To: **Investor Partners of Castlereagh Equity Pty Ltd**

From: **Peter Phan**

Date: **30 November 2017**

Re: **Monthly Update**

	Castlereagh Equity	ASX All Ordinaries	Relative Performance	CE Net Asset Value
1 November 2013 to 30 Nov 2017	66%	11.7%	54.3%	148 cents*
1 November 2013 to 31 January 2015	6.2%	2.4%	3.8%	106.2 cents
1 February 2015 to 29 January 2016	19.4%	-9.2%	28.6%	126.8 cents
1 February 2016 to 31 January 2017	19.7%	12.5%	7.2%	151.8 cents
1 February 2017 to 30 Nov 2017	9.5%	6.7%	2.8%	148 cents

To aid in understanding the tables above:

1. CE commenced on 1 November 2013 with shares issued at $1 per share, backed by $1 of cash per share.
2. The first row of the table above provides a summary of CE's performance since its commencement on 1 November 2013 until the date of this memorandum. It also compares CE's performance with the benchmark All Ordinaries index over the same period.
3. The second row of the table provides a summary of CE's performance for its first reporting period (15 months period from 1 November 2013 to 31 January 2015).
4. The third row of the table provides a summary of CE's performance for its second reporting period (12 months period from 1 February 2015 to 29 January 2016).
5. The fourth row of the table provides a summary of CE's performance for its third reporting period (12 months period from 1 February 2016 to 31 January 2017).
6. The fifth row of the table provides a summary of CE's performance for its fourth and current reporting period (period commencing 1 February 2017 to the date of this memorandum).
7. *CE NAV is after payment of dividend and director fees in Feb 2017. These payments "reset" the NAV from 1.52 to 1.34.

The XAO started at 5420 on 1 November 2013 and ended at 6057 on 30 November 2017. In percentage terms, the XAO gained 11.7% for the 49 months period since the start of the CE fund. CE's performance over the same 49 months period is 66%.

For the month of November 2017, the XAO was up 1.35%. The CE portfolio was up 2% for the month.

The cash component of the CE fund is just above 12%.

Cigar Butts

The market continues to go higher, and valuations of many stocks continue to look expensive by virtually any traditional measure such as multiples of earnings, multiples of cashflow, dividend yield, etc. As I have stated previously, growth is sexy again, and growth stocks are now dominating the news, message boards, social media and party conversations.

In this environment of increasing exuberance, we are now fishing around in forlorn and forsaken waterholes. CE has recently took initial stakes in four stocks which no fund manager or broker will ever recommend to their clients due to massive career risk. Two of these stocks are trading at a value below their net working capital, and other two were trading at 3 times enterprise value to cashflow at the time of purchase. They are all operating in challenging and unglamorous sectors, soporific stuff such as scaffolding, paper and aluminium. These are the ugly cigarbutt stocks that most investors will now scoff at as value traps. On the contrary, we see loads of cash coming back to shareholders within 3 to 5 years, with relatively little risk of permanent loss of capital.

We have also sold a position in a stock caught up in the growth hysteria. We initiated this position 3 years ago. It was within the writer's circle of competence- the fruits of previous research and ownership in companies operating in sectors of telecommunications, information technology and medical imaging. This company sat at the intersection of these three sectors. We bought some shares when it was trading at about $88million. When we sold our last parcel, the shares were trading at a market capitalisation of $760million. As per usual, the share price has continued to rise since our exit.

Yours truly committed quite a few errors with this sizzling stock. We bought too few stocks initially, amounting to about 2% of portfolio size at the time of purchase. We failed to increase the position size despite further temporary price drops. We sold a big parcel too early, at a market capitalisation of $265million. We failed to reinstate our position despite improving fundamentals after the sale of our big parcel. Overall, we ended up with a 250% gain on a 2% position, moving the needle by a measly few percentage points of performance on a solid and profitable idea. To put the losses in perspective, a full 10% position would have yielded a return of over 75%, and that is before including dividends.

Although the identity of this stock will be obvious to many, I have refrained from naming it, as I believe that it is a very high quality business which I hope to have the opportunity to purchase again in the future at a less lofty valuation. Please bear in mind that this could mean buying again at even higher prices, provided that there is adequate existing or near term cashflow to underpin valuation at the time of the next purchase.

When everyone is a growth investor making overnight fortunes from fast moving stocks, we prefer to be in the safe corner preserving our precious capital. We are buying and owning unloved stocks and selling popular stocks, which is the complete opposite to what most other participants are doing. This is one of the reasons why value investing is difficult- humans being social animals are reluctant to go against the crowd and risk being the odd one out. In our ancestors' days of hunting and foraging, being ostracised by other fellow hunters and foragers will certainly diminish the likelihood of passing on one's genes to the next generation. Thankfully, in our situation, your director will merely have to suffer the mild indignity of not being the focus of lively conversations at cocktail parties.

This is a long race, and to finish first, we must first finish. For a runner, that means preserving energy and stamina, and for CE, that means preserving and protecting your precious capital.

Thank you for your trust and confidence in us.

Regards
Peter Phan
Director, Castlereagh Equity Pty Ltd