on access to better, faster and larger stores of data has attracted trillions of dollars of capital. Jobs advertised for data scientists and quantitative analysts outnumber those for fundamental analysts by a factor of eight and the number of fundamental analysts per US$1 billion of market cap has shrunk from fourteen in 1986 to less than one analyst today.

Given how under resourced the fundamental investment arena is today, opportunities are likely more abundant. BAML's analysis shows that alpha opportunities, measured by the range of market prices, have shrunk on a short-term basis but have demonstrably risen on a long-term basis. Additionally, while there is a lot of noise in the short-term, **valuation** explains almost 90% of the S&P 500's returns variability over a ten-year time horizon. We have always believed that a fundamentally-based, valuation-driven and long-term investing strategy is the preferred approach and Avenir has always conducted its investment operations in this manner.

Select Portfolio Updates

During the quarter we did not add any new positions or exit any positions.

Our biggest contributor during the quarter, for the second quarter in a row, was **BBX Capital** (BBXT) which was previously known as BFC Financial. The BBXT share price increased from $4.48 to $6.49 during the quarter. This means that the share price of BBXT has increased in the last three quarters by 35%, 25% and now 45% for a total nine-month gain of 145%. Given that we still think the company is materially mispriced to the downside, it only highlights how cheap the company had become. We have owned the company for almost three years now and for much of that time we have been underwater. We are now up 90% on the investment, however, illustrating the importance of conviction and patience in our game.

Our second biggest contributor for the quarter was **Videocon** (VDTH) which was the largest detractor the prior quarter. Videocon is the fastest growing satellite pay TV operator in India. Our purchase thesis rested on a very strong secular growth story for satellite TV in India aligned with a very well managed and rapidly growing company that was available for a reasonable price in an industry primed for consolidation. Videocon was the fastest growing company in the Indian industry due to some material competitive advantages it possessed and we felt it could grow profitably in its own right and would be well placed in any industry corporate activity. Our study of global satellite TV markets showed that national satellite TV industries inevitably moved to become 2-player operations with all of the advantages duopolies typically provide to the incumbents. We felt the 6-player Indian market (with only 4 real competitive operators) would develop in a similar manner over time.

In the fourth quarter of 2016, Videocon announced it was merging with Dish TV, the largest pay TV provider in the Indian market. The merger combines the largest direct-to-home (DTH) satellite pay TV operator in India and the fastest growing DTH pay TV operator in the country. The combined Dish TV Videocon has a

40% market share and is twice as big as the next biggest company in what is now, effectively, a 3-player market. The merger terms were favourable to VDTH and we believe the merged entity is extremely well placed to gain share and grow even more rapidly than the overall market. We added to our position during the quarter.

Our third biggest gainer for the quarter was Clear Media (SEHK:0100) which increased in price by 20% during the period. We have owned Clear Media for almost 3-years now and, while we have not yet been richly rewarded, the company has done everything we could have asked of it operationally. Clear Media holds a dominant position in the Chinese bus shelter outdoor advertising market with 80%+ market shares in the four major cities of Beijing, Shanghai, Guangzhou and Shenzhen. This is an industry where scale and relative market share[3] bestow huge competitive advantages on the leading companies. Clear Media is one of those companies whose competitive advantages strengthen over time or, as Warren Buffett likes to say, its "economic moat" gets deeper and wider every year.

In the 3-years we have owned Clear Media, the company's operating earnings have increased 36% while the net assets required by the business to generate those earnings have grown only 18%. The company has net cash on the balance sheet equal to 10% of the market capitalisation despite having paid out over 15% of the current market capitalisation in ordinary and special dividends since we have owned it. Given the almost infrastructure-like qualities of this asset and its current price equal to 5.5x EBITDA, we are confident we will be well rewarded for owning it in time.

Our largest detractor for the quarter was an investment in Australian specialty retailer **Adairs** (ADH). Adairs is reminding us why we do not typically invest in specialty retail businesses. There is a fine line dividing genius and failure in retail and, from the outside, it can be difficult to determine which is which until it is too late. For this reason, and others including a general lack of barriers to entry in the industry, we generally put the retail investing challenge in the "too hard" basket.

We were attracted to Adairs after they announced some trading difficulties and the share price collapsed 40% to the mid $1.50's. Normally, a specialty retailer suffering trading difficulties would interest us about as much as a damp, half-eaten sandwich found under the stands at the end of a football match. However, our 'triangulation' based on numbers provided by management suggested the difficulties were localised in nature, could be explained by specific factors and could be resolved in fairly short order. The investment thesis was clear and the investment fell firmly into our "special situations" category.

But, at the end of the day, a retailer suffering trading difficulties is a retailer suffering trading difficulties and we are generally best staying well away. A subsequent negative trading update from the company has shown that the situation is not as straightforward as we had initially thought and the issues may be more widespread. At the least, the investment thesis is no longer clearcut. The share price declined 30% from $1.60 per share to $1.12 during the quarter. We have not exited our position as the company's share price has been pushed down to such distressed levels that selling does not seem to be the prudent thing to do, but we are not rushing to add to our position until more information comes to light.

We look forward to completing our transition onto the Fidante boutique manager platform and being able to focus an even greater proportion of our time on identifying and researching high quality investment ideas. We have a number of ideas that we are currently researching, any of which may prove to be worthwhile investments. We remain highly confident that the value of our owned businesses will grow over time. The market may ignore this progress for periods of time but, ultimately, this value will be reflected in higher stock prices. All we need is a collection of good businesses at great prices, patience and the courage of our convictions.

I will be giving a short presentation of an investment idea at the Future Generation Investment Forum to be held at the Wesley Centre Auditorium, Sydney on Tuesday, 16 May 2017. This event is the inaugural Future Generation Investment Forum and will provide access to exclusive investment ideas in a series of five-minute presentations from Future Generation's domestic and global fund managers. For more information please see the event flyer.

The next Avenir Capital investor intake will be on 1 May 2017. We are glad to be your largest partner in the Avenir Value Fund and appreciate your long-term investment commitment. Thank you to those who have recommended us to others.

If you would like to discuss an investment in the Fund please do not hesitate to contact us.

"I am an old man and have known a great many troubles, but most of them never happened."

-- Mark Twain

Best Regards,

Adrian Warner
Managing Director

[1] New York Times; "Vanguard is Growing Faster Than Everybody Else Combined"; 14 April 2017.
[2] Bank of America Merrill Lynch; "The most contrarian theme: long-term fundamental investing", 16 March 2017
[3] Relative market share refers to a company's market share compared to the next biggest competitor. For example, if Company A has a 30% market share and Company B (the next biggest company) has a 15% market share, then Company A's relative market share is 2.0x and Company B's relative market share is 0.5x. Relative market share is often a bigger determinant of competitive advantage than absolute market share.