



INVESTING GLOBALLY FOR OVER 15 YEARS

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# THEMATIC:

## FROM THE BOTTOM UP

AUGUST 2015

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## Thematic investing...

The notion of a thematic approach to investing has appealed to many advisers and investors over the years. Largely, the appeal of thematic funds has been in the simplicity and logic of the investment proposition - easy to explain and easy to understand. However, many investment funds that have taken this path have disappointed in terms of delivering investment outcomes. It is difficult to distil the challenges down to a single issue; however the most obvious is the use of macro-economic models as part of the investment process given the sheer number of variable inputs, which make the investment process incredibly complex.

## Investment themes and PM CAPITAL...



**“ Usually there are only a few worthy investment ideas at any point in time. Finding a good idea is the hardest part. When we find a good investment idea we search the globe to see where else that idea may play out. ”**

Paul Moore, PM CAPITAL Chairman and Chief Investment Officer

At PM CAPITAL, we take a different investment approach. We apply fundamental research at the company level, which typically leads to a portfolio dominated by four or five investment propositions, represented by 20 - 35 stocks. We are often asked how fundamental stock picking can lead to such a thematic portfolio. In explanation, we prefer to invest in good businesses at a time when their share price is at a significant discount to their long term valuation. Typically this means investing at a time when there is negative short-term news at a macro, industry or company level. What we have noticed over the last 17 years since PM CAPITAL's inception is that when a business' share price trades at a significant discount, it often points to a broader industry based issue. The connected nature of global markets means on that many occasions this has led to the discovery of other similar investment opportunities. One simple investment idea has been applied across an industry and then replicated globally in various economic jurisdictions.

# Industry Focus...

One example of a global thematic idea stemming from fundamental research has been our numerous investments in brewers from around the globe over the last 12 years.



Paul Moore and Staropramen Brewery's brew master, part of Interbrew's Czech Business | April 2004

**“ Being a dominant brewer within a specific geography can be a wonderful business. Consistent demand and an ability to raise prices in line with inflation can create a cash machine (as there is no need to re-invest in fixed assets), and return on invested capital can be impressive. Producing the amber fluid can be like digging up gold. ”**

PM CAPITAL Quarterly Report - 2004

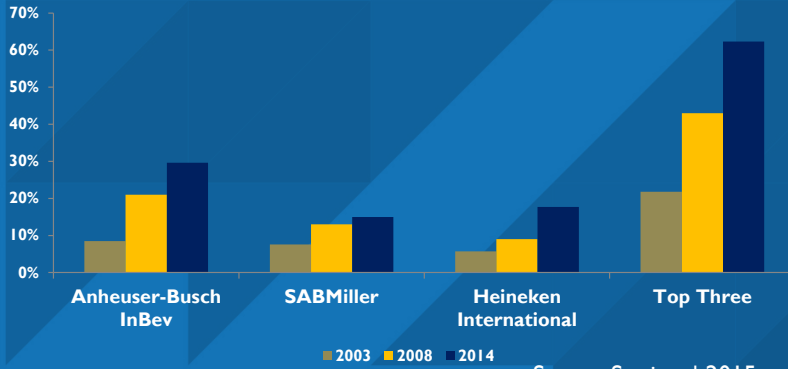
The global brewing industry has transformed dramatically over the past 15 years, from a period of flat returns due to poor expansion efforts in the 1990's. By the early 2000's, many firms had acquired beer assets (mainly in Eastern Europe) for high prices and with significant debt on their balance sheets. They were unable to manage the excessive costs out of the businesses they had acquired which in turn, stilted earnings growth. In fact, many of the beer stocks corrected up to 50 per cent, which created the initial buying opportunity. The majority of these companies were family controlled, so post the correction they restructured management and implemented an owner operator approach. This new structure successfully incentivised executive teams to reduce costs, increase free cash flow and reduce debt.

Our strategy over the succeeding years was to focus on a duopoly beer structure in a given region, with intent to purchase a business, once its price had declined to around 12 times earnings or lower. Our view was that this earnings multiple threshold indicated that investors had given up any expectation of meaningful earnings growth. Contrary to this consensus thinking at the time, our assessment indicated that the new owner operator structure should allow these companies to buy out the best assets in the market and improve earnings over time. Hindsight reveals their success in achieving this goal.



# A consolidated lager

## TOP THREE BREWING COMPANIES BY MARKET SHARE FROM 2003-2014



Source Statista | 2015

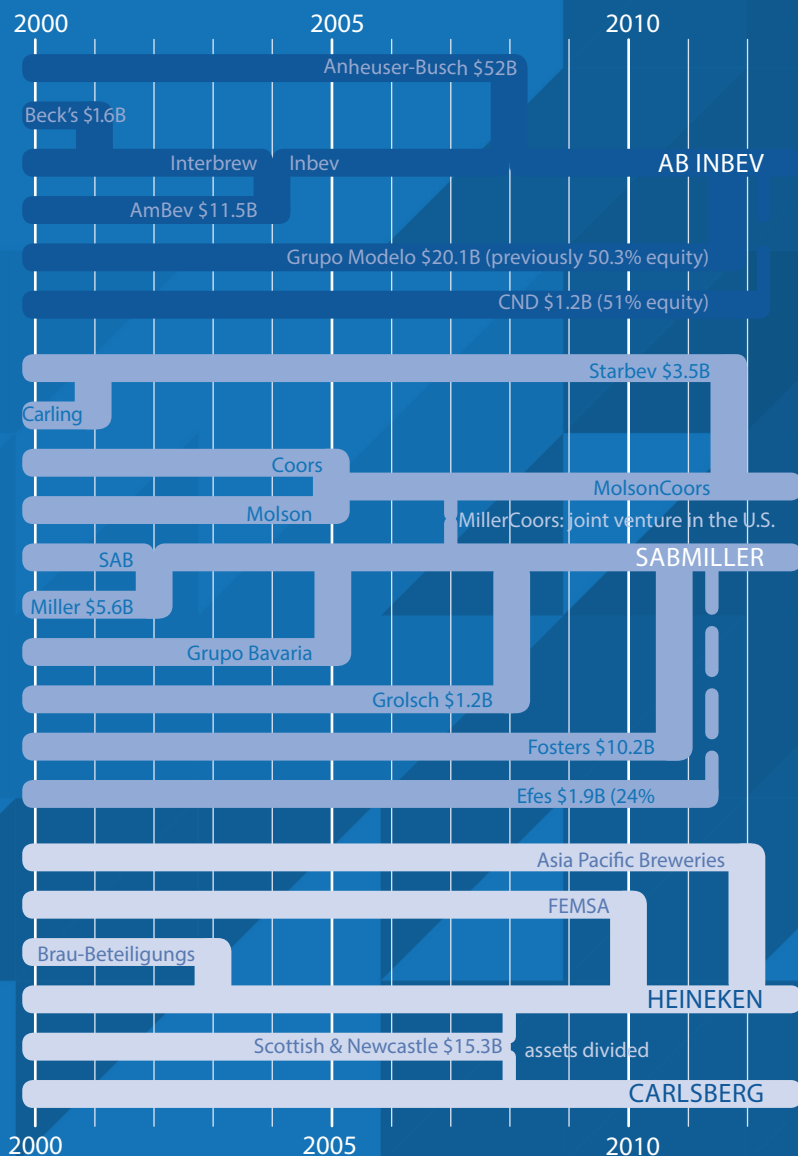
Over the last decade, the brewing industry has evolved from a very local trade and continues to move towards the end game of a global duopoly. This trend has continued to result in global sales being dominated by just three firms: AB InBev, SABMiller, and Heineken.

Our thesis originally began with one of AB InBev's precursor firms, AmBev, itself a merger of the Brazilian firms Brahma and Antarctica in 1999. At the time Ambev was the largest brewer in Brazil with 70 per cent market share in a duopoly market and a management team that was owner controlled, which meant zero based budgeting (low costs) and high earnings before interest, tax, depreciation and amortization (EBITDA) margins and returns. They were the protégé of 3G (a private equity firm), which is a group of Brazilians that subsequently teamed with Warren Buffet on Burger King and Hienz.

Within several years the firm had merged with Belgium's Interbrew, making it the world's largest brewer, and the stock of the combined firm, InBev, rose 40 per cent during 2005. As seen above Anheuser-Bush InBev is now the dominant player in the beer market with 30% global market share.

The chart to the left highlights some of the key ownership changes made by the four largest firms from 2000 to 2012 (focusing on those valued at over \$1 billion).

## INDUSTRY TAKEOVERS





# PM CAPITAL GLOBAL COMPANIES FUND HISTORICAL POSITIONS

	JUN 04	JUN 05	JUN 06	JUN 07	JUN 08	JUN 09	JUN 10	JUN 11	JUN 12	JUN 13	JUN 14	JUN 15
EUROPE												
Ambev	2%	 <b>A</b> <b>ambev</b>										
Interbrew/ Inbev	3%	3%	3%	3%	2%	3%	4%	5%	4%	3%	2%	2%
Carlsberg	5%	3%	2%									
Scottish & Newcastle PLC			3%	3%	 <b>C</b>							
Heineken Holdings		2%	4%	6%	7%	5%	5%	5%	5%	3%	3%	3%
SAB Miller									2%			
AMERICAS												
Anheuser Busch Cos Inc			3%		5%							
Molson Brewing	2%											
FEMSA					1%		<b>FEMSA</b>					
Grupo Modelo					4%	3%	2%					
ASIA												
Kirin Brewery	2%	3%		2%								
Asahi Breweries	2%	4%	4%	2%	2%	2%	2%					
HiteJinro					1%	1%	1%	1%	1%			
TOTAL EXPOSURE	16%	15%	16%	19%	22%	14%	14%	11%	12%	6%	5%	

A. Merger with Interbrew

B. Merger with Coors

C. Acquired by Heineken & Carlsberg

D. Merger with InBev

E. Beer business sold to Heineken

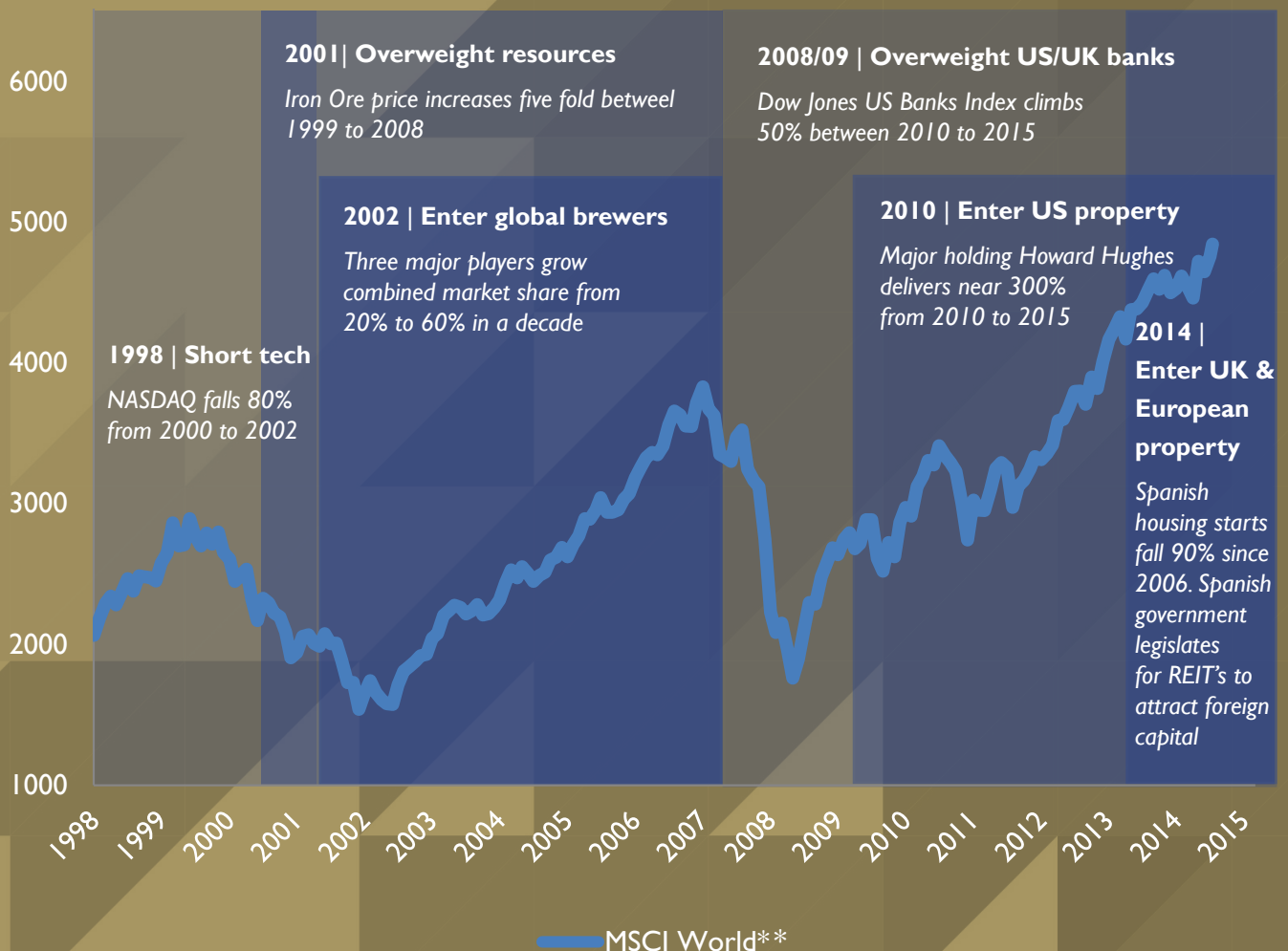
F. Acquired by Anheuser Busch Inbev

As demonstrated above, what started as a small interest in a South American brewing company that appeared to be severely mispriced, became an important theme in our portfolio over 12 years. Over this period we have seen the consolidation of one of the world's oldest industries, where the three major players have grown their combined market share from 20% to more than 60%.

# A history of fundamental themes

As the graph below demonstrates, several fundamental based themes have dominated our portfolios over time. These have included the shorting of technology stocks in the late 90's, long positions in resource companies from the early 2000's, the brewers of the last 12 years, regional banks, residential and commercial property post the GFC crisis and now futures and stock exchanges. In every instance, they all started with one small fundamental investment thesis, which reverberated across the entire industry and eventually across the globe. Another key proof point stems from the abnormally high number of take-over offers, with an average of two to three takeover bids each year across our portfolio since inception in 1998.

While past performance is not an indicator or guarantee of future performance, our experience has shown that our in-depth research at a company level and across the industry value chain has provided great comfort. Although it may take some time for the investment thesis to manifest and there may be short to medium term volatility along the way, in the long-term our conviction in the fundamentals has delivered investors 250%\* after fees more than the MSCI World Index since the inception of the Global Companies Fund 17 years ago.



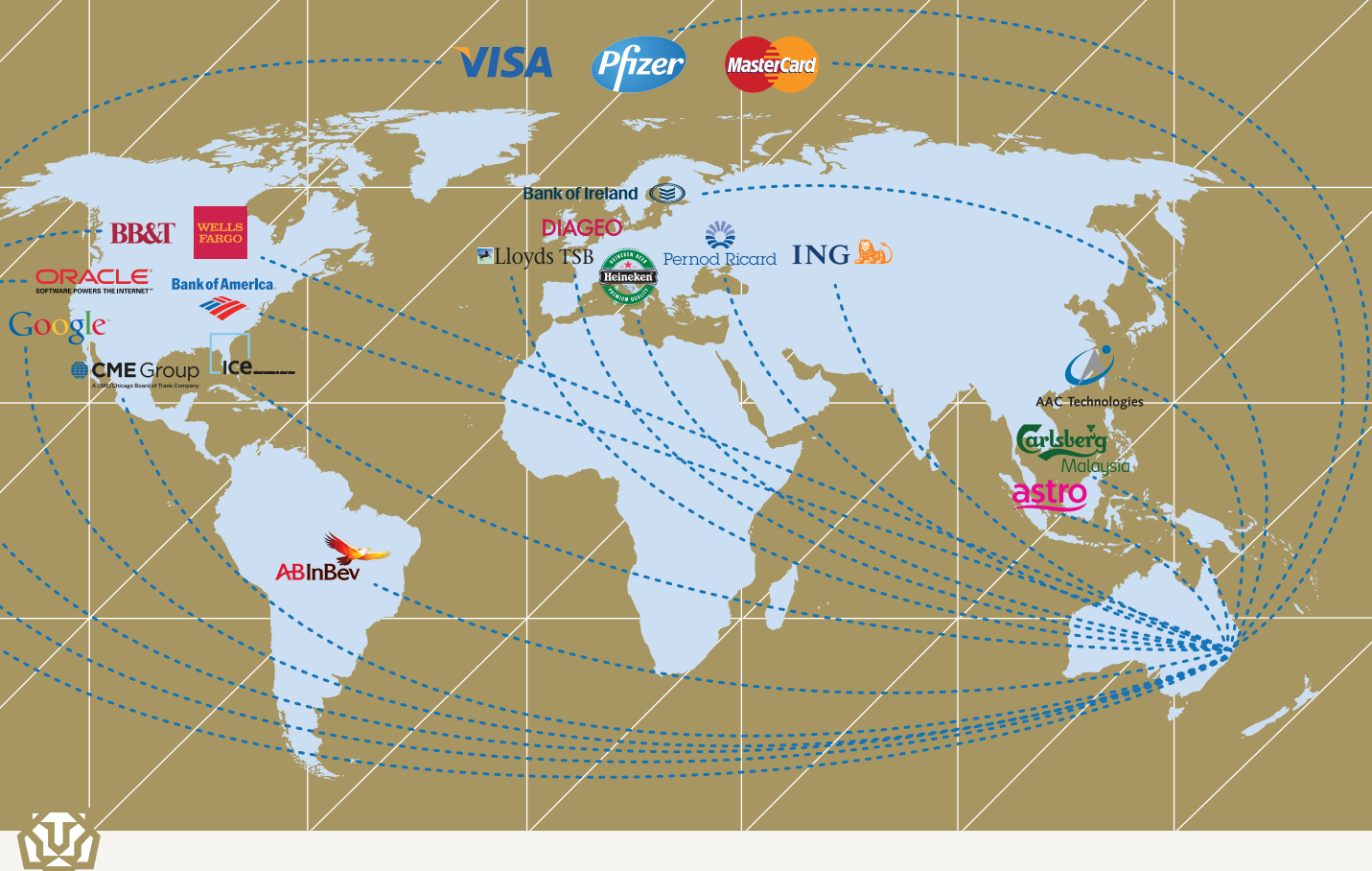
# Current portfolio themes

The global themes dominating our global portfolio currently (as at 31 July 2015) include:

	<b>UNITED STATES</b> ENTRY POINT ONE	<b>UNITED KINGDOM</b> ENTRY POINT TWO	<b>EUROPE</b> ENTRY POINT THREE
<b>POST GFC PROPERTY RECOVERY</b>			
<b>Region/Country</b>	Las Vegas	Ireland	Spain
<b>Investment type</b>	Residential	Residential and commercial	Residential and commercial
<b>Holding example/s</b>	Howard Hughes, Realty	Hibernia	Hispania
<b>DOMESTIC BANKING FRANCHISES</b>			
<b>Holding example/s</b>	Wells Fargo	Lloyds	ING, Bank of Ireland
<b>FUTURES EXCHANGES</b>			
<b>Holding example</b>	CME Group, Intercontinental Exchange		Deutsche Börse

If you are looking for an investment manager that takes a simple investment approach, invests in business that can be understood and communicates with its investors on a regular basis, we encourage you to visit our website at [pmcapital.com.au](http://pmcapital.com.au), and seek further information from your financial adviser or research consultant about PM CAPITAL's investment funds.

# A world of opportunity for Australian investors



## RESPONSIBLE ENTITY

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## IMPORTANT INFORMATION

This Report is issued by PM CAPITAL Limited (ABN 69 083 644 731 AFSL 230222). It contains summary information only to provide an insight into how we make our investment decisions.

This information does not constitute advice or recommendations, and is subject to change without notice. It does not take into account the objectives, financial situation or needs of any investor which should be considered before investing. Investors should obtain and consider a copy of the current Product Disclosure Statement (PDS) which is available from us, and seek their own financial advice prior to investing. The PDS explains how the Net Asset Value of the funds are calculated. Past performance is not a reliable guide to future performance and the capital value and income of any investment may go down as well as up due to various market forces.

\* Returns for the PM CAPITAL Global Companies Fund (ARSN 092 434 618, 'Fund') are calculated from exit price to exit price assuming the reinvestment of distributions from Inception Date to 31/07/2015 and represent the combined income and capital return. Inception Date was 28/10/1998. The stocks mentioned in this Report were held by the Fund as at 31 July 2015. They are provided for illustrative purposes only, and are not recommendations, and may, or may not, be currently held.

\*\*The Index is the MSCI World Net Total Return Index in Australian dollars, net dividends reinvested. See [www.msci.com](http://www.msci.com) for further information on the Index.

The stocks mentioned in the above graphic were held by the Fund as at 31 July 2015. They are provided for illustrative purposes only, and are not recommendations, and may, or may not, be currently held.