

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

**From: Peter Phan**

**Date: 28 February 2021**

**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
1/11/13 to 28/2/21	195%	171%	72%	99%	28%	167%	223 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 29/1/21	20%	16.5%	-0.7%	17.2%	-3.8%	23.8%	253 cents
1/2/21 to 28/2/21	-0.8%	-0.8%	1.4%	-2.2%	1%	-1.8%	223 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 2021 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.

(e) 2.53 to 2.25 in Feb 2021.

The XAO started at 5420 on 1 November 2013 and ended at 6940 on 28 February 2021. In percentage terms, the XAO gained 28% for the 88 months period since the start of the CE fund.

The XAOA started at 44054.2 on 1 November 2013 and ended at 75713 on 28 February 2021. In percentage terms, the XAOA gained 72% for the 88 months period since the start of the CE fund.

CE's performance over the same 88 months period is 195%.

For the month of February 2021, the XAO gained 1% and the XAOA gained 1.4%. CE dropped 1% for the month.

The cash component of the CE fund is just under 39%.

### **Moving Along**

CE enters its 8<sup>th</sup> year in February 2021. Together with our initial 3 years incubation period, 10 years have elapsed since the idea of CE was first germinated and actioned. Another milestone has quietly passed. May we have the opportunity to celebrate many more of such milestones in the future.

Recently, I was fortunate enough to come across an excellent book- The Art of Execution by Lee Freeman-Shor. The book supplemented and reinforced many of my prior learnings. More importantly, the book has catalysed for CE a framework of risk and portfolio management which fits our investment philosophy and objectives.

CE ended up as net seller for the month of February. Our cash balance is building up as a result of our sales. Broadly, the sales can be categorised as follows:

1. I have liquidated several small positions in accordance with the 10 best ideas rule advocated by Freeman-Shor. We are not quite done yet. Several small holdings are just too illiquid to sell in a hurry. Due to the current popularity of making concentrated bets in a small number of stocks, some managers have advocated a contrarian approach of building diversified portfolios consisting of many small positions with good risk/returns profile in order to reduce risks. I am not convinced that this is the correct approach. I agree with Freeman-Shor's sentiments, which echoed both Li Lu and Charlie Munger. Going from concentrated to diversified basically means exchanging idiosyncratic/company specific risks for systemic market risks. Risk is not being reduced- we have merely swapped one type of risk for another. Furthermore, the timing could not be worse, as it is difficult to argue that market risks are low in the present environment.
2. I also sold a position where I made an error last year which took away nearly 4% of portfolio value. I am doing post-mortem on this position and will report in detail in due course. Suffice to say that if I had enacted Freeman-Shor's ideas earlier, our losses would have been under 2%. Of course, it would have been much better if I had not acted on this lousy idea in the first place. More later, but my apologies in advance for a silly rookie error. As an aside, if I had not acted by selling, the total loss to date would be 6% of portfolio (and counting).
3. I sold over half of one of CE's biggest position. The latest reported numbers are not supportive of my thesis. Moreover, the share price has gone up faster than warranted by the performance of the business. The future of the business is still uncertain, with a new CEO

following a major merger last year. Lastly, due to a capital raising which largely excluded retail shareholders, there was enough liquidity to sell a lot of shares without depressing the price. The remaining position is still significant for CE and I will be watching this closely.

4. I trimmed some of CE's other major positions when their prices spiked.

The half yearly reporting season has been mixed so far as CE is concerned. In particular, the developments in one of our large holdings, ICS Global, was disappointing. The board, with the support of PIE Funds being the largest shareholder, decided to sell the medical billings business in the UK for a price of roughly 10 times normalised cash earnings. The business was growing at nearly 20% per annum with a market penetration of less than 1% in a fragmented market. Whilst various reasons were given by the Board, it appeared to me that the Board probably did not quite have the necessary capability, motivation or patience to take the UK business to higher levels. This was always a risk that I took into account when the position was initiated. It is unfortunate that this risk has come to pass. CE made adequate returns out of this investment due to a low average cost price of entry. The cash return to be made to us in April this year will add another 8% to our cash holdings.

Once the portfolio spring-cleaning is completed, CE will be invested in 8 positions, unless an actionable idea comes along in the interim. The current positions are not equi-weighted and most of them are trading at prices at which I am unwilling to add further. Nevertheless, things can change fast, as evidenced by March 2020 when the market tanked 30% within less than a month. I continue to make preparations to act when great opportunities are presented. We are also headed into our traditional tax loss selling season, but I am not optimistic that any major opportunities will arise in this current market environment.

### **Soft Closing**

We welcome several new investor partners for this intake period. We are currently at 49 investor partners in total. Once we reach 50 investor partners, CE will be soft-closed. This means that no new investor partner will be admitted unless an existing one exits. Existing investor partners can continue to make additions, subject to the usual limits. I expect this situation will remain until CE reaches a size of roughly \$40m in net assets. We are currently below \$10m in net assets, so there is quite some way to go yet. Once we get to \$40m in net assets, I will reassess our options. My personal preference is that nothing changes unless there is a compelling reason to do so.

Once again, all director fees this year have been reinvested into CE. We are in for the penny, in for the pound.

Lastly, diligent investor partners using a simple Google or other searches, will be able to verify that CE is listed as a top 20 shareholder in the annual or half yearly reports of at least 5 companies on the ASX. Ideally, I prefer not to disclose CE's positions, especially the larger ones. However, this is not a matter within my control. Using the number of shares held and an estimation of the trading share price of each respective company can be made to calculate the value at holdings worth several million dollars. If any investor partner wishes to obtain exact details, please do not hesitate to contact me at any time.

Thank you for your trust and confidence in us.

Regards  
Peter Phan  
Director, Castlereagh Equity Pty Ltd