QUARTERLY REPORT #15: PERIOD TO 31 MARCH 2020[1]

A uniquely challenging quarter

This was a unique quarter in equity markets since I entered the investment world in 1980.

The euphoria prevailing at end December 2019 grew to an even greater extent in January and February before dissolving in spectacular but unique fashion with the spread of COVID-19 from its home base in Wuhan, China. To compound these events, one of the world's longest lived cartels, OPEC, descended in acrimony on 8 March 2020 with fundamental disagreements between Saudi Arabia and Russia. Over the month of March the Brent crude oil price declined 61% from US$66 to US$26.

"The period from November to January was the craziest period in 40 years on Wall Street" (Jim Chanos, Kynikos Associates, CNBC Interview 2 April 2020

The chronological progression of the quarter unfortunately caused us significant difficulty, Our significant hedge against the Australian equity market – equivalent to 100% of equity at end December 2019 - was painful with the index rising over 6% at one stage, settling with a gain of 3.6% in that month. Our largest stock position, a short in Telsa rose from $418 at end December to $651 (+56%) at 31 January 2020; we deliberately covered our short position using derivatives ahead of the Q4 2019 result on 29 January 2020, correctly forecasting (despite our negative view on the company's valuation) that the numbers would exceed market expectations, which would see the shares take-off again. They duly did which provided a further opportunity to establish a short position at even more ludicrous price levels.

The first three weeks of February saw speculative activity reach a crescendo around 19 – 20 February. The space company, Virgin Galactica (no position) floated at $11.75 in October 2019, for a $2.3billion valuation, but saw its shares rise from $11.80 at 2019 year end via $17.15 at end January to a 19 Februry peak of $37.26 before falling back to $24.60 at month end.

Tesla, the other darling of RobinHood[2] investors continued its rise to a closing peak of $917 on 19 February, at which time it was priced at $168billion - $10billion more than the then combined market capitalisation of Ford, GM, Fiat-Chrysler and Daimler-Benz. Between them, these four companies make 21million cars, profitably. Tesla makes ~450,000 unprofitably before green credits.

Given the aggressive strategy we were running, it became increasingly difficult for us to maintain this extent of short positions as indices rose and individual stocks blew off. As a result, we were forced to cut back the position at a relatively inopportune time, just before markets started to fall in the latter part of February.

[1] East 72 Holdings Limited (**E72**) provides quarterly **unaudited** updates on its company performance and exposure. Readers are referred to footnotes 14-19 explaining the derivation of the numbers. All returns are pre-tax unless stated otherwise. At the current level of net assets, cost imposition is estimated at 0.4% per month over the course of a full year (excluding capital raising related expenses) and is fully accrued monthly according to the best estimates of management. Readers are explicitly referred to the disclaimer on page 13.

[2] Robinhood Financial is a California based company offering the ability to trade in shares, fractional shares and other financial products with investments as low as $1.00 and tends to be popular with millenials

There were compensations; we sold a number of individual stock positions in January & February which either had undesired market exposure, and exited three long held positions in Aercap (as soon as the COVID word was heard), ING Groep and McGrath, after the H1 FY2020 results – all profitably.

After the falls of late February, we did see opportunities to pick up holdings in companies which had fallen prior to the COVID situation; in retrospect, we bought some of these too early.

We did move to a geared long position in early March, but our derivative and hedge positions added value.

Our problems in March were our core long positions, which fell into five categories:

- Special situations in Australia where share prices were marked down on no volume and with wide bid-offer spreads, irrespective of the progress of the business; shares in our largest position, Yellow Brick Road, fell 45% over the quarter despite completing all of the key aspects of its transformation we highlighted in the December quarterly report and continuing to generate income from its mortgage portfolio;
- Two US stocks which were caught up in credit market fears in the second week of March – Alliance Data Systems and Jefferies Financial Group, both of which fell 70% and 36% over the quarter and 63% and 32% in March;
- Our holdings of investment companies saw their NTA decline AND discount to NTA increase – see the separate section below;
- Our three property exposures – Gowing Brothers, Brookfield DTLA and Vornado all fell more than overall stockmarket benchmarks; and
- As at end March, some of the high quality companies we bought earlier in the month had declined in price – as noted, we did buy a few of these too early, but are seeing benefits in April.

Compounding this was the fact that we use gearing within the portfolio, which exacerbates the negative impact on equity. Don't forget, a 25% fall in a 50% geared investment translates to a 50% fall in the underlying equity.

We did make profits in March on our hedges/exposures on indices, but with wild volatility – markets falling & rising 11% a day – it is difficult to take too large a position for fear of being margined out of it.

As a consequence of these three months, our portfolio fell in price by 58.7% over the quarter, of which over two thirds was in March. As we discuss, we have numerous holdings where the end-March price is no representation of value, and we expect to see a rebound in the short term let alone the medium term. This has been the case so far in April.

COVID strategy

There are major differences between a decline (and rebound) in markets caused by an issue like COVID, which we know will eventually blow away in a shortish time frame[3], and that caused by

[3] We are highly cognisant – as discussed below – of a slower re-opening of economies than many other commentators. In theory at least, economies should not re-open until a COVID vaccine is developed and distributed.

the conclusion of an economic cycle, or financial markets difficulties, as seen in the past two major downturns in equities commencing in 200 and in 2007-8, which can be longer lived.

Ironically, there is a degree of predictable evolution about a "conventional" market downturn, even to the degree of "expected loss in price" from peak to trough, despite the fact that the extent and duration of downturn in the real economy is unpredictable over a period of time.

This COVID influenced downturn is entirely different on a number of fronts:

- Evaluation of the spread of COVID changed significantly and very rapidly (generally for the worst) in early March – at the same time as the oil price collapsed – this doesn't happen in the case of conventional downturns, where opinions move far more slowly;
- Different countries – or parts of countries - have adopted different "lockdown" strategies, which will have differing consequences in slowing economic activity and on moderating the spread of the virus itself – there is a high degree of Government influence;
- There is the known fact that COVID will die or be vaccinated away and that share prices of many (but not all) companies will rebound as economic activity picks back up again – people will be willing to move in ahead of this as there is a degree of certainty when activity picks up, unlike a conventional downturn;
- Since Government are responsible for economic lockdown, they have simultaneously relaxed fiscal policy to a degree never seen outside of wartime, through social welfare, lending and backstop schemes, accompanying central bank interventions to assist (loan guarantees, preparedness to buy debt issued by lower and lower rated credits etc); and
- It is Government (at every level) which will dictate the timing and pace of the re-opening of the economy.

These five dot points, in essence, provide the "bull" story to COVID: an upturn is a certainty and since interest rates are near-zero, then stocks should be bought at these lower prices.

It needs to be stressed that equity markets are forward looking beasts and will start to discount the impact of the lifting of COVID restrictions before they happen in respective countries. Share prices have already started to do so, focusing on the "second derivative" – the rate of change of new COVID cases, which by and large has been slowing, to different degrees, pending on country. What is yet to be more deeply thought about is the aftermath and what happens when lockdowns are removed and a move back towards normality is attempted.

There is some limited guidance for this from China – limited insofar as Chinese numbers are utterly unreliable and the sheer volume of checks and restrictions are easy to impose in a totalitarian society. It is clear that there will not be a wholesale re-opening of the economy in one fell swoop; certain offices may re-open, but the opening of entertainment venues may be more gradual and re-admitting folks to major events (concerts, football) may be further down the track.

But our job is to think through the medium term implications of a re-opening. There are five areas we view as being of serious consideration:

- **Psychology**: people outside of warzones, (especially in Australia) have had one of, if not the biggest peacetime shocks of their lifetimes; potentially financially, emotionally with a raw fear of death and contact. This is a stark contrast to the prior extreme consumer driven societies of expenditure, debt and speculation. Does a period of enforced

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isolation change people's views, make them more conservative and minimalist? If so, there are stark implications for economies themselves since steady state growth rates will be much lower, and certain assets like retail property, residential property and (perhaps) office property will become far less attractive. Overseas travel will take some time to recover[4]; nearby travel on the other hand could see extraordinary growth; however, after the degree of imposed financial shock, in places like Australia, the vast level of consumer debt relative to the size of the economy will be a major anchor on growth;

- **Unemployment** will NOT simply bounce back down to pre-COVID levels. The old adage of "don't waste a crisis" will take root in more aggressive company management who will use the opportunity to prune their cost base. In other cases, smaller companies will simply not have been able to survive a few months without cash flow and have businesses inadequately attractive for investors to infuse capital. Worth noting is that it is job growth which has been the stated[5] aim of loose central bank monetary policy around the world since early 2009; the progress made has been swept away but the measures used – quantitative easing and low interest rates are pretty much maxxed out. It's down to fiscal policy – in tandem with money printed by central banks used to buy the Government debt (recent Reserve Bank of Australia policy) which is the last weapon left, but at the cost of saddling the future with unheard of levels of Government debt relative to the size of the economy in many countries. As a guide, debt relative to economic activity is already twice the level of 2007[6];
- **Wage growth** across the world has been extraordinarily subdued for years; recent events have shown the clear need for larger numbers of relatively low paid workers and the efforts they have had to make. There is ample past evidence that in the wake of pandemic stresses like this, wages growth accelerates afterwards[7] [8]
- **Politics**: most major democratic countries have operated with right-of-centre Governments through this COVID pandemic. In many, the health system has been shown to have been under-equipped, shorn of investment and with a degree of financial discrimination. It is a reasonable prospect that politics will swing left once the pandemic has passed. This has significant implications. Wage inflation will pick up and there will be higher levels of regulation, especially as it is evident that income and wealth inequality has reached extreme levels. Given probable quasi-nationalisation in certain industries (airlines, banking) and Government's knowledge that they must inject equity not debt into these companies[9]. There will inevitably be a greater push to break-up "Big Tech" at some stage.
- **The dispersion of the rating of earnings will grow dramatically**. The COVID crisis has shown the weaknesses of certain companies, versus some inherent strengths of others, with some obvious outliers who have become temporarily fashionable (e.g. processed food producers, bleach manufacturers). It is typical in the aftermath of market dislocations that the very best companies re-rate quickly (the chance to buy

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4 At the time of writing, Australia's tourism minister is floating the idea of no overseas travel before the year end.

5 Other commentators would suggest that whilst growing employment was the stated aim, the unstated aim was to keep bolstering asset prices.

6 Source: Felix Zulauf "We have created the biggest excesses in Generations" interview 6 April 2020

7 "The Pandemic and radical change in wealth distribution to come" (Financial Times 9 April 2020)

8 "When plagues pass, labor gets the upper hand" (John Authers, Bloomberg) based on San Francisco Federal Reserve research

9 The Obama Government learned the lessons of the savings and loan crisis of 1990-92 and injected equity (not loans) into their bailout companies. As at March 2020, of US$634billion invested, the US Government has been repaid $755billion or a $121billion "profit" before other opportunity cost charges (time value of money etc). The three largest recipients were Fannie Mae, Freddie Mac and AIG. Source: Propublica

"good companies cheaply") but also that there are elements of extreme value which emerge where companies trade below cash backing or fractions of liquidation value. Not being caught in the middle – modest valuation but persistent negative earnings revisions - is important. Hence, our portfolio will gravitate towards a barbell strategy – high quality on the one hand, and extreme value on the other. You can see some evidence of this already.

The post March rebound in equity prices needs to be treated cautiously. With the oil price decline imperiling the US shale industry with its high level of debt, this has significant implications for credit markets and likely foreclosures. At the time of writing, S&P500 is trading at over 17x record high earnings of 163 (in 2019) – at the start of a precipitous fall in profits and with 10% of the US workforce now claiming employment insurance in three weeks.

Equities may look expensive versus co-incident earnings at the bottom of the price cycle, though they didn't in 2008/9; the next month to six weeks will start to see some of the magnitude of damage to profits as well as a clearer view of the re-opening of economies. At this juncture, markets appear to have been too sanguine.

In that respect it's worth noting that two of the largest 11 historic daily percentage GAINS in the Dow Jones Industrial Index took place in October 2008 – 11.1% on 13th and 10.9% on 28th – at index levels around 9,000 – 9,400; the index eventually bottomed on 6 March 2009 at 6430. Hence, recent buoyant gains perhaps need to be treated carefully.

Top 10 long positions in alphabetical order

Alphabet Inc	Namoi Cotton Limited
Berkshire Hathaway Inc	Prime Media Limited
Exor NV	Renn Fund Inc
J P Morgan Chase Inc	Virtu Financial
L1 Long Short Limited	Yellow Brick Road Limited

Prime Media, L1, and Renn Fund are discussed below.

Our lengthy piece on **Exor** in the December quarterly noting the value inherent in the reinsurance business turned out to be prescient, with an agreement to sell Partner Re to the French giant Covea for US$9billion announced in early March and slated for close by year end.

Even with the decline in share prices of Fiat Chrysler, CNH Industrial (down over 40%) and Ferrari since 31 December 2019, the 32% decline in Exor shares from $69 to $47 over the quarter has increased the discount to our assessed NAV to ~40%!

Virtu Financial is having a quarter like no other, yet the shares are only up around 30% since 31 December 2019. Virtu benefits from financial market (especially equity) volumes and volatility as a market maker and liquidity supplier. Aside from a better than expected Q42019 announced on 11 February, the company has made two updates over the quarter on 3 March and 20 March. The last of these was truly remarkable.

Virtu's record quarter in Q1 2018 generated net trading income (NTI)[10] of $5.58million/day for a top-line return of $340million. In the months of January and February 2020, Virtu generated just under $5.9million per day; in the first 14 trading days of March 2020, the company generated daily NTI of just under $20million. Based on a sensible extrapolation, Virtu should earn adjusted NTI of $620million for the quarter – 80% above its prior record. Volatility, whilst off the highs of mid-March is not surprisingly still elevated, reflecting changing views about the impact of COVID on the real economy and credit markets.

Virtu's $4billion market capitalisation at 31 March 2020 (plus recently downwardly priced $1.975billion in debt), in our view doesn't reflect the significant returns on trading capital available to the company – over 70% annualised in the March quarter.

New opportunities now better priced: Baby Bunting

One of the exciting aspects about market downturns is the opportunity to buy exceptional businesses at sensible prices – a facet lacking in the liquidity driven markets of the past fourteen months. I am obviously scouring the world for such opportunities, mindful of the fact that a number are in industries which will struggle for the time being, and be highly cash consumptive. Think about selected companies in the travel business, for example.

I am an extreme sceptic on retailers, particularly in Australia. The nation is the third most (over)retailed on earth in respect of shopping mall square footage per person (behind US & Canada). In the environment to come, that is going to make things extremely difficult, especially for some of the mall owners. However, for the retailers themselves, I don't see people "breaking out" and being extravagant spenders for some time, given the hit to incomes and the hefty personal debt load.

The decline in share prices has given us the opportunity to buy into Baby Bunting (BBN), a ~$300m market capitalisation retailer specialising in everything for the baby and toddler. BBN was founded in 1979 and has been ASX listed since late 2015. Since that listing at $1.40 a share, the company has progressed from 33 stores to 56 outlets, but the share price has been influenced by fears over competitors, most of whom are now bankrupt, and euphoria about the strong fundamentals of the business. As a result, forward P/E's have fluctuated between 9x and 22x!

BBN has essentially "big-boxed" the baby goods segment providing a one stop shop for parents and parents-to-be. The larger format stores of 1500-2000sq.metres have exceptional economics. As a rough guide, fitout for larger stores is approximately $1.4million, with inventory of a similar amount. Average mature store sales are ~ $7.8million, but year one revenues are generally two-thirds of this. Based on BBN's gross margin of 35-36% and cost of doing business, the stores generally have a payback of around three years.

The baby goods sector has significant barriers against on-line behemoths. Mothers-to-be are generally very selective about the accessories and accoutrements for their precious new-born, and hence require the right design, feel, fabric, colour etc – <u>decisions best made in-store</u>. BBN

[10] Net trading income is a specific Virtu definition including trading income, commissions earned plus interest & dividends less brokerage paid, exchange fees, payments for order flow and interest and dividends paid away.

is increasingly selling on-line but generally products requiring less examination, but in any event, the online store can be used after visiting the physical premises itself.

Whilst the best time for investing in a retailer may be at the start, the optimal time in Australia is when the retailer has proven the format, established at least a partial moat (public listing in BBN's case) but has significant store growth to come. BBN's 56 stores is around 70% of the way through to 80 outlets, which are now a mixture of bulk, regional and a small number of new mall formats.

Under non-COVID circumstances, with below $11million in net debt, gross margin return on inventory of over 190%, and cost of doing business around 27% of sales, the business can self-finance the store roll-out and continue to paydown debt,. Within the COVID scenario, BBN can operate under strained circumstances for around 10months, without recourse to new equity.

Like most companies, BBN has withdrawn earnings guidance for FY2020 due to COVID; however, at prevailing prices, the shares trade at just below 14x previously given earnings forecasts. For a retailer with proven management – the CEO Matt Spencer has eight years tenure - and an established and difficult to replicate format, plus further 4-5 year growth runway, we feel this is excellent value.

Hampered by blowout in discounts of closed end funds

We currently have investments in four closed end funds/companies, all of which are esoteric and offer an investment style/process which is out of the mainstream and lends itself to permanent capital:

- Pershing Square Holdings (PSH), where we have recently bought back in at ~ 40% discount to NAV; PSH runs a concentrated portfolio of ~10 securities but hedged itself very adroitly in the recent downturn;
- Treasure ASA, a Norwegian company whose sole asset is a 12% interest in the Korean company, Hyundai Glovis;
- L1 Long Short Fund (LSF, listed on ASX); and
- Renn Fund (RCG, listed in US) run by Horizon Kinetics, a very astute and different hedge fund manager based in NYC.

Owning the last three has hampered our performance in the short term.

Treasure is bizarre in that the main asset is in Korean won, the accounts in US$ and share price in Norwegian Krone. Given this exotica, and that Treasure is 74% controlled by Wilh. Wilhelmsen Holding, one would expect a controlled company discount. However, this might be offset by the lack of debt and simplicity of the structure. Treasure owns 4.514million shares of Hyundai Glovis one of the world's leading automotive logistics companies, operating 80 car carrying vessels. Glovis shares have fallen from ~KRW143,000 at end 2019 to a prevailing level around KRW99,000 (and recent low just above KRW90,000). At current levels around NOK9.30/share, Treasure shares trade at a 48% discount to NTA (NOK17.86) based on the listed market value of the Glovis holding; not only did the NAV fall over the March quarter by ~21%, but the further expansion of discount to NTA, from ~40% previously, saw the shares fall by one-third during the quarter.

Treasure has bought shares back via reverse auction in each of the past two years from cash reserves gleaned from Glovis dividends, so whilst the company are conservative, there is at least some attempt at capital management. A key major catalyst, once global automotive activity returns is a reorganization of Hyundai Group, or a sale by Treasure of its minority stake. Our holding in Treasure is not large given the "one-day"[11] nature of the shares.

LSF is a real fallen angel, listing on ASX in April 2018 at $2.00 per share, in a massively scaled up $1.32billion IPO. The investment company rode the crest of a wave of strong performance by the manager, L1 Capital, in its flagship long/short product.

The manager has a "value-style" bias investing in Australia and offshore, and struggled in the early months of the new company – a situation with which we can empathise. However, the hype of the float led to extreme investor dissatisfaction, which has not realistically moderated given on-going performance difficulties.

Between end-December 2019 and end-March 2020, LSF's NTA/share fell by 34% pre-tax, with losses on a number of cyclical securities and on short positions such as Tesla. If that wasn't enough, the discount to pre-tax NTA blew out from around 11% at year end to an extreme high of 35.8% on 24th March 2020. Remember, this is a long-short fund with current net exposure of 74% and a strong value bias, and willingness to engage with management to liberate value – witnessed by the agreement by Iluka Resources to spin out its highly lucrative Mining Area C (BHP) iron ore royalty.

Moreover, the manager has real skin in the game having invested over $25million since last August, a further commitment, and a 10% on-market buyback, which has been active in recent days at discounts in the 30-35% arena. The ingredients of a portfolio we like, massive discount to NTA, net exposure below 100% and strong capital management provide an attractive recipe, in our view.

Renn Fund (RCG) is managed by Horizon Kinetics, a well -respected and highly innovative NYC hedge fund manager, who took over running of the fund in mid-2017. The fund is small, with net assets of ~$12million and no management fees are currently paid as the fund is below US$25million in assets.

At 31 December 2019, RCG was carrying ~40% cash but had a significant exposure to Apyx Medical, a $123million company focused on helium plasma technology used in cosmetic and surgical tissue procedures. Apyx has half of its market value in cash, but saw a 58% decline in its share price over the March quarter. Horizon Kinetic is best known for its attempts at installing a higher level of corporate governance at Texas Pacific Land Trust (TPL), one of the largest landowners in Texas which derives oil and gas royalties and benefits from water rights and management. TPL has a long history of using asset sales to pay attractive dividends and retire equity. The trust, which has significant cash reserves, is now converting to a company. TPL is RCG's second largest stockholding.

[11] "One day" shares are where "one day something will happen", but until then.....

Over the course of the March quarter, RCG's NTA fell from $2.08/share to $1.40; moreover the discount to NTA increased marginally from 25% to 26%, resulting in the shares falling from $1.64 to $1.07 over the three months. The discount to the value of the investment holdings is, of course, far wider given the high cash weighting. Horizon Kinetics have widened the investment mandate to allow for short selling which we would expect to benefit RCG over time.

Rumours of Prime's demise seem greatly exaggerated

We have continued to maintain a shareholding in one of the two listed Australian regional TV broadcasters, Prime Media. Prime, whilst not a growth business, now appears ludicrously cheap, partly as a result of one of the worst executed corporate manoeuvres in living memory. The failed attempt by Seven West Media (SWM) to acquire Prime in October 2019 has (along with COVID factors) not only reduced Prime's share price by half, but has decimated SWM's price by around 84% in six months (we don't own SWM!).

Prime has its roots in the late 1980's with the acquisition of an assortment of regional NSW television licences (Orange, Dubbo, Albury, Wagga) by Paul Ramsey, the later healthcare magnate who died in 2014, under the banner of his (then) listed holding company, Ramcorp.

Ramcorp went through various incarnations but evolved as Prime TV in 1991 after divesting the healthcare business. At a similar time, Prime hitched its wagon to Channel 7, and became the major rebroadcaster of Channel 7 content in regional NSW, Victoria, Gold Coast, and from late 1996, in regional Western Australia, with the acquisition of GWN from Seven's Chair, Kerry Stokes.

In the late 1990's, Prime made excursions into Argentina and NZ and also maintained a radio and production business for some time. However, by the time of the GFC, the company was massively over-extended with net debt of $271million in early 2009 against an equity value of just over $120million prior to a $110million capital raising in March 2009.

Paul Ramsey's interests existed the register just prior to his death in mid 2014, sold to institutional holders who have gradually flittered away. <u>But there's something remarkable about Prime over the past ten years</u>. The near death experience in 2009 has left a culture of severe debt aversion; strong – albeit gradually declining cash flows from broadcasting – together with some asset sales, have facilitated <u>the repayment of ~$185million of debt without recourse to shareholders over a rough ten year period</u>.

The changing of the guard at SWM – Prime's programming supplier - in mid 2019 with James Warburton now the CEO, has produced a blitzkrieg of deals – the sale of a Perth radio business, attempted sale of magazine publishing, now being renegotiated and the attempted acquisition of Prime. SWM now labour with a debt load of $540million against an equity value of ~$106m. Little wonder the pre COVID, pre bushfires annual cash flow, after capex, of just over $20million a year from Prime was of interest. Especially since SWM were attempting to acquire this with (highly geared) shares priced at the time at around $67million and with the ability to extract $11m pa of synergies.

That SWM would expect Bermuda based mogul Bruce Gordon to accept a ~20c per share scrip bid when Seven had sold shares to him at 40c in September 2017 – to take him to a 15% stake (+ equity swaps) seems incomprehensible. Neither did it take the threat of the owners of regional newspaper group Australian Community Newspapers seriously; Messrs. Catalano and Waislitz have spent $11million acquiring over 14% of Prime at 20c per share. The December 2019 Scheme meeting comprehensively voted down the SWM proposal; SWM have since performed a share swap to acquire 15% of Prime themselves.

So three players control half the register. All want something. Only SWM are in at the right price, thanks to an advantageous share swap. SWM's scrip bid of 0.4582 SWM shares per Prime share (plus a dividend) would now value Prime at only 3.2c per share; such is the extent of the relative decline in SWM's price, they would need to offer over **six times** the amount of shares to buy PRT at the equivalent price as December 2019.

For anyone to get something is likely to require movement from a hitherto intransigent Communications Minister, Paul Fletcher on scrapping media laws within regional Australia, as recommended by the Department of Communications[12]. Recent disasters affecting regional Australia and the need for local news output may act as a persuasive factor.

The stalemate, recent equity market downturn, media revenue uncertainty and issues specific to SWM programming – deferred Olympics 2020 and waning flagship evening shows - have combined to leave Prime shares seemingly priced for extinction.

At 10c, the company has an equity value of $36.6million. It has net cash of $3.3million but also a significant working capital surplus of nearly $24million. That leaves the business ostensibly valued at less than $10million. In normal conditions, the company should produce cash flow of $20million per annum, declining over time. Prime also owns its head office in the Canberra suburb of Watson, plus other sites, carried in the books at just over $6million.

Whilst comparisons at the present time are very difficult, the recent recapitalisation of debt-laden Southern Cross Media (SXL), the other listed regional media company[13] give it an enterprise value of ~ $509million ($310m equity, $169m debt and $30m negative working capital) for a revenue base in FY2020 of ~ $560million, so 91c per dollar of revenue. Prime's estimated $170million of revenue is equivalently priced at below $10million – one fifteenth the price.

Prime is obviously not a growth entity, threatened with streaming of programming from every source imaginable, including its parent. But it's a very cheap source of cash flow, with real attractions to at least three parties.

[12] "Report to Government urges shake-up of media rules" Australian Financial Review 4 November 2019

[13] SXL owns the MMM and Hits-FM radio networks and rebroadcasts Channel 9 to regional Queensland, regional Victoria and regional Southern New South Wales licence areas. It also broadcasts Channel 7 in Tasmania and Channels 7 and 10 in Darwin, Broken Hill (also 9) and certain remote areas. SXL regional TV revenues are broadly similar ($180m) to Prime.

Conclusion

Our mark-to-market performance to 31 March 2020 is predominantly that – it's mark to market where markets for a number of our smaller capitalisation shares are thinly traded and wide bid-offer spreads. It is NOT a permanent loss of capital.

Yet in virtually all cases, there is positive progress with the underlying business. **Yellow Brick Road** have effected all asset sales, established their warehouse finance facility, reduced costs as promised and have a net cash balance. With four shareholders controlling around two-thirds of the shares, it is easy to envisage why the quoted price, in a thin market, fell by 45% in the quarter.

Similarly, there is only minimal trade in the shares of **Namoi Cotton**, where a block of 8.4% of the company changed hands in February 2020 to a smart long-term shareholder, who had been researching the company for some time. In addition, the company has renewed its working capital facilities. More importantly, of course, there has been widespread rain in the relevant areas, which will support a cotton crop in 2021 which should be multiples of the 2020 outturn. Given that Namoi's ginning and corporate costs have been significantly reduced, this bodes well for significant profitability in the future.

Our past track record in smaller Australian shares is good, but they require patience and being prepared to put up with significant mark-to-market volatility over shorter periods, before arriving at the finish line. For example, we endured such volatility in both Dreamscape Networks and Webster Limited, before emerging with excellent outcomes.

For these holdings, it's mark-to-market, not a forced sale price; moreover, the use of gearing within the East 72 entity does exacerbate these moves.

Additionally, we have retained exposures to differentiated investment companies where discounts to net asset value have widened sharply, but will in time, reduce back to more normal levels. Imagine a company with net assets of $1 trading at a 15% discount to NAV (85c). If the NAV falls 20%, but the discount blows out to 30%, the shares fall to 56c – a 34% decline. That is not untypical of what we saw in the March quarter. We are highly confident these discounts will repair themselves, with the assistance in most cases of management action, and which will be to our benefit.

For further information:

Andrew Brown
Executive Director
(02) 9380 9001 / 0418 215 255

STATISTICAL APPENDIX: QUARTER & FYTD TO 31 MARCH 2020

1. Monthly performance, exposure and NAV

	Investment return[14]	Cost imposition[15]	Net Return[16]	R12 Return	NAV/share pre tax (c)	Gross Exposure[17]	Net Exposure[18]
30 Jun 17				46.6%	35.5	276%	-6%
30 Jun 18				-18.8%	29.0	278%	81%
30 Jun 19				-25.8%	21.6	395%	0%
				R12 return			
30 Apr 19	1.7%	-0.6%	1.1%	-20.2%	24.0	386%	43%
31 May 19	0.4%	-0.5%	-0.1%	-19.4%	24.0	382%	24%
30 Jun 19	-9.4%	-0.4%	-9.8%	-25.8%	21.6	395%	0%
31 Jul 19	-1.8%	-0.7%	-2.6%	-24.7%	21.1	413%	-13%
31 Aug 10	-7.9%	-0.6%	-8.5%	-26.0%	19.3	416%	-15%
30 Sep 19	0.9%	-0.6%	0.3%	-26.4%	19.3	415%	-31%
31 Oct 19	0.6%	-0.7%	-0.1%	-25.7%	19.3	429%	-55%
30 Nov 19	-2.4%	-0.8%	-3.2%	-27.8%	18.6	440%	-76%
31 Dec 19	-4.4%	-0.6%	-5.0%	-23.4%	17.7	446%	-106%
31 Jan 20	-18.6%	-0.9%	-19.4%	-43.3%	14.3	475%	-142%
29 Feb 20	-13.5%	-0.9%	-14.4%	-50.4%	12.3	305%	218%
31 Mar 20	-41.5%	-0.5%	-42.0%	-70.0%	7.1	339%	56%

2. Equity and index exposure as at 31 March 2020[19] (as % month end pre tax shareholders funds):

	percent	exposures
LONG	197.5%	37
SHORT	(141.6%)	6
TOTAL	339.1%	43
NET	55.8%	

[14] Change in market value of all investments – cash and derivatives – after interest charges, dividends receivable, dividends and fees paid away divided by opening period net asset value and time weighted for equity raisings

[15] All accrued expenses for company administration (eg. listing fees, audit, registry) divided by opening period net asset value and time weighted for equity raisings

[16] Calculated as 2 (above) minus 3 (above)

[17] Calculated as total gross exposures being nominal exposure of all long and short positions (cash and derivative) divided by end month pre tax net asset value – assumes index ∂ of 1

[18] Calculated as total net exposures being nominal exposure of all long minus short positions (cash and derivative) divided by end month pre tax net asset value – assumes index ∂ of 1

[19] Figures may not sum due to rounding

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