

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

**From: Peter Phan**

**Date: 30 June 2019**

**Re: Monthly Update**

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	CE	CE ex-fees	XAOA	CE ex fees vs XAOA	XAO	CE vs XAO	CE Net Asset Value
1 November 2013 to 30 June 2019	85%	77%	57.4%	20%	23.6%	61.4%	159 cents*
1 November 2013 to 31 Jan 2015	6.2%	6.2%	7.7%	-1.5%	2.4%	3.8%	106.2 cents
1 February 2015 to 29 Jan 2016	19.4%	16.4%	-4.7%	21.1%	-9.2%	28.6%	126.8 cents
1 February 2016 to 31 Jan 2017	19.7%	16.3%	17%	-0.7%	12.5%	7.2%	151.8 cents
1 February 2017 to 31 Jan 2018	9%	8.3%	13%	-4.7%	8.3%	0.7%	146 cents
1 February 2018 to 31 Jan 2019	0%	0%	0.6%	-0.6%	-3.4%	3.4%	139 cents
1 February 2019 to 30 June 2019	15%	14%	15%	-1%	12.8%	2.2%	159 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 (XAO) and the All Ordinaries Total Return Index (XAOA) 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 (and subsequent rows) provides a summary of CE's performance for its reporting period (12 months period from 1 February to 31 January).
5. The last row of the table provides a summary of CE's performance for its current reporting period (period commencing 1 February 2019 to the date of this memorandum).

6. \*CE NAV is after payment of dividend and director fees in Feb 2017 and Feb 2018. These payments “reset” the NAV from 1.52 to 1.34 in Feb 2017, from 1.46 to 1.39 in Feb 2018, and from 1.39 to 1.39 in Feb 2019.

The XAO started at 5420 on 1 November 2013 and ended at 6699 on 30 June 2019. In percentage terms, the XAO gained 23.6% for the 68 months period since the start of the CE fund.

The XAOA started at 44054.2 on 1 November 2013 and ended at 69327 on 30 June 2019. In percentage terms, the XAOA gained 57.4% for the 68 months period since the start of the CE fund.

CE’s performance over the same 68 months period is 85%.

For the month of June 2019, the XAO gained 3.8% and the XAOA gained 3.4%, roundly outpacing the CE portfolio which dropped slightly for the month.

The cash component of the CE fund is 20%.

As a matter of record, the CE fund performance over the financial year of 2018 to 2019 is 16%.

The “death of value” chant is back, nearly 20 years from the height of the technology boom in the 90s, which is just about enough time for one generation of humanity to lose its collective memory. Over the last few months, we have seen reports of many small cap fund managers losing mandates and closing up their funds. By inference, money redeemed from these managers are either going into passive index funds which are chasing stocks rising in price, or going to momentum managers having a hot run fuelled by the same set of hot stocks.

During June, we have either closed or reaching closure of several positions. I sold our DNA position for a loss, which took away about 2% of portfolio value. This was a salutary lesson in underestimating the risk of bad decisions from second rate management operating outside their area of competence and the risk of litigation and conflict with local parties in a foreign jurisdiction. This loss was balanced out by closing out a small position in EVS which had gained 100%. With EVS, I am not confident placing my trust on an overly promotional management with a demonstrated track record of spending more than they earned. The business does have some promise and I am keeping a watch on it.

We also reached closure in SRS which is subject to a takeover and capital return, and sold our position in CAA which is facing serious challenges but being operated by management which appears to have incentives opposed to shareholder’s long term wealth. These two positions were essentially cigar butts bought as a quasi-replacement for holding cash. The thesis for both was similar- extreme deep value. We bought our positions for a price which was nearly half of the value of both cash and inventory on the balance sheet. Both businesses- paper trade and aluminium milling- were dreadful and barely earning single digit returns on their massive capital bases. These are uncompetitive businesses which should cease to exist and return all capital to shareholders to be deployed elsewhere more gainfully. The difference between SRS (which we made 100% gain, giving CE a boost of 2%) and CAA (which we made about 10% over 2 years) is that of management incentives. SRS management, with fairly light paychecks and heavy shareholdings, were incentivised and motivated to release and return capital back to shareholders, whereas CAA management is incentivised to keep the business operating, bearing in mind their fat paychecks and minimal shareholding. Another important lesson is reinforced here.

We still have a few more positions waiting for closure and I will report these when the time is right.

I am also pleased to report that I have managed to secure more shares in a company which I have mentioned in my two past memorandums. I was also very lucky as the company provided an earnings upgrade just shortly after we have doubled up our position. I intend to buy more shares in this company at the right price, so unfortunately, this position will remain undisclosed at this time.

In other good news, our large position in SRG has recovered over 35% on the back of a string of contract announcements, despite continuing large selldowns from CBA and other value funds closing up shop. As Tony Hansen of EGP has opined, these contracts are with longstanding customers and should not be a surprise to Mr Market. I expect the recovery of SRG to continue for some time, given the large tailwinds behind them.

Thank you for your trust and confidence in us.

Regards

Peter Phan

Director, Castlereagh Equity Pty Ltd