

Annual Review: 2019

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ABN 34 136 795 170 | AFSL 341 474
PO Box R 1777, Royal Exchange Sydney NSW 1225
Ph (+612) 8241 – 1000 | www.longtailasset.com

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Introduction

We believe that genuine longer-term investment ideas are scarce, particularly of a size where larger institutional investors are essentially unconstrained regarding capacity. We offer two products, the fund, through which we invest our personal capital and institutional mandates, targeted at larger institutional investors, structured to invest in discrete investment opportunities. Our business, product offerings and research processes are organised to enable us to pursue these investment ideas.

Our thinking regarding asset prices and markets broadly did not really change through the year. We view asset prices as generally expensive and we expect there will be opportunities to invest in the future at better prices than are available today.

In September, we identified an investment that we considered to be appropriate for our mandate offering. We regard our mandate offering as being aligned with the objectives of the industry funds and their stakeholders. The offering is scalable, it has a genuine long-term focus, it focusses on our key ideas, it is tax efficient and there is an appropriate level of engagement and governance around how we handle the research process and relevant information flows. The rationale behind and structure of our mandate offering are complimentary with the forces pushing the industry funds to manage increasing amounts of money in house; we perceive that the offering adds to the research capacity of the institutions that engage with us.

We recognise that the results of the fund have lagged the broader equity markets. Contributions from long equity investments have been positive without there being individual investments that have performed to an extent to meaningfully drive the returns of the overall fund. The cost of the Yen options and other derivative positions have detracted from returns and the AUD cash balance has muted them. We are content to continue progress as we have to date. When we find an investment that we like, that we believe we understand and have an insight that is differentiated, we will invest aggressively around these discrete ideas. Without this level of conviction, our preference is to be patient rather than investing in what we consider to be lesser ideas.

We appreciate the support and engagement that we have received from our clients and other interested stakeholders over the year. Please contact us if you would like to discuss our activities in detail.

Best wishes for the holiday period and the year ahead.

Miles, Nigel and Toby.

Fund Positioning

The fund is 48% invested and holds 11 long investments compared to 64% and 12 investments at the start of the year. 37% and 8 investments have common characteristics around “tolls on the real economy”. These characteristics include: a degree of pricing power; reasonable balance sheets; scale in the context of their individual markets; and significant internal reinvestment opportunities. 20% and 4 investments are in businesses that are owner operator / family led entities. We perceive that these businesses are often managed from a long-term perspective. 27% and 5 investments are meaningfully exposed to trade and emerging market dynamics.

During the year we bought new positions in Ponsse Oyj, National Grid Plc, and Sto SE & Co. KGaA. We exited the balance of the investment in Akzo Nobel N.V., we sold the investment in AltaGas Canada Inc. and we materially reduced the investment in Twin River Worldwide Holdings, Inc. Our thought process around each follow:

New Investments

Ponsse Oyj

The fund bought a 2% position in Ponsse Oyj (Ponsse) in August at EUR27.94 and increased this investment by an additional 1% in November at EUR26.31. Ponsse is a Finnish based business that designs and manufactures forest harvesting machines focussed on the cut to length method. Ponsse have focussed on this activity since they were established in 1970. The founder’s family and children currently own 60% of the shares on issue and are involved in the business in varying capacities. Ponsse’s major markets are located in Northern Europe and Russia with expanding activities in North and South America. Ponsse holds leading to strong market shares (ranked 1 – 3) in their various geographic markets. Their key competitors are Deere & Company and Komatsu Ltd.

We regard the financial progression of Ponsse as being very good over time. The business has internally funded significant growth without issuing equity or the extensive use of debt. They have steadily invested in research and development and increased their manufacturing capacity; they have also consistently expanded their direct service, maintenance and distribution capabilities globally. Ponsse’s customer base is fragmented. Typically, they sell machines to operators with fleets of 4 – 10 machines. The machines are extensively used by the operators and the ongoing performance of a machine is vital to the operator’s financial success. Ponsse have a reputation for producing and maintaining high quality machines, their historic financial progression is consistent with this reputation.

The demand for forestry machines is cyclical, and current activity appears to be starting to slow after a number of positive years. We have used the derating in Ponsse’s valuation and to a lesser extent share price to buy an initial position in the fund. Our view is Ponsse is a high quality, high performing business with some interesting longer-term organic growth opportunities. We think that these positive company specific traits are obscured to some degree by the cyclical nature of the industry that they operate in.

National Grid Plc

The fund bought a 2.5% position in National Grid Plc (National Grid) in May at GBP8.03.

We are interested in investing in electricity grids globally. We see electrification as a means to reduce carbon emissions. To achieve this goal we perceive that there needs to be a significant capital investment cycle upgrading the capacity and functionality of existing grid assets. If we can invest in a grid operator at a reasonable initial price, where they are adequately incentivised to invest additional capital, we think there is a dynamic where we can earn attractive equity returns from the regulated return on the incremental future investment. It has been difficult to identify suitable investments around this thinking, significantly because prevailing low interest rates have pushed the valuations of many of the grid operators above levels that we think are reasonable.

National Grid has an unusual geographic asset mix, 50% are located in the UK and 50% in the Northeastern United States. We suspect this geographic mix complicates National Grid as a prospective investment for many investors. The share price has also been further derated recently by uncertainty around Brexit and related issues. We believe these issues have enabled the fund to acquire an investment in National Grid at a reasonable price.

Sto SE & Co. KGaA

The fund bought a 2.5% position in Sto SE & Co. KGaA (Sto) in May through to July at an average price of EUR94.81. Sto is a family controlled German based manufacturer of external wall façade systems, façade coatings and interior plaster and paint systems. Sto holds the leading market share in the external façade market in Germany. 75% of Sto's revenues are generated in Western Europe (over half in Germany). The business also has activities in North America and Asia. A number of the façade systems are designed to provide thermal insulation to pre-existing properties. Sto directly distributes products in its key markets, it focusses its sales efforts towards builders, architects and property owners. Sto's products are branded and a number of products have a functional or design advantage, as opposed to being a manufacturer of commoditised building materials.

Sto is a highly cash generative business with a significantly under levered balance sheet. They are generating some organic growth and their earnings are starting to benefit from a cost out initiative. The enterprise value of the business is EUR658m (Market cap EUR732m - Net Cash EUR173m + Employment benefit provision EUR99m) compared to recent historic and forecast EBIT of EUR80 to 90m (equivalent cash generation has been about EUR5m less than EBIT in recent years).

Volumes in Sto's core German external façade market declined from 2012 to 2017, they then stabilised in 2018. The declines are attributable to a de-emphasis of the renovation rate of existing buildings to meet minimum energy performance requirements; the declines are also due to an association of fire risk in the cladding industry. We perceive that Sto's product composition and application of products is different, we also get some comfort that the demand they are seeing in Germany for their exterior façade systems seems to have stabilised. Sto has made a concerted effort to be transparent around these issues. We think the recent volume trends in the German external façade market and the association of some of their products with fire concerns is enabling the fund to invest in this business at an attractive price.

Investments Sold / Reduced

Akzo Nobel N.V.

We exited the balance of the fund's investment in Akzo Nobel in September at EUR81.64. The fund held an investment in Akzo Nobel from July 2016. The investment generated an annualised IRR of 21.4% and contributed 3% to the fund's returns. We reduced and then finally sold the balance of the investment because we lost confidence in the agenda of senior management and the Directors.

AltaGas Canada Inc.

We sold the fund's investment in AltaGas Canada in June at CAD23.10. The fund held an investment in AltaGas Canada from November 2018. The investment generated an annualised IRR of 137.7% and contributed 1.8% to the fund's returns. We exited the investment because the share price appreciated above our valuation.

Twin River Worldwide Holdings, Inc.

The fund has held an investment in Dover Downs Gaming and Entertainment, Inc (Dover Downs) since July 2010. In 2018, Twin River and Dover Downs agreed on a merger that would facilitate the listing of Twin River upon closing of the merger agreement in 2019. At the start of 2019, the fund held a 10.3% investment in Dover Downs, it currently holds a 2.0% investment in Twin River. The investment has generated an annualised IRR of 9.5%.

We materially reduced the fund's investment in Twin River during the year because the operating performance of their key asset has been significantly lower than expectations at the time of the merger agreement with Dover Downs. We are concerned that the realised operating performance of this asset has made a nonsense of the numbers that Twin River management and Directors used as the basis of valuation for the Dover Downs transaction. Given this concern, we regarded the fund's exposure to this investment as being too large and we reduced it accordingly.

Existing Investments

Our thought process regarding the fund's existing investments has not changed materially. Below we have listed a number of the investments with brief comments regarding our interest in each.

Asics Corporation

We are attracted to Asics' push towards increasing the direct distribution of their products. They are achieving this by focussing activities on their company owned stores and a direct to customer website. We think that the brand, functionality and quality of their products will enable this transition to ultimately be successful.

Schlumberger Limited

We perceive that Schlumberger is uniquely positioned to increasingly engage directly with the various National Oil Companies. If this observation is correct, it infers that the earnings power of the business is meaningfully stronger today than it has been historically. This dynamic has been obscured since 2016 by the incremental supply of oil being generated from US onshore assets.

Cargotec Corporation

We are attracted to Cargotec's capabilities and activities in port automation equipment and terminal management software. We also regard Cargotec as being well placed to continue to shift the business from a focus on selling equipment to one where they have greater exposure to ongoing service and maintenance activities. We think this shift in activities is steadily progressing and in doing so improving the quality of the overall business.

Tikkurila Oyj

We regard Tikkurila as being a reasonable quality paint and coatings business with strong market positions in Northern Europe and Russia. We perceive that their underlying earnings power is being obscured by a number of transient issues.

Topps Tiles Plc

Topps Tiles is a UK based retailer. The business has attractive economics, and we think that their position is defensible. We consider that Topps Tiles is well placed to continue to steadily and progressively win market share from other tile retail specialists and big box retailers.

Eurokai GmbH & Co. KGaA

Eurokai operates a network of strategically important ports in Germany. We think the shares are currently materially mispriced. We attribute this valuation gap to their capital structure being complicated, the relative illiquidity of their listed shares and there being a considerable amount of volatility in container volumes in the industry due to the ongoing consolidation of shipping lines and alliances. We continue to be attracted to the position and capacity of Eurokai's assets, the low levels of debt through their entities and their high cash generation.

The following tables summarise the fund's investment position at 31 December 2019.

	USA/Canada		UK/Europe		Japan		Total		Tolls on the Real Economy	Owner Operator / Family Led	Trade / Emerging Market Exposure
	%	no/.	%	no/.	%	no/.	%	no/.			
Tenet - Paint / Coatings			9	2			9	2			
Tikkurila			6	1					✓		✓
STO SE			3	1					✓	✓	
Tenet - Oil Related	5	1					5	1			
Schlumberger	5	1							✓		✓
Tenet - Global Trade Related			3	1			3	1			
Cargotec Oyj			3	1					✓		✓
Tenet - European Container Terminals			9	1			9	1			
Eurokai			9	1					✓	✓	✓
Twin River Worldwide Holdings Inc	2	1					2	1			
Topps Tiles			5	1			5	1			
Asics Corp					4	1	4	1			
Kinder Morgan	4	1					4	1	✓	✓	
National Grid			3	1			3	1	✓		
Ponsse Oyj			3	1			3	1	✓	✓	✓
Gross long	11	3	33	7	4	1	48	11	37	20	27
Gross short											
Gross invested position	11	3	33	7	4	1	48	11			
Derivatives (annual cost)							3	3			

Notes: Totals may not add due to rounding. Data as at 31st December 2019.

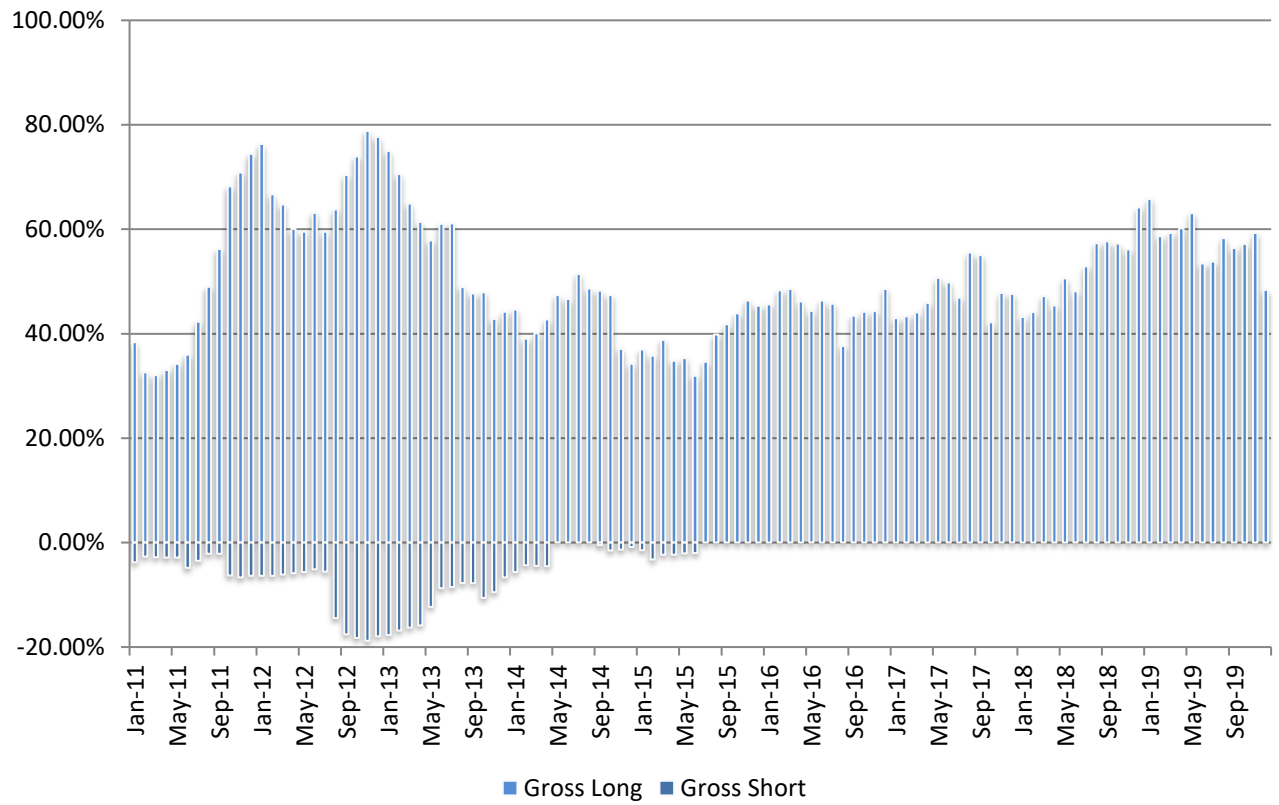
	31-Dec-18	Purchases	Sales	31-Dec-19
Tenet - Infrastructure Related				
Undisclosed	7.8%	3.0%	-10.5%	0.0%
Undisclosed	7.7%		-8.7%	0.0%
Tenet - Paint / Coatings				
Akzo Nobel	2.6%		-2.7%	0.0%
Tikkurila	5.4%		0.0%	6.3%
STO SE	0.0%	2.5%		3.1%
Tenet - Oil Related				
Schlumberger	4.6%	1.0%	-1.0%	5.0%
Tenet - Global Trade Related				
Cargotec Oyj	2.8%			3.0%
Tenet - European Container Terminals				
Eurokai	8.9%			9.1%
Twin River Worldwide Holdings	10.3%		-7.3%	2.0%
Topps Tiles	4.6%		-0.1%	5.4%
Asics Corp	3.0%			3.8%
AltaGas Canada Inc	3.5%		-4.9%	0.0%
Kinder Morgan	3.0%			4.1%
National Grid	0.0%	2.5%		3.2%
Ponsse OYJ	0.0%	3.1%		3.4%
Total	64.2%	12.1%	-35.2%	48.4%

	Long (%)	Short (%)	Currency (%)
Australia	0	0	61
United States/Canada*	11	0	9
UK/Europe*	33	0	27
Japan	4	0	4
Total	48	0	100
Derivatives (annual cost)	3		

Notes: Data as at 31st December 2019. * UK/Euro & USD/CAD approximate only.

	31 December 2019
Large capitalisation (\$3 billion plus)	19%
Mid / Small capitalisation (\$100 million to \$3 billion)	29%
Micro capitalisation (less than \$100 million)	0%
Total	48%

Fund Investment position 2011 - 2019



Investment Results

The fund returned 7.8% for calendar year 2019.

The contributors to the return were as follows:

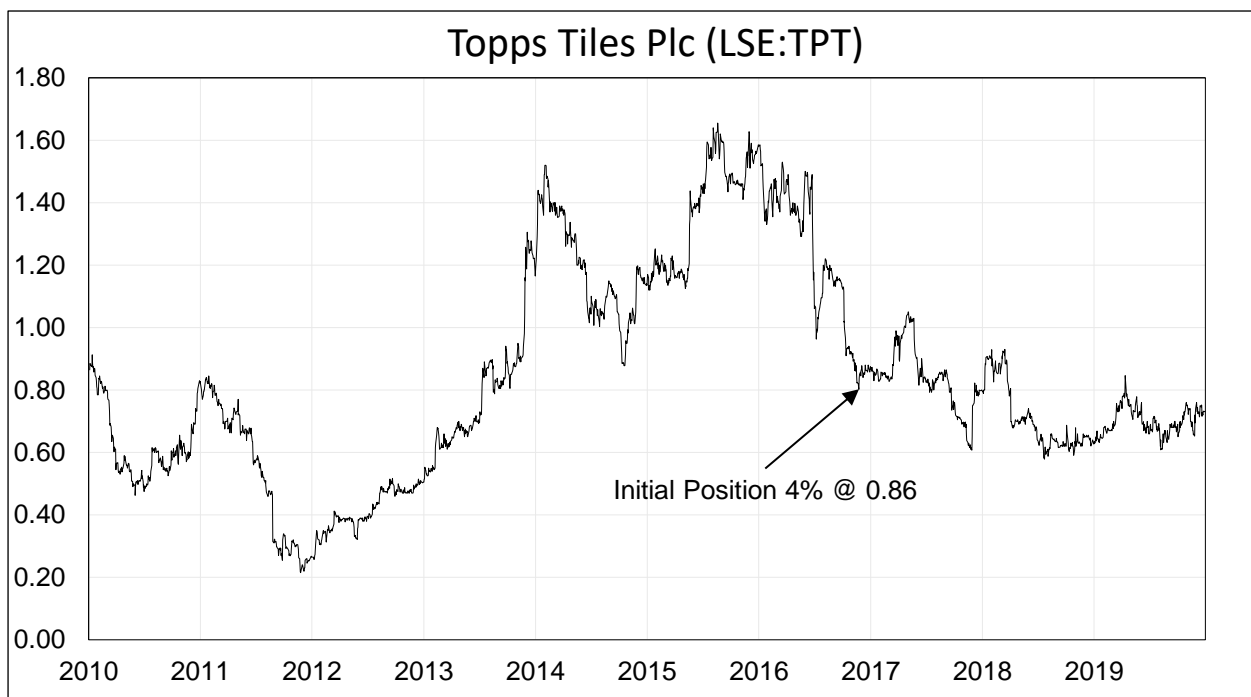
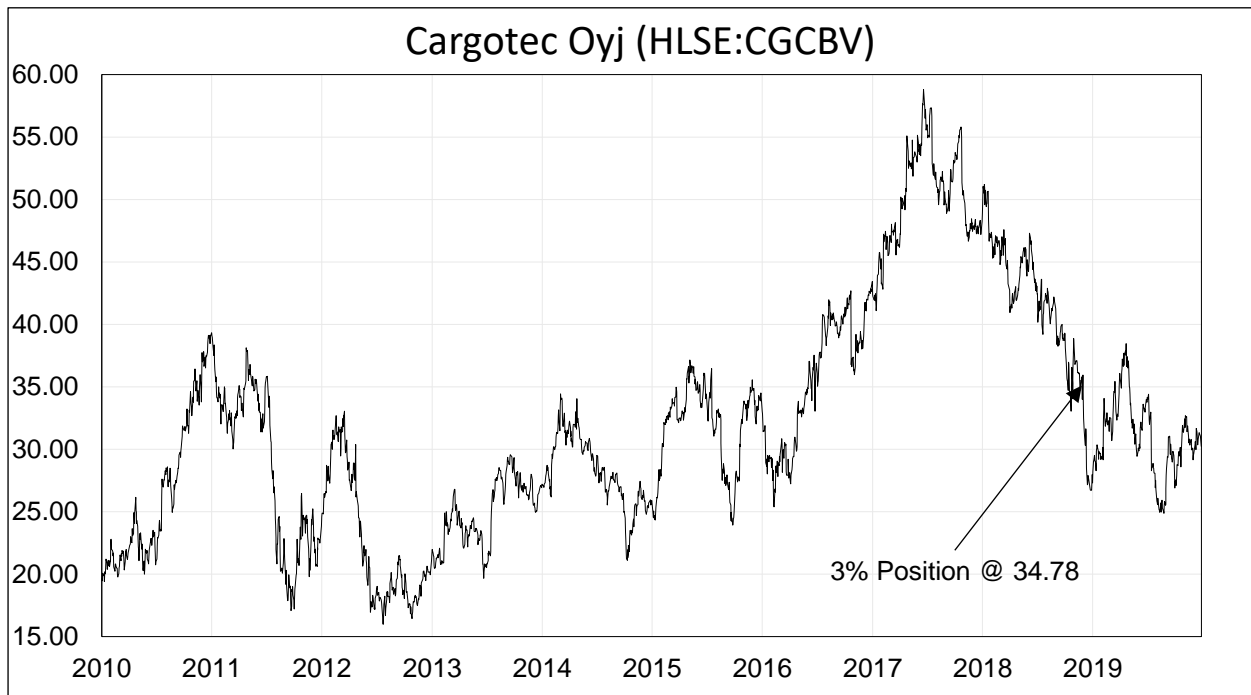
- Long equity investments (in local currencies) contributed 10.6%;
- Movements in the Australian dollar contributed 0.45%;
- USD call / Yen put options cost 1.1%;
- Currency hedges cost 0.3%; and
- Equity derivatives cost 0.6%.

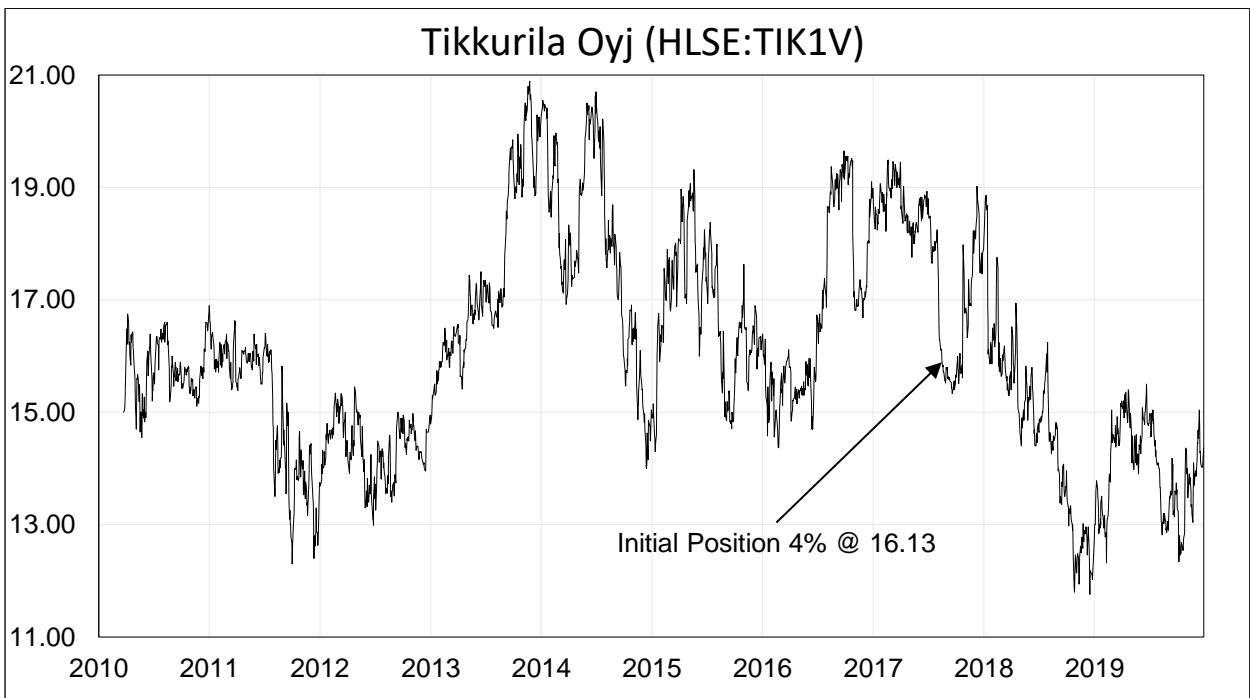
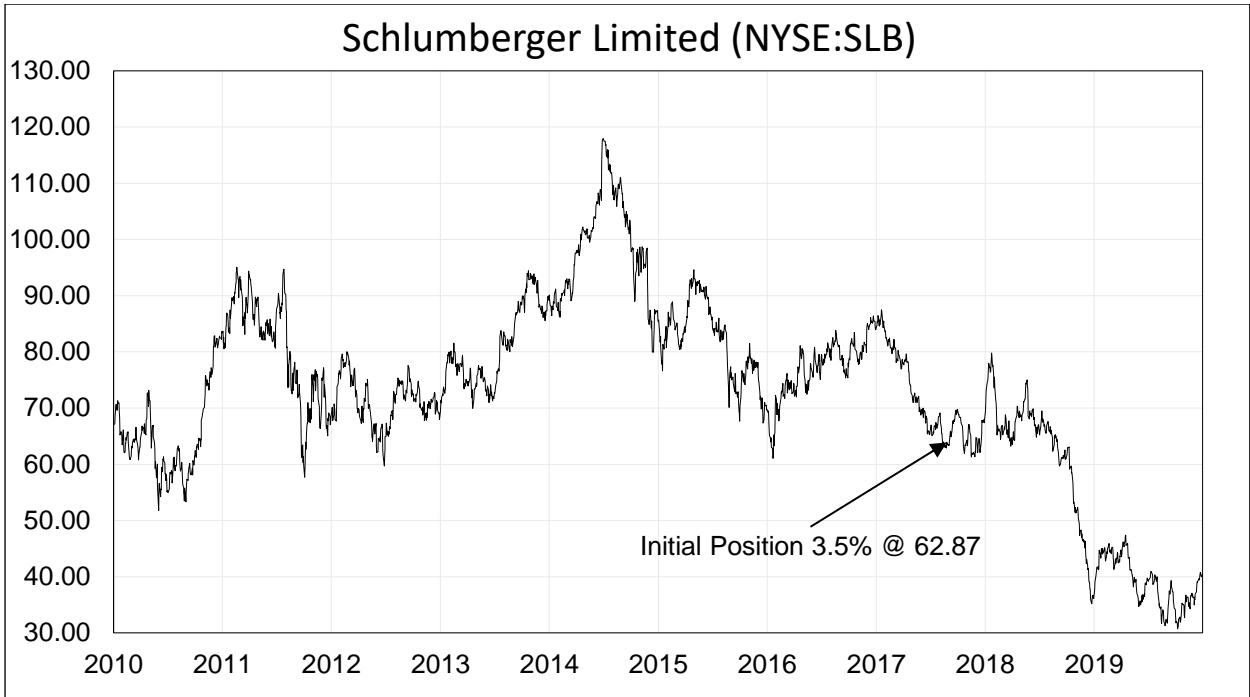
Returns (to 31/12/2019)	Fund
Since inception* (annualised)	8.5%
Since inception* (cumulative)	122.1%
Rolling 5 year (annualised)	2.9%
Rolling 3 year (annualised)	2.7%
Rolling 1 year	7.8%
Standard deviation	8.6%

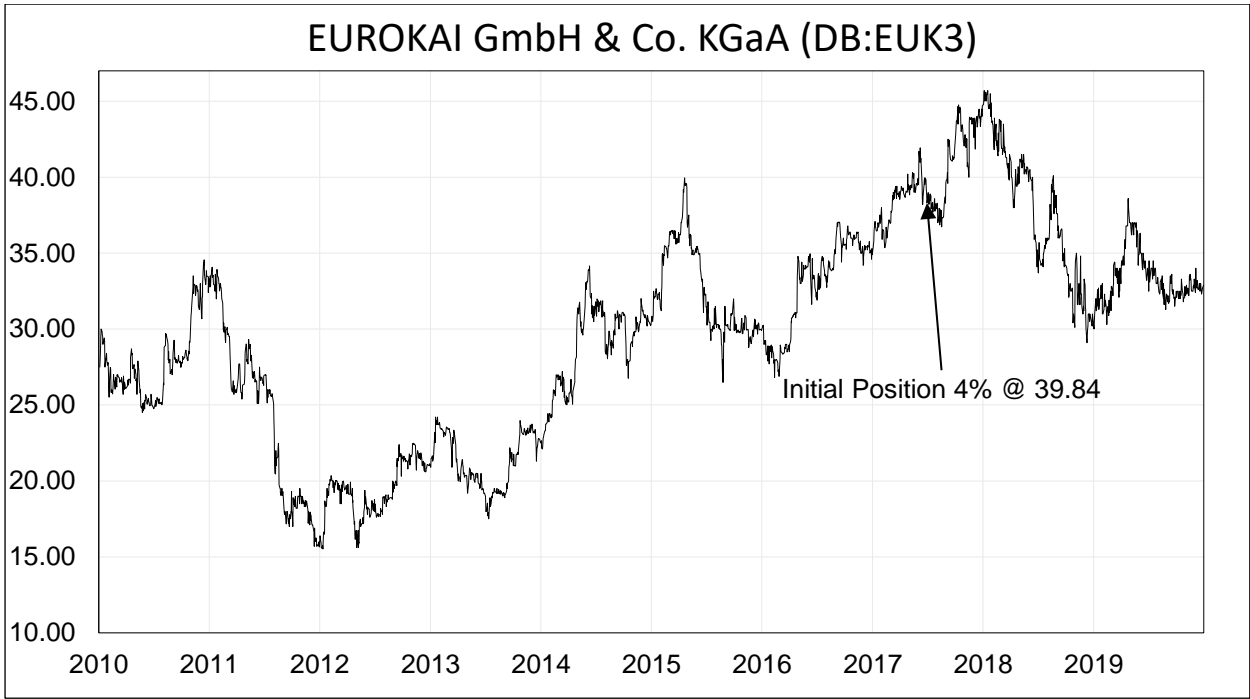
Financial Yr	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
July		1.14%	-1.95%	-3.06%	2.03%	1.98%	0.45%	-1.62%	-1.57%	4.99%	-0.35%
August		-0.33%	-0.32%	0.45%	1.42%	-0.39%	-1.39%	-0.18%	1.21%	1.50%	-1.64%
September		0.60%	-2.18%	1.89%	0.52%	4.18%	-1.19%	1.34%	3.04%	-4.26%	1.23%
October		2.12%	0.83%	1.30%	1.43%	2.53%	0.27%	-0.21%	0.56%	-1.60%	0.51%
November		0.47%	-1.22%	-2.46%	3.97%	11.10%	0.60%	4.50%	2.73%	-0.54%	1.36%
December		-0.24%	0.27%	6.93%	1.13%	3.00%	-3.07%	2.46%	0.06%	-3.05%	-0.02%
January		0.31%	0.84%	9.92%	-0.54%	0.97%	-1.77%	-5.16%	1.32%	2.20%	
February		1.78%	0.02%	2.69%	-0.81%	1.57%	1.77%	-0.59%	-1.66%	3.91%	
March		1.06%	5.59%	-0.44%	-1.45%	-0.04%	-0.84%	1.21%	-0.52%	0.53%	
April	*0.04%	-1.94%	1.62%	4.45%	0.08%	0.32%	1.72%	1.34%	1.27%	2.11%	
May	-0.78%	1.01%	-0.37%	8.63%	1.29%	0.47%	4.12%	1.84%	-0.23%	-3.64%	
June	-0.76%	-0.70%	-2.58%	1.68%	0.02%	-2.61%	-0.79%	0.37%	-1.21%	1.56%	
Financial Yr	-1.49%	5.33%	0.29%	36.06%	9.33%	24.95%	-0.31%	5.10%	4.97%	3.28%	
Calendar Yr		-3.10%	10.12%	43.95%	22.40%	-3.70%	10.76%	4.89%	-4.23%	7.82%	

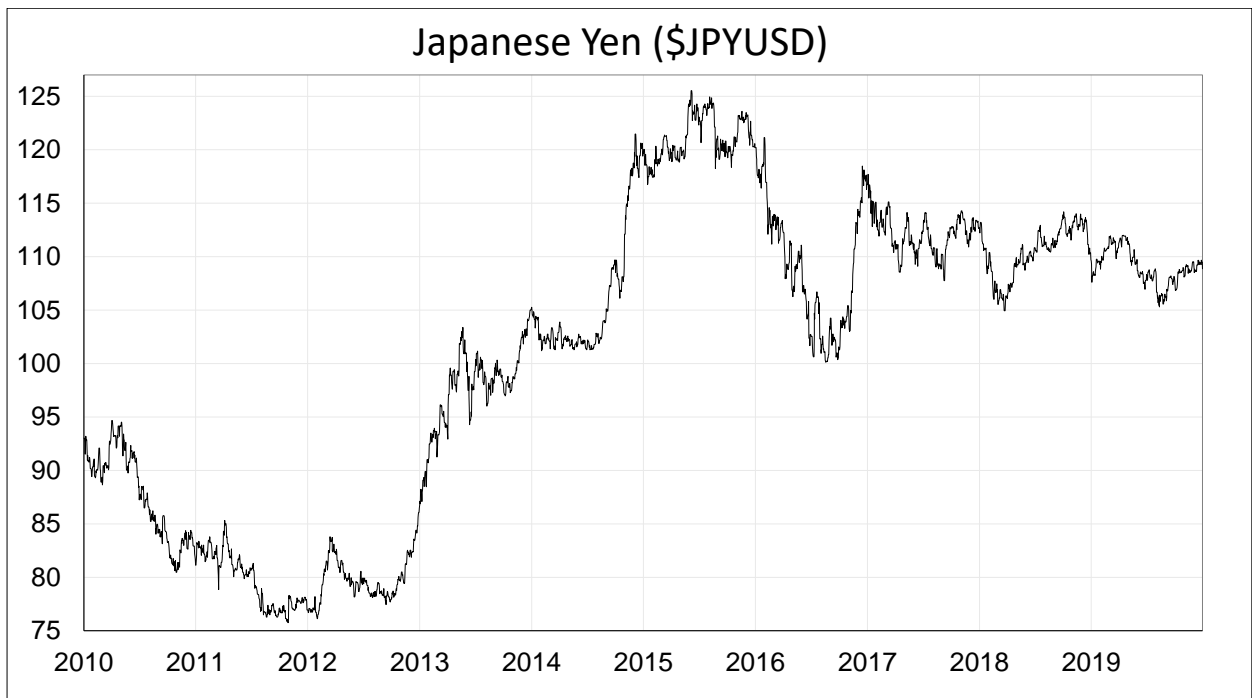
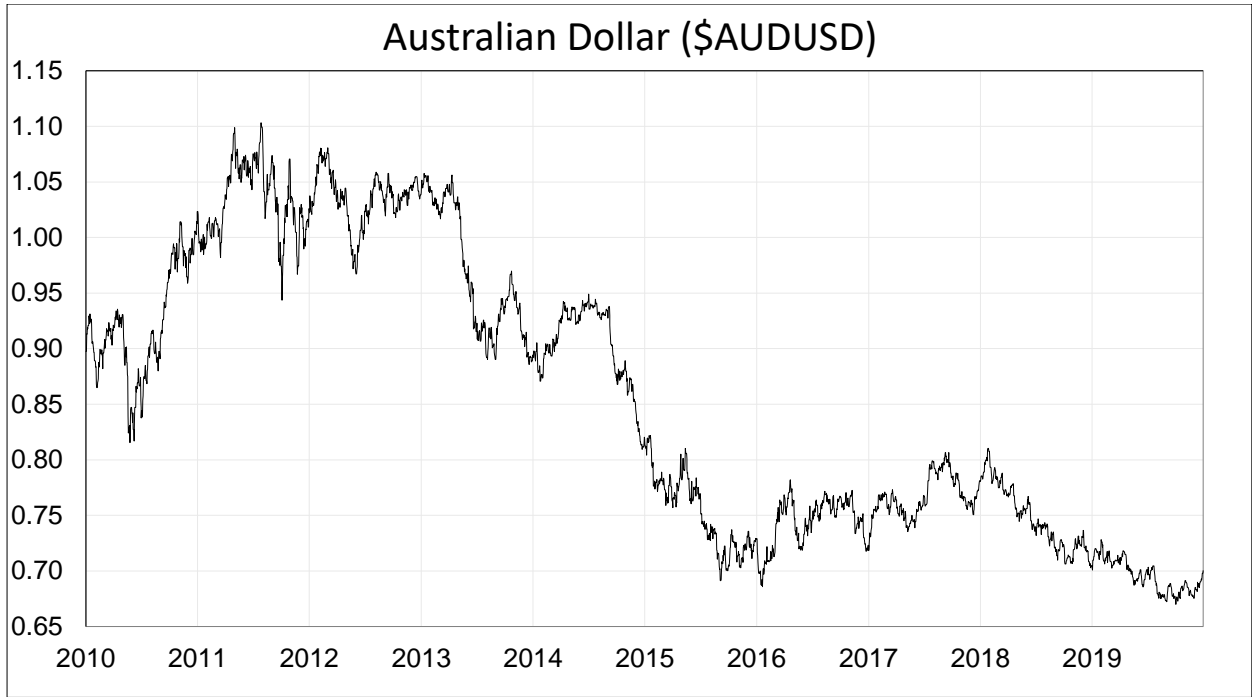
* Inception date: 15/04/2010. Past Performance is not a reliable indicator of future performance and no guarantee of future returns is implied.

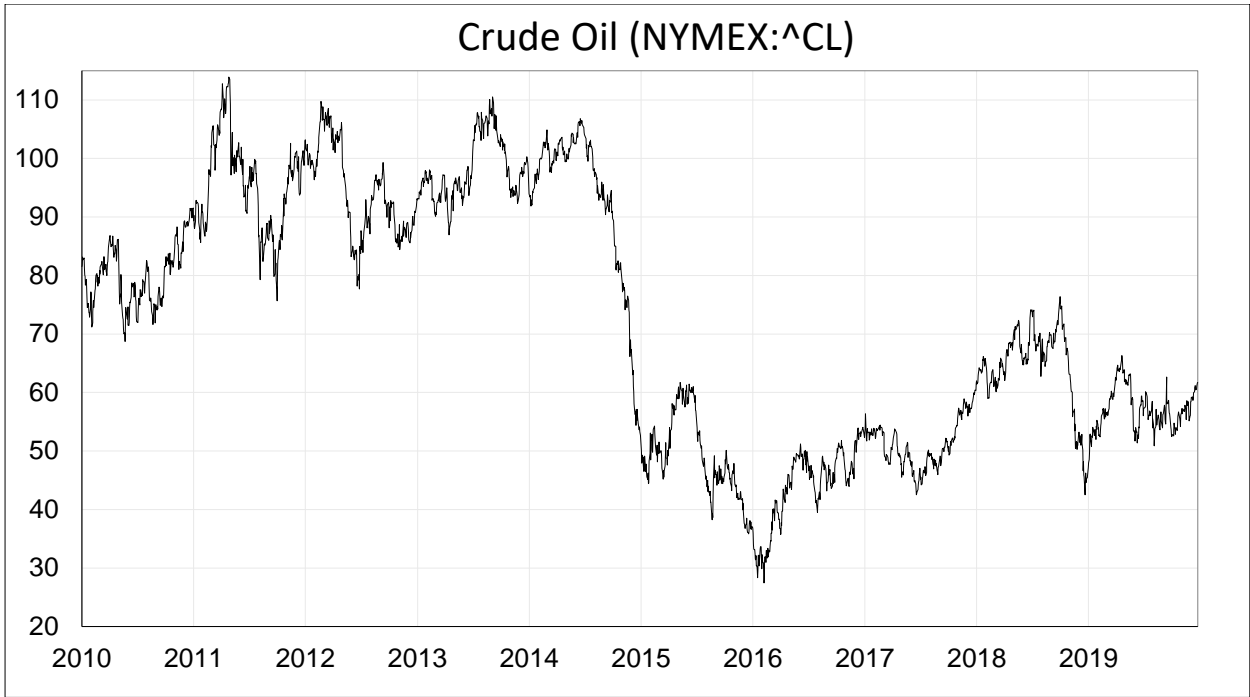
Appendix A: Chart Pack











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