Sandon Capital

‘Ever since 1934 we have argued in our writings for a more … energetic attitude by stockholders toward their management’

Ben Graham, The Intelligent Investor

Shareholder Conference Call

15 April 2020

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This presentation has been prepared for use in conjunction with a verbal presentation and should be read in that context.

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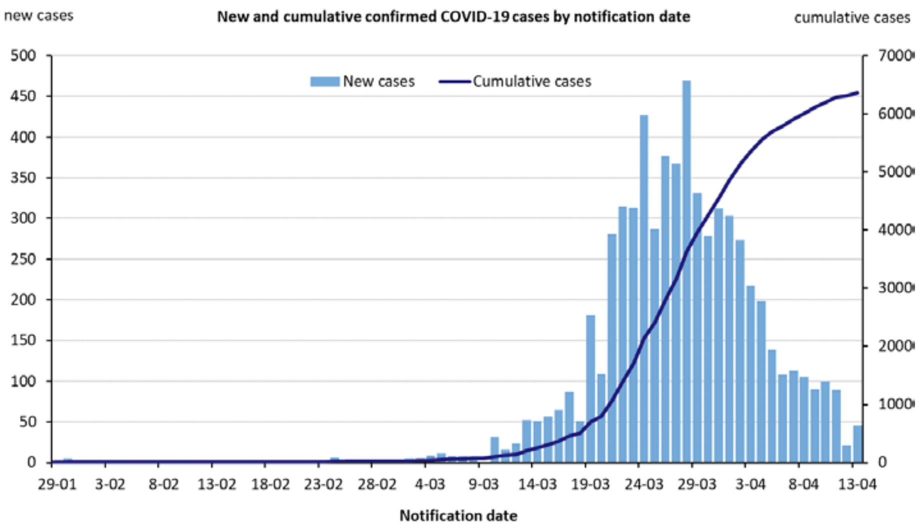
COVID-19 Pandemic: public health and economic shock

- COVID-19 is a perfect storm, combining health and economic shocks at the same time

- We give Australian governments an "A" for effort



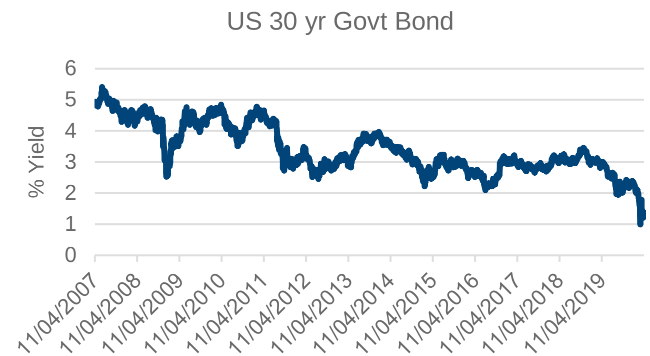
- The public health responses so far appear to have been effective
- Economic and fiscal stimulus and mitigation responses are significant
  - Measures announced by the Federal government exceed $300 billion over the next 3-4 years
- The message seems to be a "whatever it takes" approach

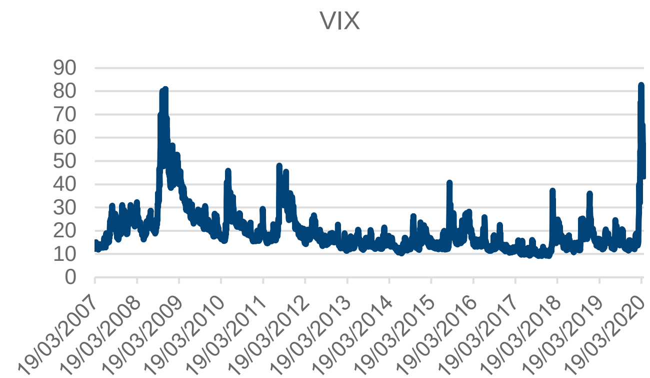
Australia's stimulus measures – these are significant

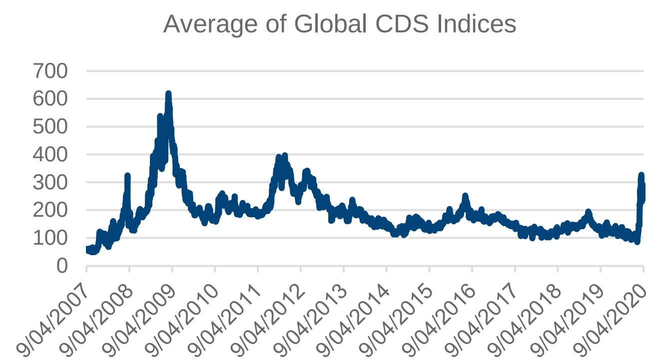
- The Federal Government has announced an increasing number of measures to mitigate the economic impact of public health responses to COVID-19. These include but are not limited to:
  - Tax relief to business to assist with cashflow
  - Instant asset write-offs to stimulate investment
  - A temporary increase in the Job-Seeker allowance
  - Creation of a Job-Keeper scheme to assist employers keep staff employed
  - AOFM buying RMBS and other securities to ensure liquidity
- The RBA has also taken action:
  - It has cut its target cash rate to 0.25%
  - It is buying 3-yr Govt bonds to target a yield of 0.25%
  - It has provided at least $90 billion in loans to ADIs for them to lend to business

Global investor reactions

- Globally, market reactions have seen markets decline sharply and at great pace
- There has been a flight to safety across asset classes
  - Govt bond yields have fallen
  - USD has rallied
  - Volatility has spiked
  - Credit default protection has soared





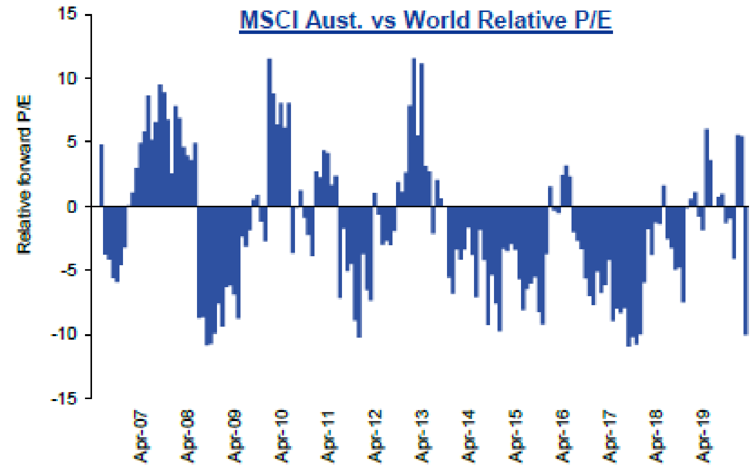


Source: Bloomberg

Risk off movements

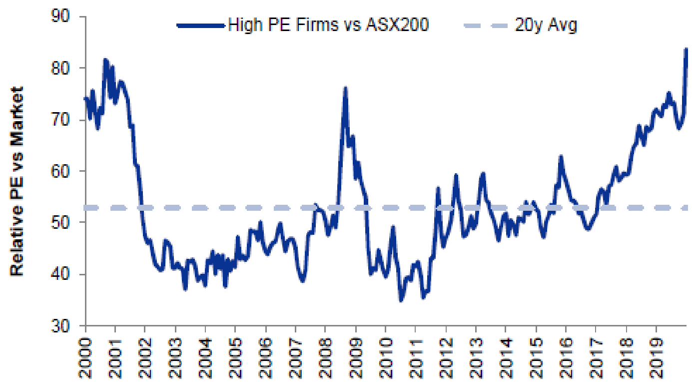
- Within equities, there have been shifts away from perceived risks into those perceived as offering safety, e.g. sell small cap, buy large cap
- Investor reactions have created opportunities

MSCI Australia trades at a 10% discount to the MSCI World, close to its largest discount in the past 15-years

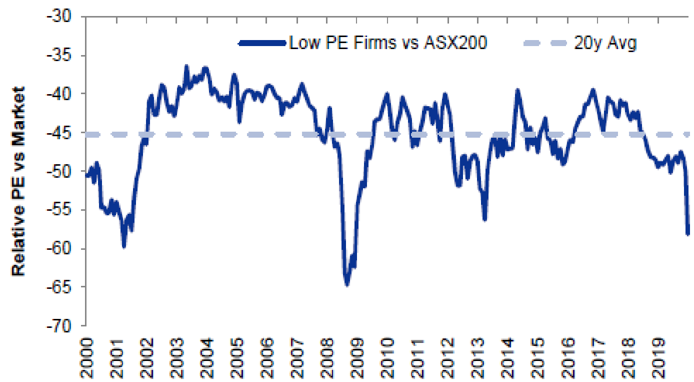


Source: Goldman Sachs

High PE firms trade at a 84% premium to the market, which is 30% above the 20-yr average



Low PE firms trade at a 58% discount to the market, which is 13% below the 20-yr average



Source: Goldman Sachs

Our approach to this turmoil

"the time to buy is when there is blood in the streets, even if that blood is your own"

- In Jan 2020, we wrote: *"Markets generally remain challenging, with macro headwinds (such as bushfires and novel coronavirus) and a seemingly unconstrained appetite for growth by some investors, regardless of value. We are not of that ilk, preferring instead to focus on our value-oriented approach, despite shorter term underperformance."*
- In Feb 2020, we wrote: *"…we do not know when normalcy will return, but we know it will. In the meantime, we will apply ourselves as diligently as we can to the task of creating long term value while minimising any permanent impairment of your capital. "*

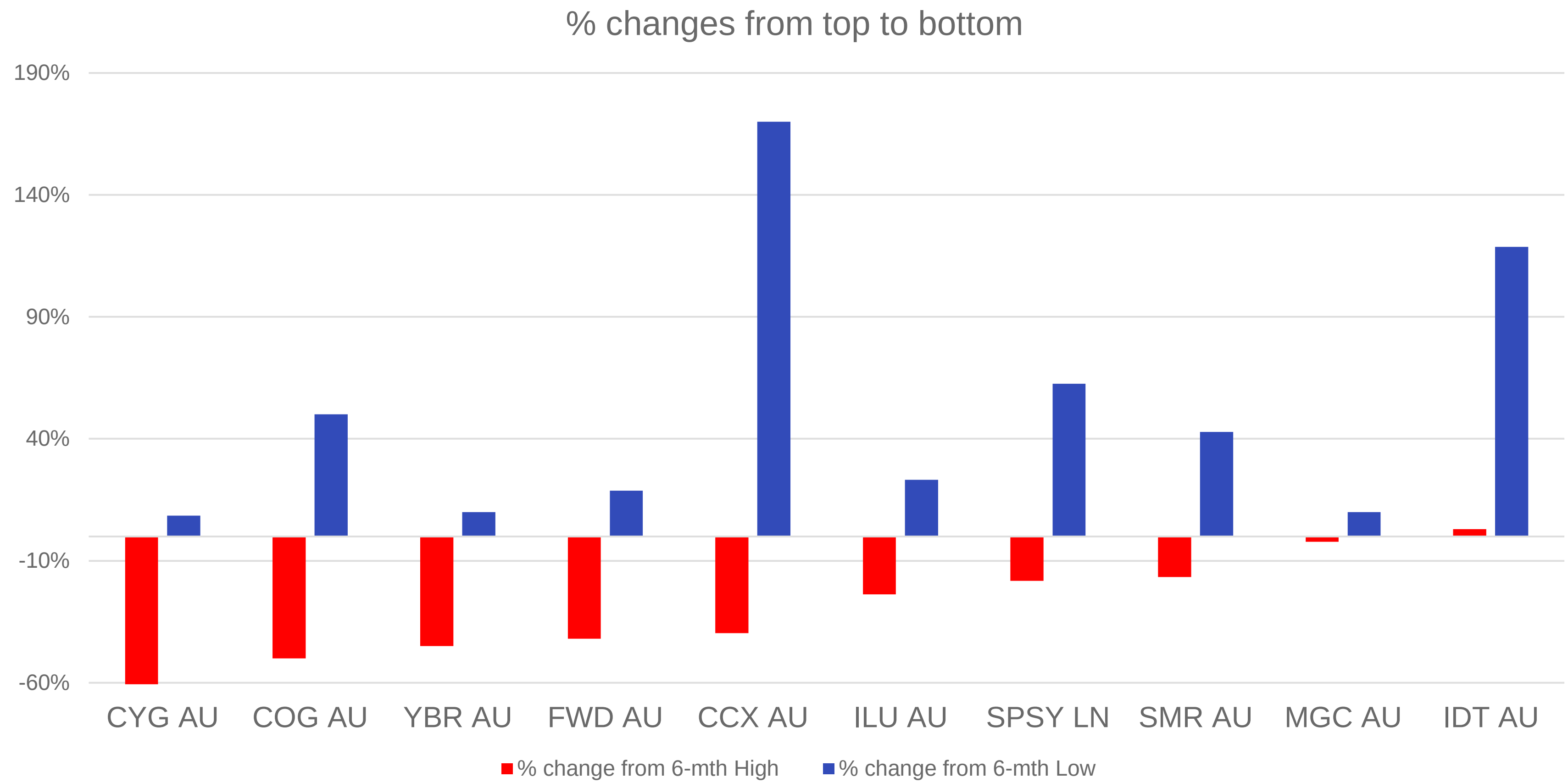
↗ We have been net buyers during this turmoil

Our approach to this turmoil

- It is futile to try to determine when the market will hit rock bottom
- Our approach has been to:
  - Hold on to our investments whose prospects in the medium-term and beyond are sound (and in some cases buy more)
  - Buy new investments that we consider undervalued –
    - we have begun buying two new investments so far
  - Sell those whose prospects we rate as poor –
    - we have exited two companies whose prospects we rated as poor. Both were very small positions in the portfolio (<0.5% weighting combined)
  - Sell those whose shares prices have risen beyond our estimates of value
    - we are selling two such companies

Our approach to this turmoil

- The decision to hold has already been rewarded in a number of stocks

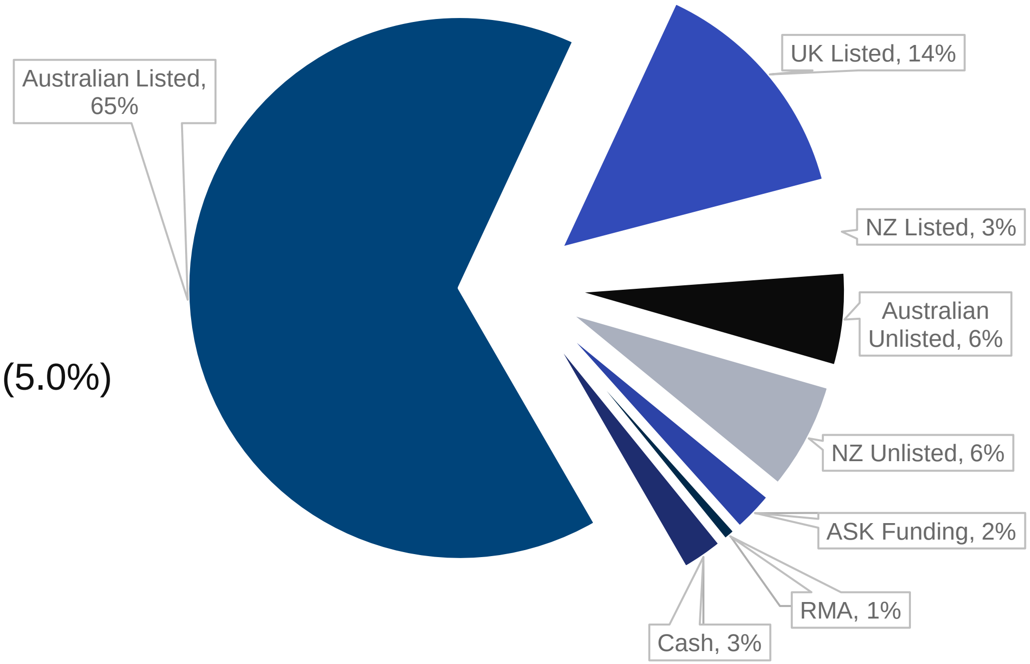


Our approach to this turmoil

- We have undertaken a review of our largest investments, with a view to assessing how they can deal with the economic downturn
  - The crucial questions are about survival
- Our exposure is largely to the industrial economy. We expect this part of this economy will be first to benefit from government stimulus
  - Post-GFC experience may provide a roadmap, but caution is required due to pandemic catalyst
  - We anticipate business confidence will improve before consumer confidence
- We have limited exposure to the consumer economy
  - We have limited exposure to retailing
  - We have been accumulating an investment with exposure

Portfolio snapshot

- Top 10 positions:
  - Spectra Systems Corp. (10.2%)
  - Fleetwood Corporation Ltd (8.4%)
  - Foundation Life (6.0%)
  - MG Unit Trust (5.7%)
  - Consolidated Operations Group Ltd (5.0%)
  - CM Capital Venture Trust 4 (4.9%)
  - Iluka Resources Ltd (4.6%)
  - Yellow Brick Road Ltd (3.9%)
  - OneMarket Ltd (3.5%)
  - Coventry Group Ltd (3.2%)



Gross portfolio composition as at 31 March 2020. All figures are approximate.

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Investment – Spectra Systems Corp. (LSE:SPSY)

Portfolio Weighting	10.2%
Description	Spectra provides advanced technology solutions for banknote cleaning, banknote and product authentication and gaming security. Its banknote customers are central banks around the world
Financial Status	At 31 December 2019, Spectra had USD27 million of net assets, of which USD14.5 million is held in cash. It has no debt. The majority of Spectra's revenues are derived from long term contracts. Spectra's shares have fallen significantly from their January 2020 highs. This decline would appear to be unrelated to the fundamentals for the company. Spectra is our largest shareholding and provides valuable USD exposure (whilst the shares are listed in the UK, in the company's functional currency is USD).
End Market Exposures & COVID-19 impact	We believe Spectra shares were sold down without regard for the company's prospects The annual results reinforced that Spectra's business is backed by large corporate and central bank customers and existing contracts are largely immune to COVID-19

Source: Spectra Systems Corp., Sandon Capital analysis

Investment – Fleetwood Corporation Ltd (ASX:FWD)

Portfolio Weighting	8.4%
Description	FWD operates across 3 business divisions. (i) Building Solutions operates the largest modular construction business in Australia (ii) Accommodation Solutions owns and operates an accommodation village at Karratha (Searipple) and manages another in South Hedland (Osprey) (iii) RV Solutions provides parts, accessories and services to the recreational vehicle market.
Financial Status	FWD reported net cash of $20.1 million as at 31 December 2019. It also reported $65 million in unutilised financing facilities. A significant proportion of FWD's costs are variable, which means they should be able to reduce costs materially in the event that revenues fall significantly. FWD's current assets exceed its total liabilities by more than $48 million. Despite our negative views of management, the balance sheet is robust and we believe it is well placed to withstand a protracted slow-down.
End Market Exposures & COVID-19 impact	We expect demand for the company's Building Solutions products to remain solid due to the large proportion (~2/3) of government related contracts. Whilst we do not expect any short term impact on the Accommodation Solutions business, the medium and longer term outlook is more uncertain due to the precipitous fall in hydrocarbon prices. Investment decisions on project construction in the Karratha region have been delayed. The RV Solutions will be materially negatively impacted by the fallout from the Covid-19 pandemic. We expect demand for the businesses products and services to decline markedly. The company's decision to acquire Northern RV is looking like another example of a poor use of shareholder capital.

Source: Fleetwood Corporation Ltd, Sandon Capital analysis

Investment – Foundation Life (NZ) Holdings Ltd (unlisted)

Portfolio Weighting	6.7%
Description	Foundation Life is a private company that is focused on the acquisition and long term prudential management of life insurance portfolios which are no longer being actively marketed
Financial Status	Foundation Life has been undertaking preparations for its restructure and ultimate wind up. The Manager had moved portfolio assets into cash (from equities) and fixed income assets were adjusted so that asset duration largely matches liability duration. As a result of these changes, the Foundation Life investment has been largely insulated from recent market dislocations. The Manager has also undertaken stress tests of the life policies for NZ regulators to ensure policy obligations can be met.
End Market Exposures & COVID-19 impact	Market movements will likely push out the restructure timetable by at least one quarter, but with limited impact on the final investment outcome. We anticipate further information from Foundation Life over coming weeks as more information regarding the restructure is settled.

Source: Foundation Life (NZ) Holdings Ltd, Sandon Capital analysis

Investment – MG Unit Trust (ASX:MGC)

Portfolio Weighting	5.7%
Description	MG Unit Trust provides exposure to the cash proceeds received when Murray Goulburn's operating assets were sold in 2018 to Canadian diary company Saputo, Inc.
Financial Status	As at 31 March 2020, MGC had $264.5 million in cash. This equates to ~$0.48 per share. The other assets and liabilities in the vehicle are immaterial.
End Market Exposures & COVID-19 impact	On 7 April 2020, the Federal Court approved the settlement of the Webster Class Action. With all legacy issues now resolved, MGC can now move onto liquidation and returning cash to shareholders. We expect the Notice of Meeting to appoint a liquidator will be issued in the near future.

Source: MG Unit Trust, Sandon Capital analysis

Investment – Consolidated Operations Group Ltd (ASX:COG)

Portfolio Weighting	5.0%
Description	COG provides equipment finance and also owns stakes in finance brokers specialising in small- and medium-size enterprise finance. Products brokered included asset leasing for business equipment and working capital product solutions such as invoice financing and factoring. COG's leasing business originates leases from a wide range of brokers. Key end markets include financing for commercial vehicles, industrial plant & equipment, fixtures & fittings and IT.
Financial Status	As at 31 December 2019, COG reported unrestricted cash of $43 million. Net assets were reported at $218 million and net tangible assets were $62.5 million. Subsequent to year end, COG spent approximately $22 million acquiring its stake in CML. If the Scottish Pacific Scheme is successful, COG would receive ~$23m as scheme proceeds and dividends. COG reported approximately $104 million of interest-bearing liabilities as at 31 December 2019, half of which were current liabilities. The bank facility from Bendigo is small. The debenture funding and leasing funding liabilities have recourse back to the leased assets, but not COG itself.
End Market Exposures & COVID-19 impact	COG announced on 31 March that it no longer seeks to acquire CML Group Ltd (CML) and is therefore supportive of the Scottish Pacific proposed CML Scheme of Arrangement proceeding. Should the Scheme proceed COG will receive cash, leaving it with a significant war chest with which to make acquisitions, most likely in the broker aggregation space. COG announced on March 24 that they are scaling back their direct lending business with immediate effect and will instead focus on the collection and management of its current portfolio of lease receivables. COG's lease book is well diversified by industry, asset type and geography

Source: Consolidated Operations Group Ltd, Sandon Capital analysis

Investment – CM Capital Venture Trust 4 (unlisted)

Portfolio Weighting	4.9%
Description	CM Venture Trust 4 is a private equity fund in run-off. The holding was acquired in 2018 when Mercantile acquired IPE Limited. The main assets remaining in the fund are (i) SpeedDX which manufactures respiratory infectious disease tests (ii) Piedmont Animal Health which conducts research and development of pharmaceuticals for companion animals.
Financial Status	SpeedDX recently completed a USD15m fund raising. We are advised that the company's revenues are growing and it has sufficient working capital to withstand a prolonged economic downturn. Piedmont recently raised USD50M from Sumitomo of Japan, providing it with at least 3 years of cash.
End Market Exposures & COVID-19 impact	The current turmoil in financial markets is likely to impact the realisation of assets as transactions are delayed or deferred. We are advised that SpeedDX is developing a COVID-19 test, which the company anticipates will be available before the end of 2020. Piedmont Animal Health has been put up for sale, but the current uncertainty in capital markets will delay this process.

Source: CM Capital Venture Trust 4, Sandon Capital analysis

Investment – Iluka Resources Ltd (ASX:ILU)

Portfolio Weighting	4.6%
Description	Iluka is the major producer of zircon globally and largest producer of high-grade titanium dioxide products – rutile and synthetic rutile. The company also has an iron ore royalty associated with BHP Billiton's Mining Area C (MAC) province in Western Australia.
Financial Status	ILU reported net cash of $43m at 31 December 2019. The company has unutilised debt facilities of $519m that are available to tap in the event that further funding is required. The company has guided to low levels of capital expenditure of $135m in 2020. The strong balance sheet and low levels of capex place the company in a solid position to weather any protracted downturn in the global economy.
End Market Exposures & COVID-19 impact	ILU's mineral sands revenues are split roughly 50:50 between zircon and titanium dioxide feedstocks. The pace at which factory utilisation and capacity rates in China normalise will be an important influence on zircon sales for the remainder of the year. Furthermore, a number of further downstream customers (tile manufacturers) are located in Europe, particularly Italy and Spain. For the titanium dioxide feedstock business, the take-or-pay offtake agreements the company has in place for ~75% of production provides a high degree of revenue certainty. The company will continue to receive strong cash flows from its royalty over BHP's Mining Area C (MAC). The A$ iron ore price has remained strong and there are no restrictions on the mining of iron ore in the Pilbara. We expect BHP is shipping every tonne possible out of MAC.

Source: Iluka Resources Ltd, Sandon Capital analysis

Investment – Yellow Brick Road Ltd (ASX:YBR)

Portfolio Weighting	3.9%
Description	YBR is a mortgage broker and aggregator. The majority of its revenue comes from trailing commissions and upfront commissions on origination of new mortgages. YBR has also recently finalised an arrangement that has allowed it to commence providing its own mortgages via a wholesale warehouse and securitisation facility.
Financial Status	The majority of the value in YBR today, aside from its broker network, is in the rights to trailing commissions from existing mortgages. As at 31 December 2019, the net value of these trailing commissions was in excess of $43 million. YBR has a small corporate debt facility, most of which is non-current. It reported net cash of approximately $4.1 million as at 31 December 2019. It also has received an $18 million cash injection from Magnetar Capital for a 50% stake in Resi Wholesale Funding Pty Ltd, which places it in good stead for working capital and warehousing funding of its own mortgages when market conditions permit.
End Market Exposures & COVID-19 impact	We expect that as economic conditions worsen, homeowners are less likely to repay existing mortgages ahead of schedule. Given the banks' response to financial hardship, we expect the life of the YBR mortgage book to extend, and hence the value may well increase. This obviously does not account for any defaults, which at this stage we believe cannot be reliably estimated. We expect that YBR's ambitions to issue its own mortgage products will be delayed as a result of the pandemic, though given the funding is in place, we expect they will be able to accelerate this programme when market conditions permit. The business case for mortgage warehousing remains sound in the medium term, once current uncertainty dissipates.

Source: Yellow Brick Road Ltd, Sandon Capital analysis

Investment – OneMarket Ltd (unlisted)

Portfolio Weighting	3.5%
Description	OneMarket was placed into liquidation in December last year. It's main asset is cash.
Financial Status	When OneMarket was placed in liquidation, an interim distribution of $0.88-0.94 per share was expected to be paid by the end of the March quarter 2020. According to the liquidators, the time frame for payment of the interim distribution has been pushed out to May.
End Market Exposures & COVID-19 impact	The depreciation of the AUD as a result of the COVID-19 pandemic allowed the liquidator to convert the majority of the US$ cash holdings into A$ at an exchange rate of ~58c. As a result, OneMarket's cash assets are estimated to be $1.08-1.11 per share. We expect the majority of cash to be returned to shareholders by 30 June 2020.

Source: OneMarket Ltd, Sandon Capital analysis

Investment – Coventry Group Ltd (ASX:CYG)

Portfolio Weighting	3.2%
Description	Coventry supplies industrial products and services to the mining, manufacturing, construction, agriculture and defence industries through two divisions (i) Trade Distribution which distributes fasteners and other industrial products through a network of branches in Australia and New Zealand (ii) Fluid Systems which designs, manufactures, and supplies hydraulics, lubrication, fire suppression and refuelling systems and products in Australia
Financial Status	CYG reported net debt of $5.8m at 31 December 2019. The company has a receivables facility with Scottish Pacific with a limit of $25m, which leaves them plenty of headroom should it be required. Furthermore, current assets of $105m are almost double current liabilities of $53m (adjusted for the AASB16 lease liability that was recently bought on balance sheet). With a variable cost base and working capital that can be quickly turned to cash, we believe CYG is well placed to ride out a protracted slowdown in the economy.
End Market Exposures & COVID-19 impact	CYG's major end markets are commercial construction, infrastructure and mining. To date, there has been limited impact on these sectors from the COVID-19 pandemic and that has been borne out by the sales growth experienced by CYG throughout March and into April. The major impact on the business has been in New Zealand (~15% of sales) following the suspension of operations due to the Government's mandated lockdown (expected to be eased on 24 April). Despite a major operational turnaround at CYG over the past 18 months, cash flow generation has lagged due to poor management of working capital. We see inventory reduction as an easy way to generate cash in the current environment.

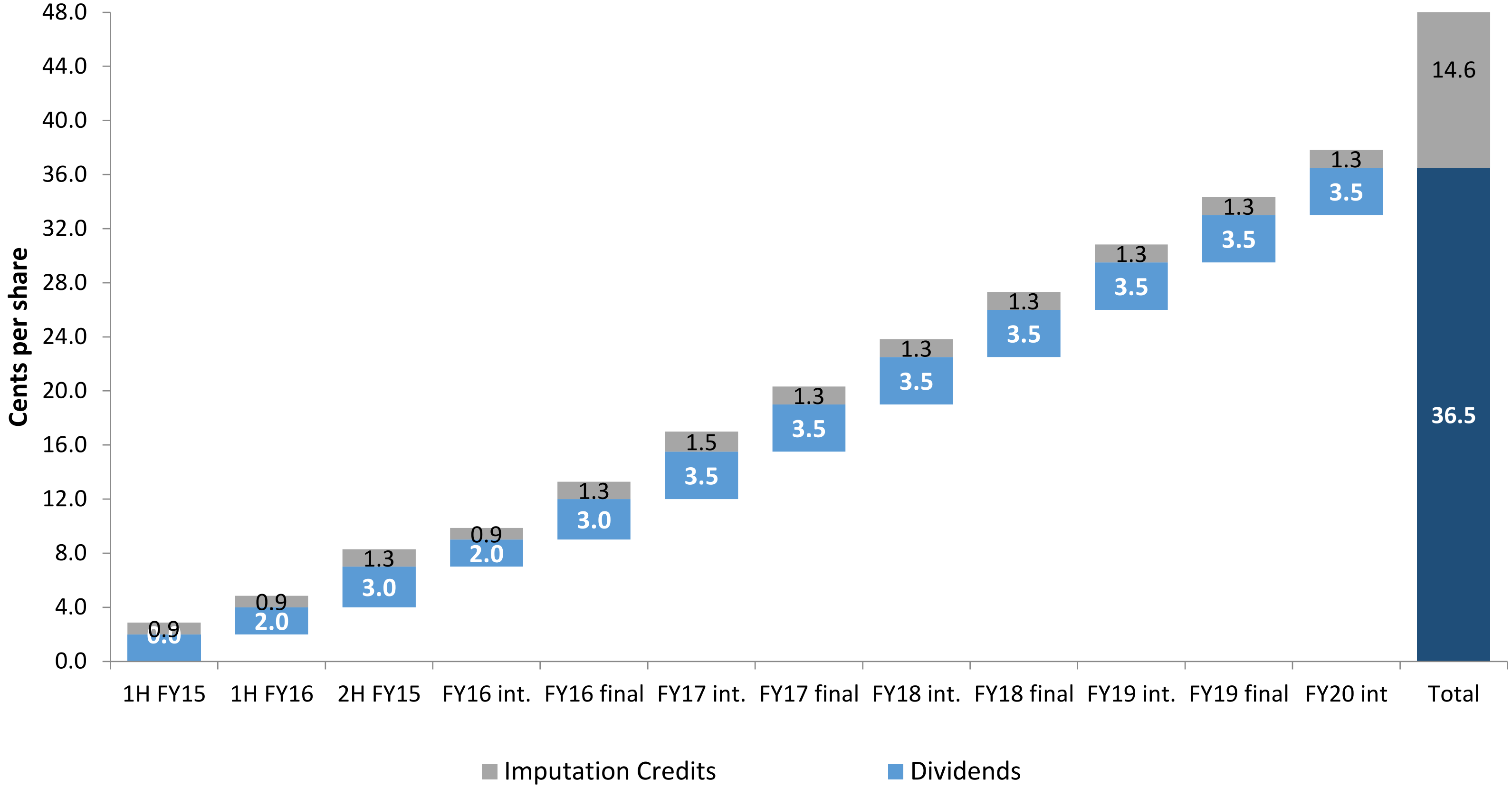
Source: Coventry Group Ltd, Sandon Capital analysis

Other Portfolio Investments

- A number of other portfolio positions have made material announcements recently:
- Stanmore Coal Ltd (ASX:SMR) ~3.0% of portfolio
  - SMR received an unsolicited takeover offer from Golden Investments at $1/share
  - Sandon are pushing the Board for an increased price as well as a special dividend given the company's large franking account balance
- BCI Minerals Ltd (ASX:BCI) ~1.9% of portfolio
  - BCI announced the sale of its Buckland Project to Mineral Resources for up to $20m
  - In the short term, the company's net cash position increases by $10m to >$40m
- IDT Ltd (ASX:IDT) ~1.4% of portfolio
  - At the request of the Australian Government, IDT has been asked to assist with certain COVID-19 response activities
  - IDT was on its way back to profitability. Any onshoring of the manufacturing of pharmaceutical intermediate products could expedite that return to profits

Dividends

- Dividend policy is to pay a growing stream of fully franked dividends



Dividends

- The fully franked interim dividend of 3.5 cents per share announced on 27 February 2020 will be paid on 28 May 2020
- The DRP will apply to this dividend
  - All shares held by director-related entities will participate in the DRP
  - We encourage shareholders to consider participating
  - The DRP will increase the availability of cash to redeploy in the current market conditions
- The Chairman will be writing to shareholders asking that they consider reinvesting their dividend. A DRP election form will be included
- Shareholders can download the DRP form from our website

www.sandoncapital.com.au/images/pdfs/SNC_DRP001_NP_140905.pdf

Dividends

- If shareholders wish to take up the DRP, they must do so by 5pm (Sydney time) on Thursday 7 May 2020
- The DRP price will be the volume weighted average price (VWAP) over the period Tuesday 5 May to Friday 8 May
- In the past, when declaring a dividend, our practice has been to indicate the size of the next dividend. At this time, we are not providing such an indication. Dividends will be considered in light of the full year result.

Outlook

- We expect volatility and uncertainty in global financial markets have become the new normal
- COVID-19 and economic recovery are likely to be the dominant themes
- A key question will be when demand resumes
- What steps will China take? Will their reaction be like that in GFC?
- Secondary themes are likely to include:
  - Geopolitics and oil – oil producing nations are being afflicted by low oil prices and COVID-19 to varying degrees. Such pressures may cause ructions
  - US Presidential elections
- We will continue to invest at prices below intrinsic value and apply our activist techniques
- We believe our fundamental approach will continue to uncover attractive opportunities with shareholder activism unlocking value

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