PM Capital Investor Forum

May 2017

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PM Capital

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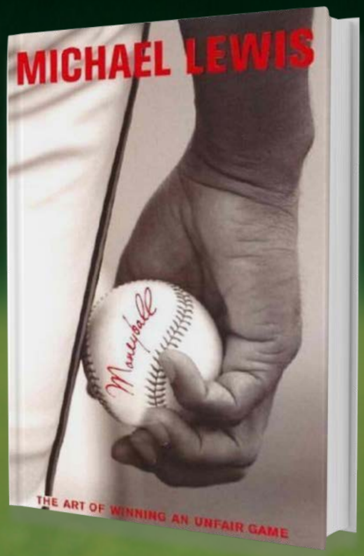
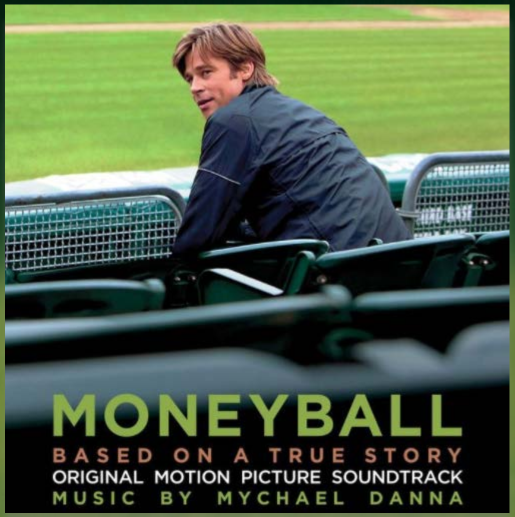
Winning fundamental *Moneyball* – making money from anomalies





Why PM Capital?

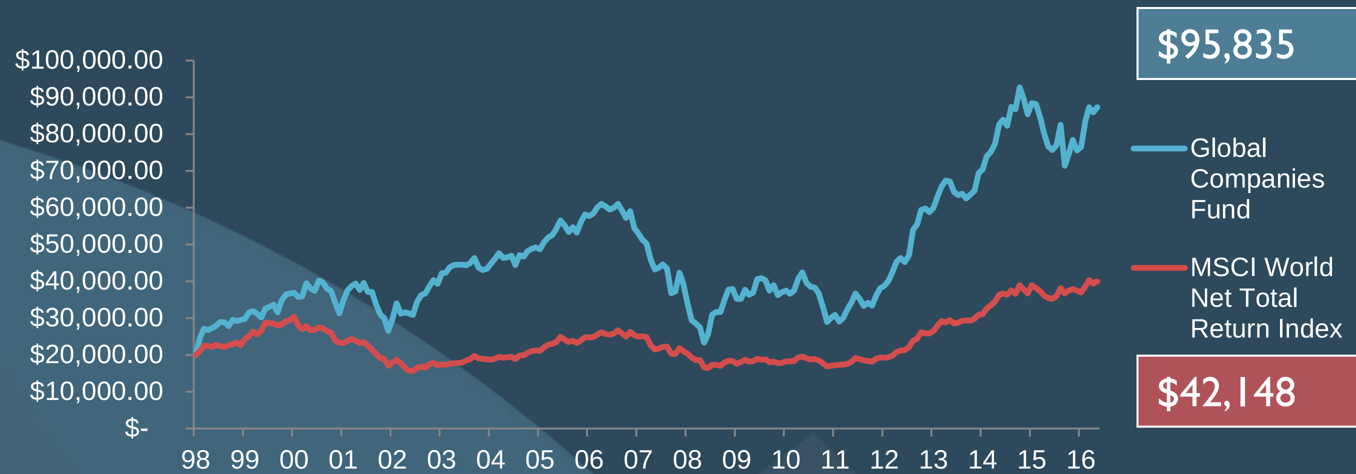
Objective: Long term performance accretion

Performance (net of fees) As at 30 April 2017	1 Year	3 Years p.a.	5 Years p.a.	7 Years p.a.	Since inception	Total return since inception
PM Capital Global Companies Fund	24.6%	14.8%	22.2%	13.0%	8.8%	**379.2%**
PM Capital Asian Companies Fund	16.5%	8.5%	13.8%	10.3%	15.9%	**268.9%**
PM Capital Australian Companies Fund	24.2%	11.2%	13.7%	10.3%	11.0%	**505.5%**
PM Capital Enhanced Yield Fund	6.3%	3.5%	4.4%	4.9%	6.1%	**145.2%**

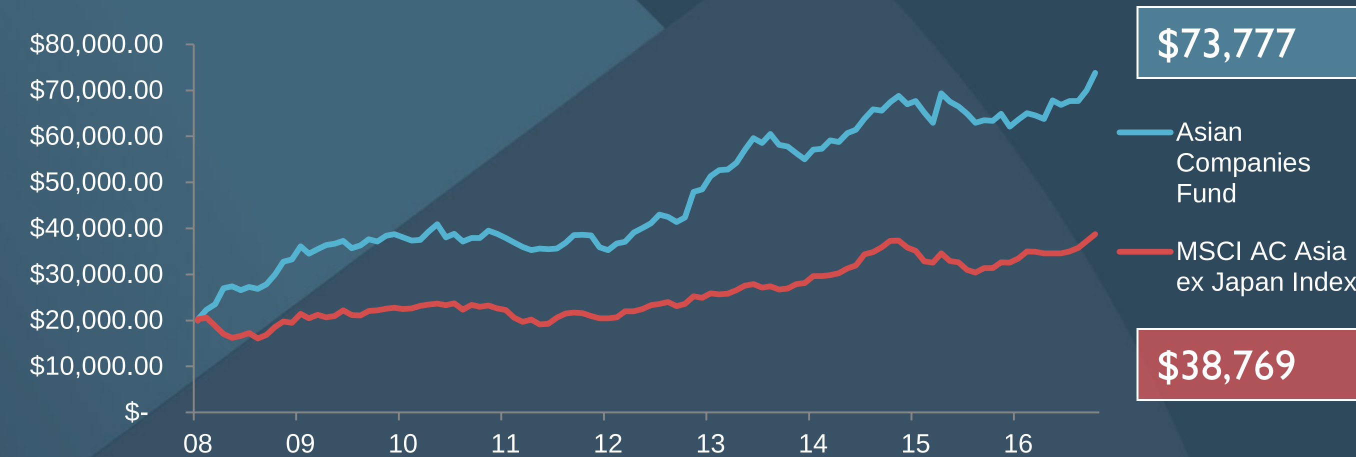
Performance calculated from Inception date for The Global Companies Fund - 28 October 1998 to 30 April 2017, The Asian Companies Fund, 1 July 2008, The Australian Companies Fund – 20 January 2000, The Enhanced Yield Fund – 1 March 2002. Past performance is not a reliable indicator of future performance

A history of after-fee outperformance...

Global Companies Fund



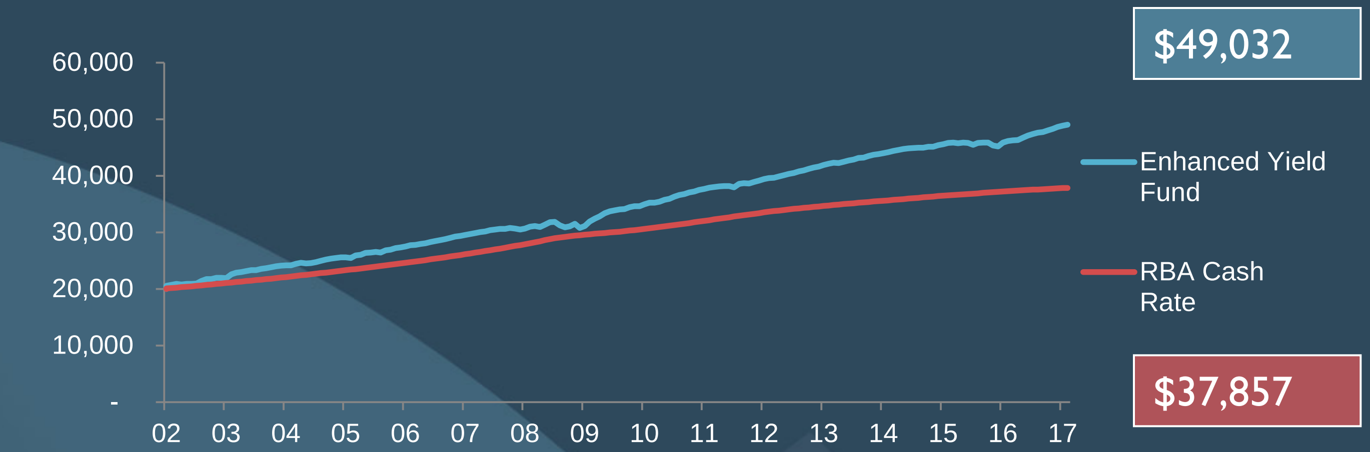
Asian Companies Fund



Performance calculated from Inception date for the Global Companies Fund, 28 October 1998 to 30 April 2017 and for the Asian Companies Fund, 1 July 2008 to 30 April 2017. Past performance is not a reliable indicator of future performance

A history of after-fee outperformance...

Enhanced Yield Fund

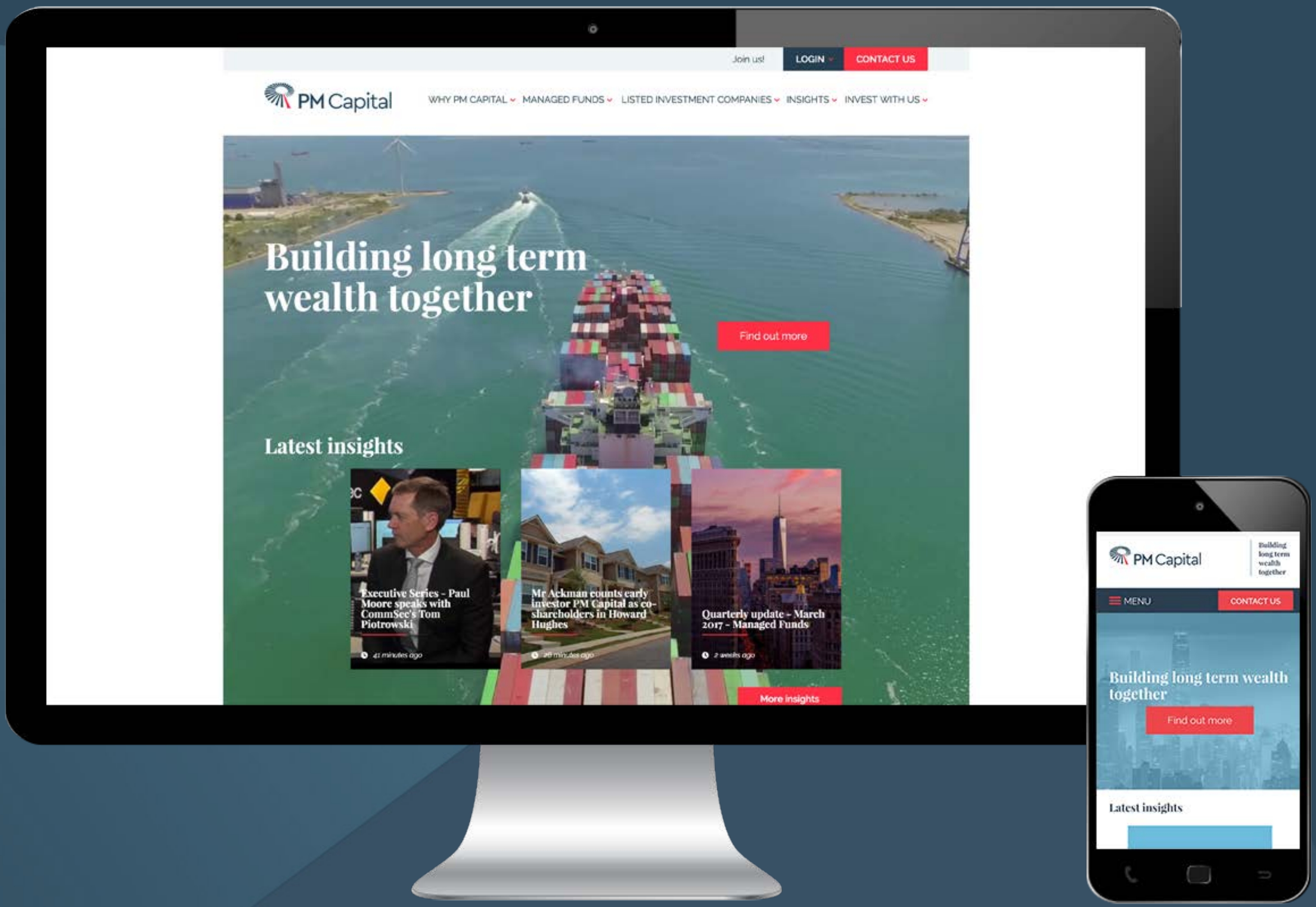


Australian Companies Fund

Performance calculated from Inception date for the Enhanced Yield Fund, 1 March 2002 to 30 April 2017 and the Australian Companies Fund, 20 January 2000 to 30 April 2017. Past performance is not a reliable indicator of future performance

Business update

Website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Mr Ackman counts early investor PM Capital as co-shareholders in Howard Hughes
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Agenda

Speakers

Jarod Dawson
Director and Portfolio Manager
Credit Strategies

30m

Paul Moore
Chief Investment Officer, Chairman
and Portfolio Manager, Global Equities

30m

Q&A 15m

Close

Jarod Dawson

Portfolio Manager
Enhanced Yield Fund

Director
PM Capital

A desire to change the game

1. Finding value

- Doing it differently
- Why search for anomalies?
- Where to look for the anomalies
- The overlooked players

2. Outlook

Changing the game

- We view risk as the risk of losing money
- Ability to be up to 100% cash – in or out of markets
- Invest globally – why be constrained?
- Exploit the capital structure
- Intense research – stick to what really matters: the facts
- Focus on the anomalies: rational when markets irrational

Good ideas are hard to find - meaningful amounts of capital in our best ideas

Investing together

Why search for anomalies?

The industry is flawed

Idea generation is based around arbitrary indices – instead of genuine investment opportunities.

- Hundreds of investments / few parameters - why?
- 5 year interest rate duration – why?
  - Interests of Issuers v Investors

Investment mandates

"baseball thinking is medieval", "asking all the wrong questions"

- Self-Constrained
  - Exploit ill discipline and herd mentality

Invest our portfolios the way we invest for ourselves

- Rarity generally implies value
- Cash + a selection of genuine investments we truly understand

Building a team
Finding value for money

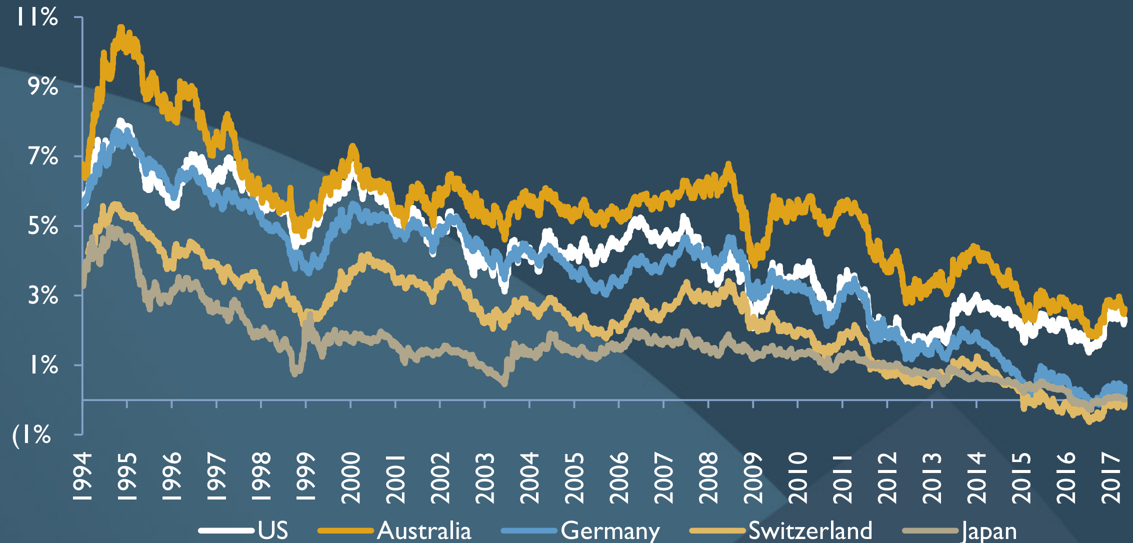
Home bias

Distressed hard assets

Rated v unrated

Listed v unlisted

The overlooked players …interest rates



Source: Bloomberg

- Germany/ Japan/ Switzerland – 10yr fixed rates still effectively 0%
- Decade of aggressive stimulus – US solid, Europe improved considerably
- Point of inflection: 2016 – pre the GFC the US cash rate ave ~5% (now 1%)
- Market convention – index with 5 year duration
- Enhanced Yield Fund positioned for higher global rates – double positive

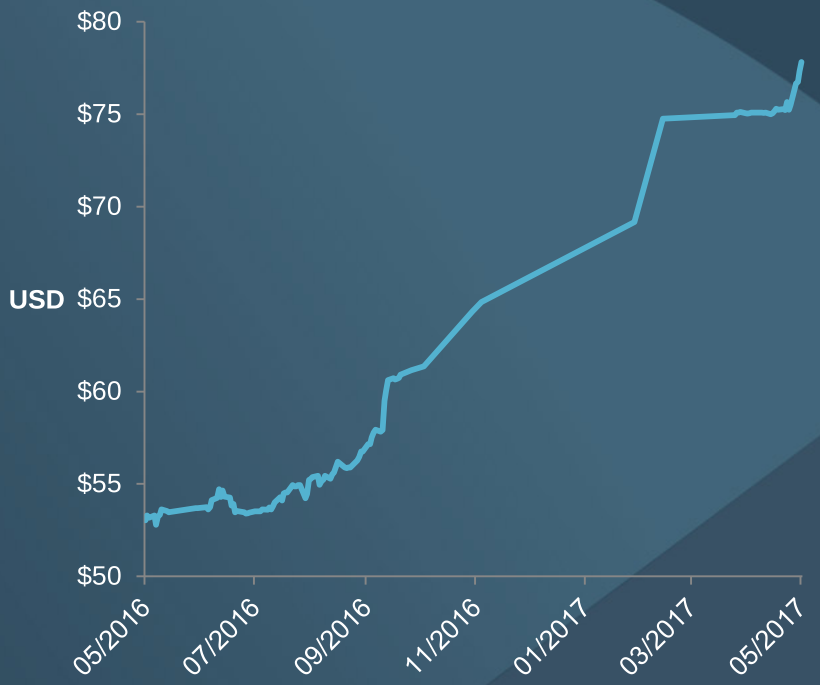
The overlooked players …USD subordinated debt

- FRNs issued by ANZ and WBC decades ago in USD – fallen off the radar
- Originally issued with tiny credit spreads - cash + 0.15%!
- Post the GFC – capital prices savaged: ⬇ 50%
- Market focused on very small coupon
- Stick to the facts
  - play on higher rates: 1% ⬆ rates = 2% ⬆ yield.
  - obsolete under Basel III

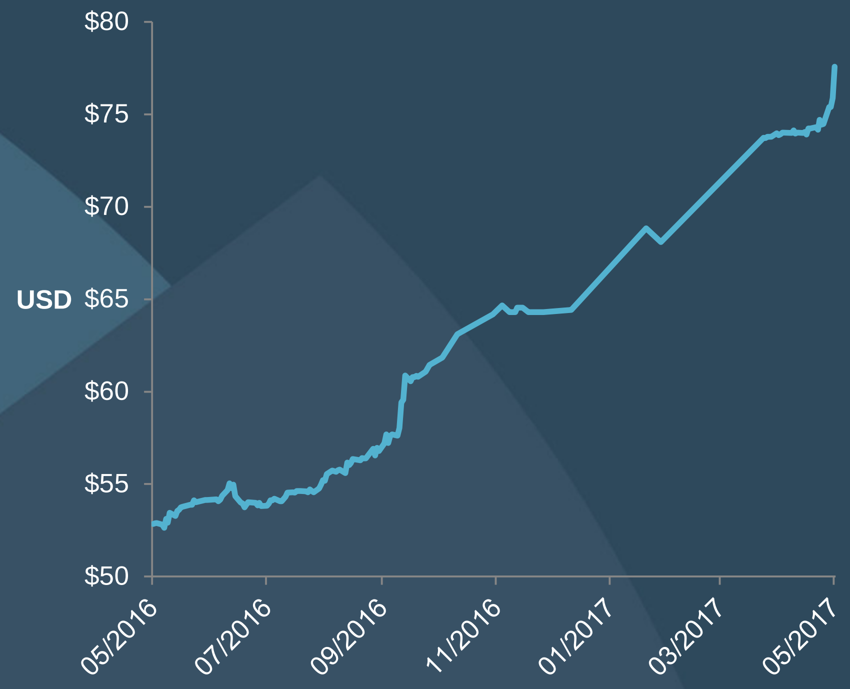
Debt investment, equity-like returns

Interest rates bottomed in 2016 – 40% return since!

Westpac Subordinated Debt (USD)



ANZ Subordinated Debt (USD)

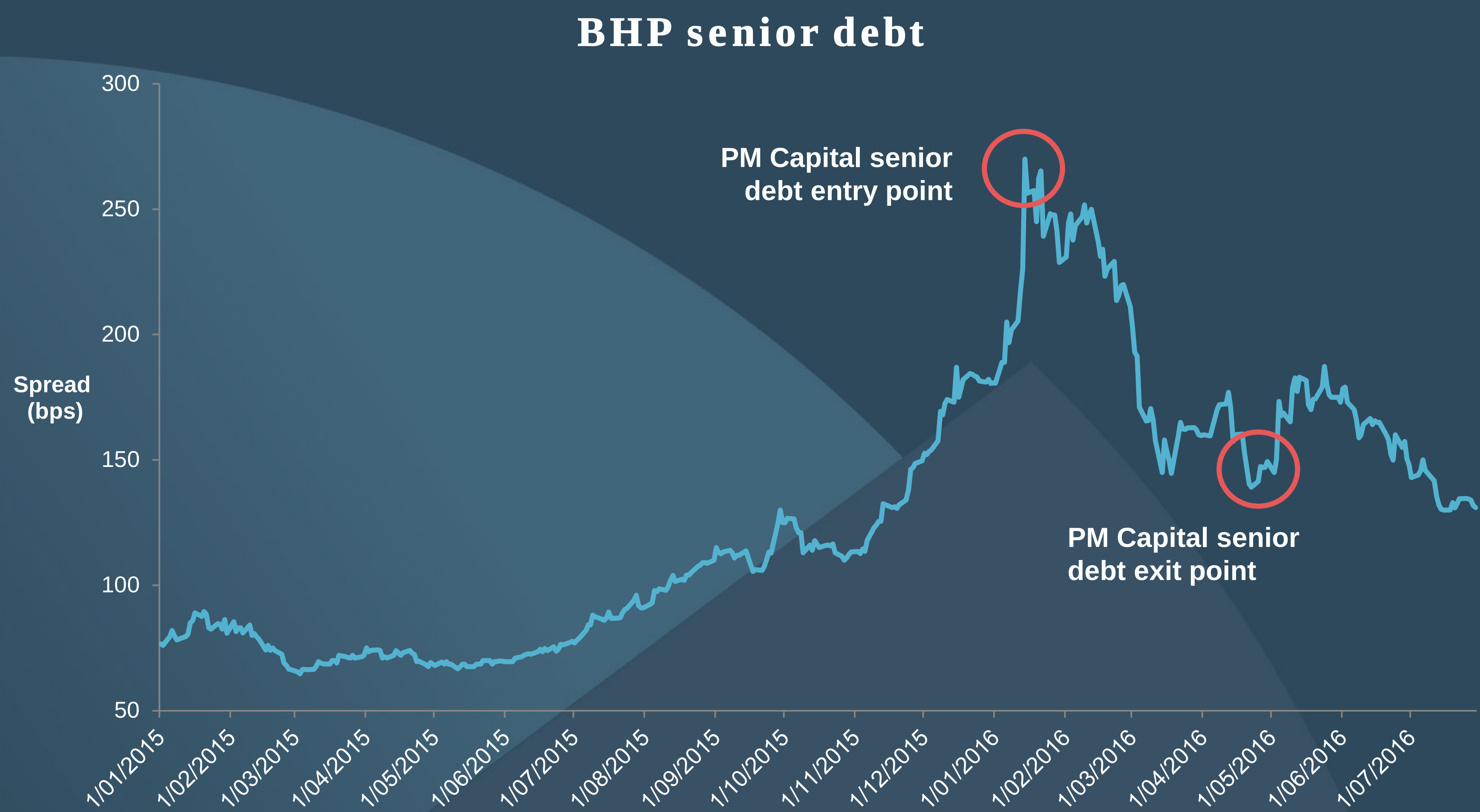


Source: Bloomberg

The overlooked players…
BHP senior/ subordinated debt

- 2015/16 – perfect storm - China scare/ oil supply shock/ Brazil mine disaster
- BHP credit spreads at distressed levels *(home bias)*
  - EUR Senior Debt — Bills + 300bp
  - USD Subordinated Debt — Bills + 600bp
- Market focussed on downside uncertainty/ noise/ capex/ dividend
- **Stick to the facts**
  - Is demand for steel going to disappear?
  - Where are iron ore prices sustainable?
  - Would have to cut capex and dividend
  - Quality business – long life mines/ seasoned management

BHP – sold after 4 months for a 7% absolute return



Source: Bloomberg

The overlooked players…
Lar Espana

- Post GFC / European Crisis chaos: Commercial property ↓ 50-70%
- Market panicking over where it will end
  - Portugal, Ireland, Greece, Spain **(PIGS)…Australia the one in the mud**

Stick to the facts - Compare the pair:

Lar Espana (Spain)	Dexus, Stockland (Aus)
Buying assets at bottom of cycle	**Commercial property at all-time highs**
8-10% yields	Sub-5% yields
Senior Secured bonds: **- We own the assets.**	**Senior Unsecured bonds:** **- No direct security**
Bills +350bp = 5.30% yield	Bills +150bp = 3.30% yield

The overlooked players... Tesco

- Unloved business – market sentiment around equity
- Market focused on profit write-downs/ accounting issues
- **Back to Basics - Turnaround Story**
    - Cleaned house - new management implementing significant change
    - 3rd largest global retailer – great brand, huge customer base
    - Earnings growing, customer satisfaction increasing, debt coming down
    - Now one of the best-performing supermarket groups globally

Bottom of the 9th
… bases are loaded

- **Higher interest rates**
  - Effectively no interest exposure + USD Sub Debt
  - Bloomberg Composite Index – 5yr duration = 10%-15% potential losses
  - Double positive if you have no interest rate duration:
    - Avoid material losses form higher rates
    - Income yield increases as market rates rise
- **Stronger credit markets**
  - US: a key driver of growth next 5-10 years – jobs/ wages/ housing
  - Corporates: 1-3% borrowings for 10yrs+
  - Europe: steadily improving

Environment for genuine stock pickers in credit

Currently seeing no shortage of opportunities to consider

Average credit spread on the Fund’s assets: ~RBA+2.25%

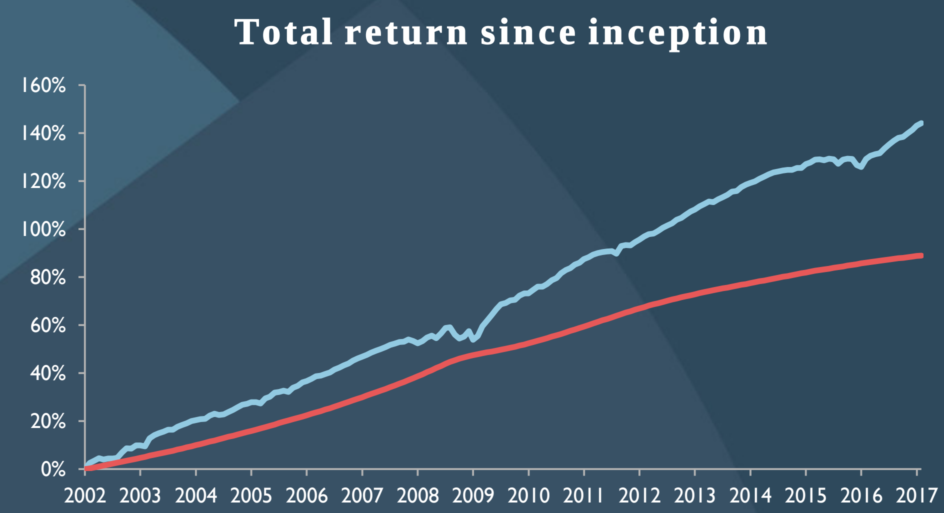
The process has to provide runs

Objective: Consistent returns, regular income

Performance (net of fees) 30 April 2017	1 Month	3 Months	6 Months	1 Year	3 Years p.a.	5 Years p.a.	Since inception	Total return Since inception
Enhanced Yield Fund	**0.4%**	**1.5%**	**3.0%**	**6.3%**	**3.5%**	**4.4%**	**6.1%**	**145.2%**
RBA Cash Rate	*0.1%*	*0.4%*	*0.7%*	*1.6%*	*2.0%*	*2.4%*	*4.3%*	*89.3%*

Winning a championship:

Generating attractive long term returns, with a low degree of volatility



Source: PM Capital. As at 30 April 2017. Past performance is not a reliable indicator of future performance. The inception date of the Enhanced Yield Fund is 1st March 2002.

Paul Moore

Portfolio Manager

Global Equities strategies

Chief Investment Officer

Chairman

PM Capital


We're Still
Proud
of you

Patience and conviction

All great investments are questioned at the time of purchase

- TMT – old v new economy
- GFC – equities v cash

"…a once in a life time opportunity to move out of cash and into debt instruments; and for those with a long term perspective straight into equities…"

Paul Moore, May 2009, Morningstar Conference

- Brewing is a no growth business
- Banks are too risky
- Las Vegas will never recover
- Mobile will disrupt the incumbents

Why invest in anomalies?

Why invest in anomalies?

From an investment perspective -

to be a successful investor you have to be doing something that others are not

Why do they occur?

- **Fear and the avoidance of pain**

  "The day after the market crashed… people began to worry that the market was going to crash." Peter Lynch, *One Up On Wall Street,* 1987

- **So what makes us feel safe?**
- **What is it that you are afraid of?**

> ***A portfolio manager for an institution…cannot afford to be an Outside Zebra. For him, the optimal strategy is simple; stay in the centre of the herd at all times. As long as he continues to buy the popular stocks... he cannot be faulted. To quote one portfolio manager: "It really doesn't matter a lot to me what happens to Johnson & Johnson as long as everyone has it and we all go down together". But on the other hand, he cannot afford to try for large gains on unfamiliar stocks that would leave him open to criticism if the idea fails.***
>
> Extract taken from *'The New Money Masters'* 1994 By John Train: Acorn Fund Report - Ralph Wagner

How does the industry overcome fear?

Perception v facts

- **Lazy research, focus on the obvious, superficial; group think**
  - *When all men think alike no one thinks very much.* Walter Lippmann, 1915

Perception v facts

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Perception v facts

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- ***"Good looking ball player"* = brand name/ blue chip**
- **"*If he's a good hitter why doesn't he hit good?"***
  - Consumer revenue growth

Perception v facts

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  - *When all men think alike no one thinks very much.* Walter Lippmann, 1915
- ***"Good looking ball player"* = brand name/ blue chip**
- **"*If he's a good hitter why doesn't he hit good?*"**
  - Consumer revenue growth
- **Not always what it seems**

Short term focus

Severe cyclical change

- Banking has to survive
- Land values long term reflect economic production
- Financial transactions are the basis of our capitalist system
- Gambling; since the dawn of time

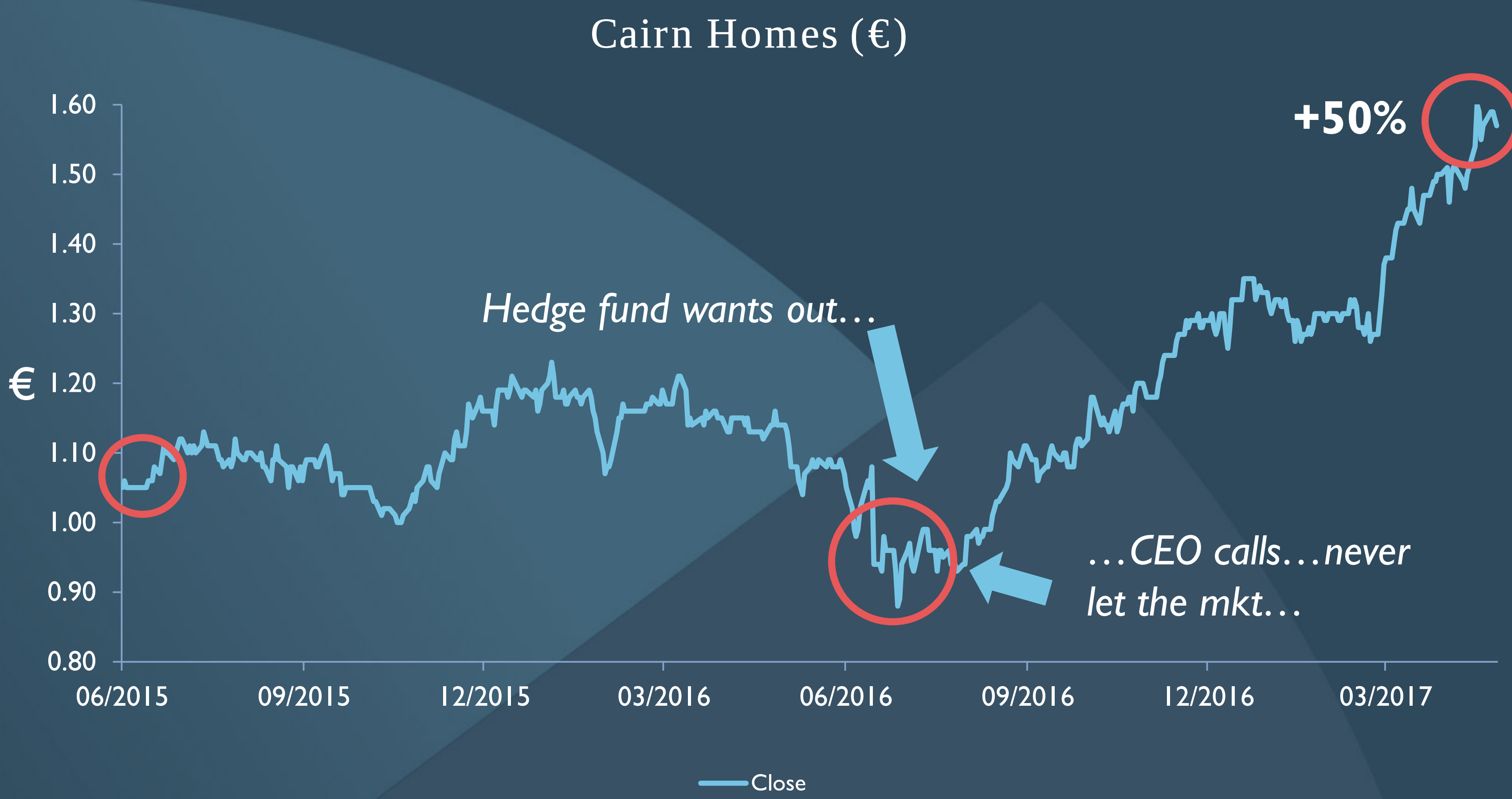
Secular change

- Desk top v Mobile
- Globalisation (Brewing)
- Capital and Dividends (Banking)

Distractions

- Administration/ superannuation/ regulation
- Macro – Brexit

Las Vegas (Howard Hughes) … to Ireland to Spain (Hispania)



Source: PM Capital, Bloomberg

Conflict/ misunderstanding

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"People who run ball clubs, they think in terms of buying players. Your goal shouldn't be to buy players (raise funds), it should be to buy wins (businesses that will give your required return on your capital)…"

Source: Moneyball

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"When I see Johnny Damon, what I see is an imperfect understanding of where runs come from…"

Source: Moneyball

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Why co-investment is so critical

How do you find anomalies?

- Insight, judgment and intuition
  - Brewing
  - Banking
  - Monopoly service providers
  - Macau
  - Alternative asset managers

- Investing can't be reduced to an algorithm or a mechanical process.

What gives you the conviction to invest?

What is the objective?

What is the problem?

What gives you the conviction to invest?

What is the <u>objective</u>?

What is the <u>problem</u>?

If you don't know what you are looking for, hard work won't find it

Background research is key

You need to ask the right questions

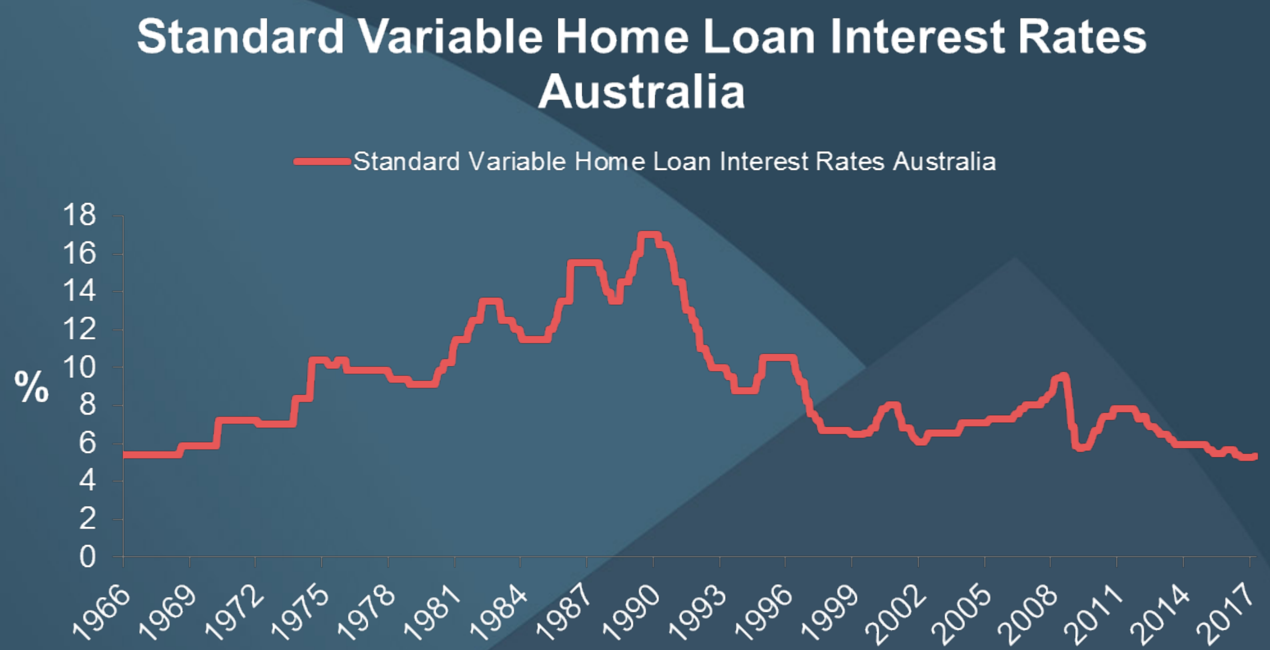
- You need to be focused both in the number of opportunities and the specifics of your research
- Better to know a lot about a little than a little about a lot

When do I pull the trigger?

- You will never know the exact time – but it has to be based on valuation as valuation is what protects you
- Understand how the plumbing works
  - Buying: Las Vegas access to bank credit
  - Selling: Alternatives – corporatisation
- Most importantly, trust your instincts and back your convictions
- Never let the opinion of the crowd stop you from acting on what you know to be right

Bondnado

June 1989 17% SVR



Source: RBA

- May 2017 -0.3% VR HSBC (FRANCE)

The theory of evolution – Charles Darwin

- **Australian residential property**
  - 1988 - **Mortgage risk weight dropped to 50%**
  - 2007 - Mortgage risk weight calculated using internal models - RWA drops to ~15%
  - 2007 - Borrowing to purchase property allowed for SMSFs

    + Open slather for foreign investors

    = the perfect storm

2016: APRA announces 25% average RWA for mortgages - banks increase interest rates

2017: first home buyers can access super – politicians vs plumbers

The more subtle anomaly

- Passive investing
- Distributors and regulators driving at full speed ahead
- Dominate flows and free float
- Not based on valuation
- Everyone will own the same assets!
  - Where all people think alike!
- The capitalist system will break down?
- Correlated with bond yields!
  - So if rates have inflected?

“*Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.*”

John Maynard Keynes

“Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.”

John Maynard Keynes

Investing in businesses at a discount to their inherent value (anomalies) is business common sense

How is the portfolio placed?

Global Brewing	Industry consolidation; 2003 – 2016+
Post GFC Housing Recovery	Las Vegas + Ireland + Spain; 2009+
Domestic Banking	From crisis comes opportunity; 2009+ Global CBA equivalents; yield
Service Monopolies	A good business at a good price; 2011+ Google/ Visa/ Chicago Mercantile Exchange
Pharmaceutical	Severe cyclical downturn; R&D productivity; 2012+
Macau	Severe cyclical downturn; 2015+
Alternative Investment Managers	Severe cyclical downturn; 2015+

Genuine long term opportunities

Simple ideas, simple businesses, multiple iterations

Conclusion

- It’s not easy - you have to work hard and wait for the genuine anomalies to appear and you must have conviction because…

Conclusion

- It's not easy - you have to work hard and wait for the genuine anomalies to appear and you must have conviction because…
- The best ideas always come at a point of maximum uncertainty.

Conclusion

- It’s not easy - you have to work hard and wait for the genuine anomalies to appear and you must have conviction because…
- The best ideas always come at a point of maximum uncertainty.
- That is how we believe you can genuinely add value over the longer term

PM Capital Limited

Rebecca Morgan

Sales Director

PM Capital

Q&A

PM Capital

A differentiated approach

High conviction / unconstrained / benchmark unaware

- A different risk reward proposition to the market

Investing from an Australian perspective

- Tax and currency are part of the equation

Alignment through co-investment

- Investors not fund gatherers
- We invest as we believe

Genuine client diversification

- Model portfolio

Award winning high conviction manager applying conistent process to deliver excess long term returns

Thank you