

2018 Results Conference Call Transcript

Monday 20 August 2018 at 10:30am

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Presenters:

Mr. Robert Luciano (Director of VGI Partners Global Investments Limited, Managing Partner and Portfolio Manager of VGI Partners Pty Limited)

Mr David Jones (Chairman of VGI Partners Global Investments Limited)

Ms Victoria Arthur (Investor Relations Manager of VGI Partners Global Investments Limited)

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Presentation:

Mr Robert Luciano:

Good morning and welcome to the 2018 results conference call for VGI Partners Global Investments Limited.

I'm Robert Luciano, the Managing Partner and Portfolio Manager of VGI Partners. With me in the room is Douglas Tynan, David Jones, Chairman of VG1, and Victoria Arthur, VG1's Investor Relations Manager. We also have Robert Poiner dialling in from our New York Office on the line.

On behalf of VGI Partners and the Board of VG1, I'd like to thank you all for your support to date. As many of you know, prior to listing VG1 in September last year, VGI Partners' investment strategy had only been accessible to wholesale investors. We've been very pleased with the response to the IPO and the ongoing support of VG1 since listing.

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Please refer to page 3 of the presentation deck.

SYDNEY

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The investment company reported an inaugural \$47.4 million operating profit before tax for the circa nine-months since listing to June 30 which equates to a net earnings per share after tax of 16.93 cents.

Underpinning the result was a +9.2% increase in the value of the investment portfolio, after tax and all fees. On an annualized basis this is comfortably within our return target of 10-15% per annum through the investment cycle.

VG1's strong investment performance was achieved with an average cash holding of 68% during the period.

The VG1 share price increased +13.5% from \$2.00 at listing to \$2.27 as at 30 June 2018. The shares have traded during those 9 months at an average 4% premium to post-tax NTA.

We do note more recently that VG1 has traded at more substantial premiums of up to and above 10%.

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Now please refer to page 4 for an overview of the topics we will be covering this morning.

- Firstly, and this is primarily for those of you who have not heard directly from us before, I will provide some background on VGI Partners, including our investment philosophy and our historical performance;
- We will then look at the performance of the VG1 portfolio for the period to 30 June 2018;
- Then there will be some general market commentary;
- I'll then hand over to VG1 Chairman, David Jones, to explain what VGI Partners is doing to ensure a continuing alignment of interests between the Manager and investors;
- Then our Investor Relations Manager, Victoria Arthur, will say a few words about shareholder engagement;
- Finally, there will be an opportunity to ask questions.

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Turning to page 5:

- VGI Partners is a fund manager specialising in global listed securities.
- We now have 20 staff across offices in Sydney, New York and Tokyo. We recently hired a Head of Asian Research, based in Tokyo, to improve our research capability in the Asian region.
- VGI Partners deploys a single investment strategy across all our Funds and managed accounts. I'll explain our investment philosophy in more detail shortly.
- Our investment strategy is closed to new investors. Therefore, the only way to gain access to VGI Partners is by investing in VG1 shares. We believe that this not only differentiates us from other fund managers, but also creates "scarcity" which should continue to provide after-market support for VG1 shares.

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Turning to page 6 of the presentation.

Our mandate is to invest primarily in global equities, comprising Long investments, Short positions and cash. Our investment philosophy reflects the following three key tenets:

Capital preservation – that is, do not lose money.

We are extremely focussed on avoiding any permanent loss of capital.

We aim to increase the likelihood of capital preservation through two means. First, by investing in high-quality businesses that are easy to understand and that trade at prices which we believe exhibit a sufficient 'margin of safety' – that is, trading at prices that are significantly below the intrinsic value of the business. And second, by using little or no leverage and keeping prudent cash buffers.

Long-term compound growth – we seek to deliver superior risk-adjusted returns over the long-term. Our target is to achieve compound returns of 10% to 15% per annum, after all fees and expenses, over the long term and through the investment cycle, which is typically 5 to 7 years.

We aim to do so through **portfolio concentration** – that is, concentrating capital in a relatively small number of high-quality businesses. The top 5 long investments will typically represent 40% to 50% of the portfolio.

Importantly, we are not afraid to hold cash when opportunities do not present themselves.

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Turning to page 7. We believe that these charts are an intuitive way to demonstrate VGI Partners' focus on capital preservation and our conservative portfolio position.

As outlined in the VG1 Prospectus, we expect that VG1 will closely replicate the VGI Partners Master Fund portfolio over time. Over the nine and a half years to 30 June 2018, the VGI Partners Master Fund portfolio has delivered compound annual returns of 15.2% after all fees. This compares to 11.2% for the MSCI World Total Return Index in Australian Dollars.

Moving on to the right-hand chart on page 7. There have been 71 "up market" months and 43 "down market" months since the VGI Partners Master Fund's inception. This chart shows that the VGI Partners Master Fund portfolio has tended to outperform in periods of market weakness.

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The table on page 8 demonstrates that VGI Partners has been successful in achieving our performance objective in every year since inception. It is important to note that this has been achieved with an average cash weighting of 30%.

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Now please turn to page 10 to look at the Net Investment Performance of VG1 to 30 June 2018.

As shown in the first graph, post-tax NTA has grown from \$2.00 per share at listing to \$2.18 at 30 June 2018. Pleasingly, the VG1 share price has traded at an average premium to post-tax NTA of over 4% since listing.

The VG1 Board has not declared a dividend in 2018. As outlined in the prospectus, paying a dividend is not a primary objective for the Company.

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Page 11 breaks down the NTA Performance for the period to 30 June 2018, after all applicable fees and expenses.

Long investments contributed 5.8%, currency added 4.2% and Short positions detracted 0.8% from performance during the period.

The Largest Long Contributors for the nine months are as follows: Zillow, Amazon, CME Group, MasterCard, WD-40 and Kikkoman. There were no material long detractors during the period.

VG1 is exposed to the U.S. Dollar through both the investments it owns, as well as its cash holdings; which are currently held entirely in USD. This means that if the U.S. Dollar weakens against the Australian Dollar, there will be a drag on performance for VG1. However, if the U.S. Dollar strengthens against the Australian Dollar, VG1's returns see a positive contribution from currency. During the period ended 30 June 2018, the Australian Dollar weakened against the U.S. Dollar adding 4.2% to performance.

We continue to believe that the U.S. Dollar remains attractive relative to the Australian Dollar at current levels. The United States is seeing a sustained pickup in inflationary pressure. In response, we believe the U.S. Federal Reserve will continue to raise interest rates and gradually unwind the excess assets accumulated on its balance sheet through 'Quantitative Easing'.

In contrast, the Reserve Bank of Australia is facing very little to no pressure to raise rates. With household balance sheets stretched to their breaking point and weak wage growth and inflation, we believe that the RBA will endeavour to maintain low interest rates for as long as possible.

Our short positions detracted slightly from NTA performance for the nine months to 30 June 2018. Many of our short portfolio losses in this period remain active positions in the portfolio. We believe our thesis on each of these stocks will eventually play out. If this occurs, we will not only recoup our losses but also generate a positive return for the portfolio. In the past, some of our best performing short positions have gone against us substantially before eventually generating a significant total return for the portfolio.

Over time, we believe our short positions, which are focussed on structurally flawed businesses, fads and accounting irregularities, and in some cases frauds, will generate positive returns for the portfolio.

An added benefit of looking for potential short candidates is that everyone on the investment team is constantly on the lookout for what we call 'red flags'. Red flags can come in many forms, including key insiders selling stock, accounting irregularities or the competitive landscape of an industry eroding. The VGI Partners investment team analyses this data with a sceptical eye, a key skill which we believe adds value to our analysis of the Long portfolio, by helping us identify early any emerging red flags in our long investments.

Finally, and importantly, these short positions also enable us to reduce market exposures and profit from falling equity prices during periods of uncertainty and heightened volatility. This provides us with a very valuable tool with which we can cushion the portfolio's returns during a downward trending market.

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For an update on the Portfolio. Please turn to page 13.

The first table on the left sets out the top Long investments as at 30 June 2018. These collectively represent 45% of the VG1 portfolio.

As shown in the second table on the left, the portfolio had 41% net equity exposure at 30 June 2018, with 65% long and 24% short. The cash weighting was 59% and, as discussed earlier, all cash is currently held in U.S. Dollars.

In terms of geographic split, 76% of the Long portfolio investments were listed in North America, 14% in Asia and 10% in the UK and Europe. I'd like to point out that many of our Long investments which are listed in North America also have material exposure to global markets growth. This is especially the case for Colgate Palmolive, The Coca Cola Co, MasterCard and Amazon.

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Please turn to page 14.

When the VG1 Prospectus was prepared last year, we expected that VG1 would replicate the VGI Partners Master Fund portfolio within 3 months of listing, subject to market conditions.

Over the past nine months we have been patiently and steadily deploying the capital such that as at 30 June 2018 the portfolio was, on average, approximately 80% of targeted individual stock weightings.

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Now please turn to page 16 for some general market commentary.

The vast majority of high-quality businesses continue to trade at valuations which imply unlikely levels of growth into perpetuity. We believe this environment has, at least in part, been driven by historically low interest rates. With cash yielding close to zero in many developed countries, there are few attractive alternatives for investors. As a result, we have seen a continued flow of funds into equity markets and other forms of speculative behaviour.

As global interest rates normalise we believe this will lead to increased volatility. In addition, the recent intensification of trade conflicts, particularly between the United States and China, has emerged as a meaningful concern for equity investors.

In this environment we continue to view a high cash weighting as both a logical expression and sound proof of implementing our investment philosophy. We will remain especially prudent in this environment, where it is particularly difficult to locate high-quality investments at attractive prices.

With a high level of cash, and a shopping list of hand-selected, high-quality companies that we would like to buy when prices become attractive once again, we feel well positioned to take advantage of any future equity market sell-offs – whenever they may occur. In the meantime, we continue to work tirelessly to uncover new opportunities that we can add to our wish list.

Importantly, our large cash holding enhances our ability to execute in times of investor uncertainty, as we can be the ‘strong hands’ who purchase at advantageous prices from ‘weak hands’. Those weak hands are typically those who are highly leveraged or who trade excessively on margin.

We remain confident that we will continue to generate superior risk-adjusted returns through the investment cycle, by concentrating our capital in a relatively small number of

high-quality businesses that we believe are significantly undervalued, combined with selective short-selling and by avoiding the use of leverage.

I will now hand over to David Jones, the Chairman of VG1, to discuss the commitment that VGI Partners has made to enhance the alignment of interests between VGI Partners, the Manager, and VG1 investors.

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Mr David Jones:

Thankyou Rob. Please turn to page 18.

VGI Partners made three precedent-setting commitments at the time of VG1's listing:

- Firstly, the Manager would pay for all upfront listing costs. As a result, the Manager is absorbing over \$14 million in upfront listing-related expenses that would otherwise have been borne by investors in a typical L. I. C. structure.
- Secondly, the vast majority of ongoing operating costs will be paid by the Manager, except Independent Directors fees and the Directors and Officers Insurance which the Manager cannot absorb for governance reasons. The Manager has paid for over \$400,000 of VG1's operating costs for the period to year end. The annualised savings to VG1 investors is approximately \$650,000 per annum.
- Thirdly, the owners of the Manager have reinvested 100% of the performance fees earned, after taxes, into new shares in VG1, and these shares are escrowed for the maximum extent permitted by law. This is an ongoing commitment to reinvest in VG1 shares.

In addition, the Directors of VG1 have collectively purchased on market a further approximately 467,000 VG1 shares since listing, such that the Directors and owners of the Manager collectively own over 1.4% of the Company today.

We have been pleased to see that while this package of commitments made by the Manager was novel when the Company's prospectus was issued, a number of subsequent investment company and trust listings have followed our lead by replicating some or all of our commitments. On the first point alone, upfront listing costs, we are

delighted that most other new investment company and trust listings that have taken place subsequent to the IPO of VG1 have seen their manager commit to paying for the upfront listing costs. We estimate this has delivered savings of approximately \$100 million to Australian and New Zealand investors since VG1 listed last September.

Finally, it is important to note that all VGI Partners staff are prohibited from purchasing securities other than VG1. So, you can be confident that the VGI Partners Investment Team's energy and effort is truly aligned and focused on a singular outcome – to maximise returns while preserving capital for our collective Portfolio and investment in VG1.

I will now ask Victoria Arthur, VG1's Investor Relations Manager, to provide a quick update on our Shareholder Engagement program.

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Ms Victoria Arthur:

Thanks David. Good morning everyone.

As promised during the IPO process, we will be doing an annual national roadshow, visiting Perth, Adelaide, Melbourne and Brisbane in late October and early November. We will be holding an investor briefing in each location, and those locations and times are summarised on page 20. The invitation to our upcoming investor events has been emailed or posted to all investors and can also be found on the VG1 website. So please RSVP if you would like to attend so that we have a good idea of numbers.

Our inaugural Annual General Meeting will take place on Monday 19 November at Customs House in Sydney. If you are unable to attend in person, there will be a dial-in facility. Those details will be sent out, along with the Notice of meeting, in October.

We look forward to meeting many of you in person at one of these events.

In terms of independent research, we now have ongoing coverage from Zenith Investment Partners in addition to Independent Investment Research. Zenith initiated its coverage of VG1 with a Recommended rating in June.

We are committed to an engaged investor relations program. Ultimately, we would like to communicate with all our investors via email to ensure that they receive important



company updates in a timely manner. We have already reached out a number of occasions but if you, or any your clients, have not yet updated your communication preferences to email and would like to do so, please get in touch. My contact details can be found at the bottom of page 20 in the presentation deck.

That brings us to the end of the presentation and we'd now like to move to questions. Operator, could you please take the first question please?

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