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

From: **Peter Phan**

Date: **31 May 2020**

Re: **Monthly Update**

	CE	CE ex-fees	XAOA	CE ex fees vs XAOA	XAO	CE vs XAO	CE Net Asset Value
1/11/13 to 31/5/20	140%	119.6%	42.7%	73%	8.3%	131.7%	196 cents*
1/11/13 to 31/1/15	6.2%	6.2%	7.7%	-1.5%	2.4%	3.8%	106.2 cents
1/2/15 to 29/1/16	19.4%	16.4%	-4.7%	21.1%	-9.2%	28.6%	126.8 cents
1/2/16 to 31/1/17	19.7%	16.3%	17%	-0.7%	12.5%	7.2%	151.8 cents
1/2/17 to 31/1/18	9%	8.3%	13%	-4.7%	8.3%	0.7%	146 cents
1/2/18 to 31/1/19	0%	0%	0.6%	-0.6%	-3.4%	3.4%	139 cents
1/2/19 to 31/01/20	65%	51.7%	25%	26.7%	20.3%	44.7%	229 cents
1/2/20 to 31/5/20	-6.7%	-6.7%	-16.4%	9.7%	-17.7%	11%	196 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 calendar month February of each year. These payments "reset" the NAV as follows:
   (a) 1.52 to 1.34 in Feb 2017,
   (b) 1.46 to 1.39 in Feb 2018,
   (c) 1.39 to 1.39 in Feb 2019.
   (d) 2.29 to 2.10 in Feb 2020.

The XAO started at 5420 on 1 November 2013 and ended at 5872 on 31 May 2020. In percentage terms, the XAO gained 8.3% for the 79 months period since the start of the CE fund.

The XAOA started at 44054.2 on 1 November 2013 and ended at 62862 on 31 May 2020. In percentage terms, the XAOA gained 42.7% for the 79 months period since the start of the CE fund.

CE's performance over the same 79 months period is 140%.

For the month of May 2020, the XAO gained 4.9% and the XAOA gained 5%. CE gained 6% for the month.

The cash component of the CE fund is just over 23%.

CE portfolio

During the month of May, the CE portfolio was dragged higher in tandem with the general market. The top 5 positions in CE collectively advanced 15%. These 5 positions account for over 50% of the CE portfolio. The CE portfolio is starting to get concentrated. A consequence of such concentration is increasing price volatility. Hence forth, all investor partners should brace themselves for increasing turbulence.

We continue to monitor some interesting trends currently being generated or accelerated. The switch from cash to card payments and rapid uptake in online lessons were two trends mooted two memos ago, which have, at least temporarily, been validated. For example, our holding in KME recently reported 20,000 online lessons conducted in a week. This is astounding considering that online lessons preCOVID came in at under 3000 per month.

We are also seeing partial closures in two of our quasi-cash positions.

The first is SLM, with 11 cents per share fully franked dividends paid. I estimate a further 70 cents per share of cash plus 5 cents of franking credits remaining to be distributed. On an average cost base of 55 cents, we have now been paid 27 cents of fully franked dividends. These dividends grossed up to approximately 38 cents, being a 69% return on capital deployed in 24 months, equivalent to 1.5% of the CE portfolio.

The second is SIV, with 30 cents per share of capital return. I estimate a possibility of another $10m to $15m of capital to be returned in an optimistic scenario, pointing to another 30 to 45 cents per share. Sadly, even in the most optimistic scenario, we will end up with a loss on capital of roughly just under 16%, which is equivalent to just under 0.4% of the CE portfolio.

Farewell DTL

I sold our last parcel of DTL shares when the share price ran over $5. I commenced research on DTL in early 2014. In essence, DTL's primary business is in provision of IT services to businesses and government departments. For example, setting up office networks and IT infrastructure.

2014 was a period of uncertainty when industry IT spending was held in limbo due to a rapidly changing environment hesitating towards a cloud transition. The impact on DTL's revenue caused its share price to hit lows of below 60 cents. I did not buy a position because it was not clear at that time how the industry would have developed.

Fast forward two years later in 2016, and the trend started to become clearer. Companies are transitioning to the cloud and the increasing complexity of IT brought about increasing need for services. I established CE's position in DTL in 2016 at prices in the range of $1 to $1.40. At that price, DTL had a low multiple of earnings and a very attractive dividend yield. More importantly, it was in growth phase buffeted by the tailwinds of cloud transition and increasing fat margin services, together with device proliferation. Within these dynamics, the variant perception I was betting on was that Mr Market had completely missed the transition to increasing fat margin services.

This was a fabulous investment. From its initial investment, CE received over 10% of grossed up dividends from the first year. The dividends kept increasing every year as the earnings of DTL continues to grow. In 2019, the share price decided to run from just under $1.50 to over $5. The tailwinds to DTL's business became increasingly apparent to the market. I started slowly selling at prices above $3. At current prices of over $5, DTL is valued at a market cap of over $800m underpinned by roughly $25m of NPAT. With an earnings multiple of over 30, the market is implying a compound growth rate for DTL earnings of at least 20% per annum for the next 10 years. I think this is a possible but low probability event, so we have exited the position. Our return on investment for DTL is roughly 300% over a four year period.

Thank you for your trust and confidence in us.

Regards
Peter Phan
Director, Castlereagh Equity Pty Ltd