EAST 72

QUARTERLY REPORT #18: PERIOD TO 31 DECEMBER 2020[1]

Performance and net asset value[2]

Quarterly portfolio return: 27.5%

We had our best quarterly return since inception with a gross return of 27.5% outstripping the 20.3% seen in the September quarter of 2016. As announced to NSX on 2 December 2020, the Directors declared a 1c per share fully franked dividend payable on 11 January 2021.

We have had a few discussions with shareholders regarding the competing objectives of paying out franking credits versus compounding the capital within East 72. Given the East 72 structure both inherited and has built a bank of franking credits, it makes sense to pay them out since they have no value to the structure itself, only the shareholders. East 72 and shareholders both benefit if proportionally more shareholders reinvest the dividend; ideally if 100% of shareholders reinvest, the franking credits are paid out with no leakage of capital. As a guide, I am reinvesting around 73% of the dividends due from my relevant interests.

Compressed Catalysts

The past three to four months has been fortuitous in that a number of catalytic events have occurred within a compressed period of time. This doesn't take away from the analysis which underpinned the investment thesis for each security, but represents a reduction in time frame over which the events transpired.

The best example, by some margin, was the events of Monday 9th November in Paris into Tuesday 10th in Australia, for Europe's largest shopping centre owner, Unibail-Rodamco-Westfield (**URW**). In the space of twelve hours:

- The three strong "rebel" <REFOCUS>[3] group were elected to the URW Supervisory Board;
- The planned €3.5billion equity capital raise as part of the board sanctioned <RESET> plan (and supported by most corporate governance consultants[4]) was rejected as hoped for by the <REFOCUS> rebels;
- Pfizer and BioNtech announced their vaccine candidate BNT162b2 was over 90% effective against COVID-19; and
- Stocks which would benefit from a "re-opening" – hotels, physical retail, office and airlines – rose sharply in the 9 November US session and 10 November Asian dealings.

---

1 East 72 Holdings Limited (**E72**) provides monthly **unaudited** updates on its company performance and exposure supplemented by a more substantial quarterly note. Readers are referred to footnotes 2 and 26 - 31 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 0.9% 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 15.

2 Month by month tabulation of investment return and exposures is given on page 14, along with exposure metrics.

3 Refocusnotreset.com

4 The author is not sure what corporate governance consultants know about securities analysis….

Speculators in Europe, where 90% of URW dual listed Euronext-ASX shares reside, but where 15% of them were sold short, (#2 shorted stock in Europe as a percentage of capital) could only watch helplessly. The 10% of URW traded in Australia surged 43% in one day as these shorts scrambled to cover a security where the combined debt+equity value priced the business at a 45% discount to the gross carrying value of the shopping centre portfolio.

We felt that URW had scope to rally significantly – over time – to around a 25% discount to gross asset value which would imply a share price of €128 versus our entry at around €32 or a four-fold increase. If that sound outrageous, at its low point URW equity was valued at just over €4billion against debt of ~€24billion, but against long term assets with a book value of ~€55billion. We simply didn't expect to receive close to half of that return in a few days. To be sure, URW is high risk because of its assets and gearing, a function not only of COVID but a Supervisory Board comprehensively outwitted by the Lowy family on the Westfield acquisition. Consequently, it represents an ongoing trading opportunity against this backdrop of a large value gap; with COVID having re-emerged in far larger than previous numbers in Europe and a capital raise inevitable at some stage (but not the ludicrous level proposed by the then hopeless Supervisory Board in October) our position will change accordingly.

It is these types of events which have awoken investors to some of the amazing immediate values available in beaten down stocks; in many cases, perceived "basket-case" companies have reported earnings and/or balance sheets far better than expected, resulting in significant positive share price responses. In our portfolio, the best example is Prime Media (profiled in QR#15) with a net cash balance at 31 December 2020 equivalent to its market capitalisation as at 30 June 2020. So six months on from the fiscal year end, you were effectively receiving Australia's largest provincial TV-network, with profitable revenues of over $150million, for nothing. Hardly surprising that the shares have risen 130% since end-June.

A pronounced, but very compressed catalyst within Australian financial markets, was given additional impetus from an innocuous looking release on 19 June 2020 by AMP Capital, the asset management arm of AMP. The announcement of a new CEO of AMP Capital provoked a whirlwind of deal making within the Australian wealth management industry.

Why so? The decision to anoint Boe Pahari as the new head of arguably AMP's most valuable asset[5] in a post-Hayne world provoked a degree of invective towards AMP senior management and Board rarely seen in Australian financial circles. The emergence of credible allegations regarding Mr. Pahari's behaviour towards female subordinates was incompetently handled by board and management, further weakening AMP's already dented brand.

It drove further cash flow away from AMP towards new players, especially in the platform market, accelerated from immediate post-Hayne levels. Any new-age platform owner could see the once in a generation opportunity to pounce in the wealth management and advice area, whilst AMP examined its navel and saw its shares fall as much as 23% from the 19 June announcement, despite upward trends in markets.

Since 1 June 2020, we have seen five direct public company M&A transactions, a pending sixth and and countless private acquisitions involving public companies, notably IOOF buying MLC:

[5] AMP bought back the minority 15% of AMP Capital from Mitsubishi UFJ on 13 August 2020 in a deal valuing the whole at just over $3bn; AMP's current equity market capitalisation is ~$5.5billion

Recent M&A Transactions in smaller Australian financial services

Date	Acquiree	Acquiror	Value	Comments
1 June 2020	One Vue Holdings	IRESS	$107m	Cash based Scheme of Arrangement; price increased 7.5% - finalised
9 July 2020	Powerwrap	Praemium	$77m	Scrip and cash takeover from holding of 14% (E72 held PWL)
27 October 2020	E&P Financial	360 Capital	$145m	Scrip and cash takeover from position of position of 19.6% (E72 held EP1)
29 October 2020	Xplore Wealth	HUB 24	$59m	Scrip and cash Scheme of Arrangement due for completion on 3 March 2021 (E72 holds XPL and has hedged part of the HUB 24 consideration)
29 October 2020	Easton Investments	HUB 24	n/a	$14m placement by EAS to HUB, acquisition of advisory business and 1-3 sell-down offer
30 October 2020	AMP	Ares Mgt	$6.4bn	Indicative, non-binding offer by Ares for all of AMP equity. Not progressed further as yet.

The sins of buying high and selling low: index insanity and family buybacks

Green: well this is another area where your analysis overlaps with mine, as I look through the holders list on IBM, I need to get to number 49 holding slightly less than 0.35% of the company before I can actually find a HUMAN BEING who might have looked at something."
Chanos: That is probably right

"TAMSanity & the Golden Age of Fraud" Mike Green, Jim Chanos (Real Vision, 16/11/2020)

Passive investment management, or the mere replication of a benchmark index (such as S&P500) has more than arrived. According a recent Bank Of America analysis, by mid 2022 – on current trends – there will be more dollars in PASSIVE equity funds than active, where the manager takes under or overweight positions against said index, which is usually weighted by capitalisation.

A strictly passive funds manager need employ no stock analysts; they will employ "statisticians" to keep track of index moves, performance and weightings, but there's no individual company analysis or modelling. The index fund doesn't care whether BHP is $4, $40 or $400, merely its weight in the relevant ASX index (usually 200).

But the dirty secret of passive equity investment is now out (for those who care to look) into the general discourse: it's not really passive. It's a dirty game played by rapacious, for profit companies, just like those that rate corporate bonds for payment[6].

On 18 December 2020, Tesla shares traded for the last time preceding their entry into the S&P500 index at the open on Monday 21 December. US$148BILLION of Tesla shares traded in a single session (~222.1m shares at an average price of ~$666[7]) making it the largest individual stock

[6] This is exceptionally explained by Jamie Catherwood in "Tesla, Passive and Herding" in his "Investor Amnesia" blog 20 December 2020
[7] Appropriately, perhaps see Revelations 13:18

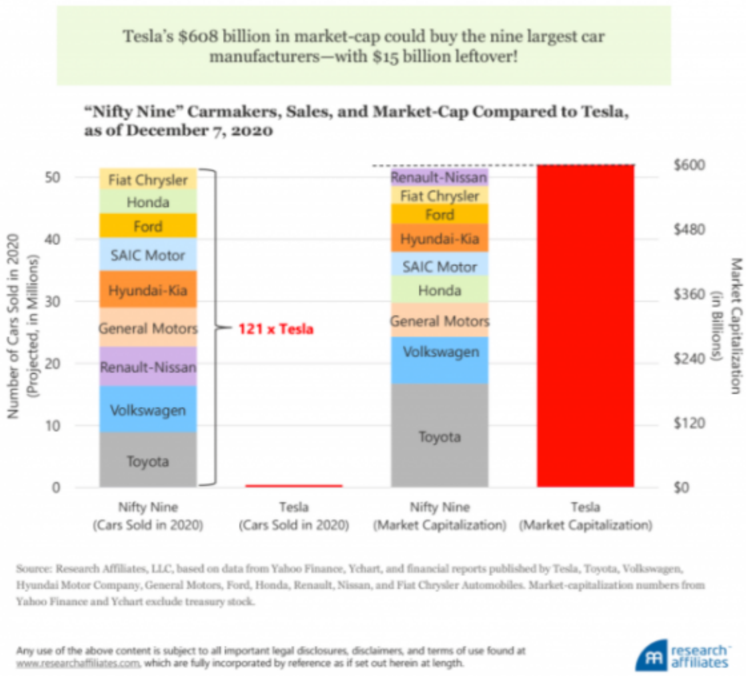
single day's trade value in history, beating the SPDR S&P500 ETF on 28 February 2020 (~US$113billion).

Tesla's entry to the S&P500 has been gamed, probably by two companies – Tesla itself, which has issued more than $10billion of "at the market" equity this year – unthinkable around eighteen months ago – and S&P Global Inc. (SPGI). SPGI (Standard and Poors)[8] is a NYSE listed $77billion behemoth. It's simply NOT in S&P's interest to have a heavily traded cult stock such as Tesla not in the S&P500. It came in at #6, despite having no operating earnings ever, other than through the sale of regulatory credits.

Even the sale of these credits has its question marks – Tesla's quarterly accounts are not audited, yet they have racked up $1,170million in Q1 to Q3 2020, making up 146% of income from operations. (c.f. $461mn equivalent in the corresponding quarters of CY2019). In 2019, we could track that Fiat Chrysler acquired $327million of such credits - not necessarily all from Tesla but equivalent to 71% of the Tesla sales. In 2020 to date, the Fiat purchases of $599million represent only 51% of Tesla's sales. So what are Tesla's disclosures in their filings regarding the purchasers of "products" which constitute nearly 150% of operating profit:

"other automotive manufacturers and related entities".

So we can "buy high": go down this road of paying a $627billion price[9] for a company with technology but no earnings from it as it enters an index. Or we can "sell low" and give away our shares at a fraction of NAV – to other investors in the same company!



---

8 Standard and Poors is the 1941 merger between Standard Statistics (founded in 1906) and the investment information service started in 1860 by Henry Poor. On 30 November 2020, SOPGI announced a merger with the $44bn IHS Markit, a multi-industry data provider

9 Chart Source: Research Affiliates

In QR#17 (September 2020), we profiled two family controlled companies, E-L Financial (ELF.TO) from Toronto and the Wilhelmsen family's single purpose vehicle, Treasure ASA. Both have been busy, reflected in 16% and 39% gains in their stock prices over the past quarter.

Until 2020, ELF (and its associated companies) have been adamant about not buying back shares, explicitly warning that discounts to net asset value can go into the 40's percent. In 2020, ELF itself has had two buybacks, garnering just under 8% of its issued capital at roughly a 50% discount to NAV. The cancellation of these ~310,000 shares at close to an average C$900 discount to NAV is worth some C$280million to shareholders, or C$73 a share remaining.

Given that the controlling Jackman family interests now hold around 77% of the capital in various vehicles, it's a real boon to them AND the remaining minorities like ourselves. We've had over a 10% return from the two exercises this year plus accretion in NAV from the investment portfolio.

In QR#17, we spent significant column inches on the woes of the Wilhelmsen family and postulated that the 77% owned Treasure ASA might offer a way to create some much needed cash, whilst benefitting minority (and Wilhelmsen) shareholders who have to endure a ludicrous discount to NAV despite the company holding only one asset: Hyundai Glovis shares.

Santa arrived eight days early when Treasure announced it had sold 1.04% of its 12.04% shareholding in Glovis and generated US$62.5million of cash. That's just less than half the amount (US$140million) required to completely get rid of the minority shareholders (~50m shares) at full NAV of ~NOK24 – 24.50 a share, against the much increased share price of NOK18.45 – about 40% up on the end September level of NOK13.25, and reducing the discount to NAV down to ~25%. Treasure have an AGM on 16 March 2021 by which time they have promised "more information". Just so long as it's not Thomas Wilhelmsen investing the proceeds...

Portfolio structure

Our top ten long positions in alphabetical order as at 31 December 2020 are:

CIMIC Limited	Prime Media Limited
Deterra Royalties	Treasure ASA
E-L Financial Corp	Virtu Financial
EXOR NV	Xplore Wealth Limited (hedged)
Namoi Cotton Limited/Australian Rural Capital	Yellow Brick Road Limited

The more I look in equity markets, the more the prevailing environment has a stench of 1999-2000 about it. Overall indices are expensive in absolute terms, skewed by egregious valuations in technology. At the other extreme, despite recent rallies, companies with lower perceived levels of growth ("value") remain fundamentally cheap.

Care always needs to be taken with "value" since a proportionally significant component of that subset is usually comprised of large scale banks. Whoever catches the banking cycle across the world correctly will do extraordinarily well, but there is a strong argument that the environment for such institutions has improved little. In Australia, maybe. In the USA investment banking scene, assuredly. In Europe – less so. As a gross generalisation, revenues remain under pressure from low spreads, slow loan growth and an inability to really trim costs. Returns on capital are poor.

The four following charts were compiled by GMO for their Q3 letter[10] to investors and show the extremes of the opportunity in September 2020 – so extreme, that despite recent rallies, not so much has really changed.

EXHIBIT 1: U.S. VALUE'S 2007-2020 RELATIVE RETURNS

EXHIBIT 2: U.S. VALUE'S RELATIVE VALUATION

EXHIBIT 3: VALUE IS CHEAP NO MATTER HOW YOU DEFINE IT

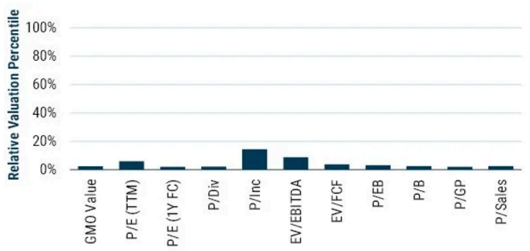
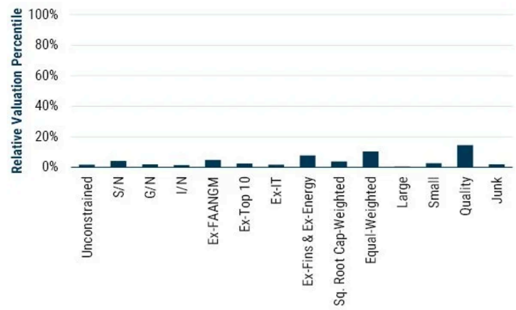


EXHIBIT 4: VALUE IS CHEAP NO MATTER WHERE YOU LOOK



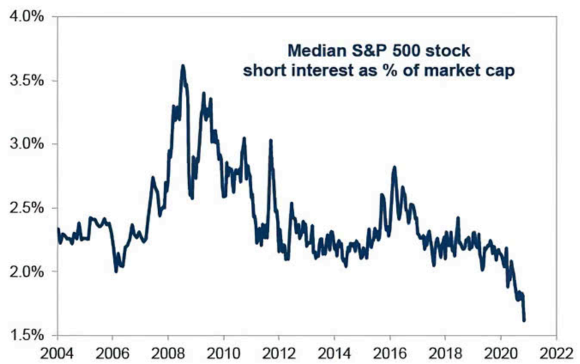
[10] Gmo.com "Value: If not now, when?" Ben Inker & John Pease

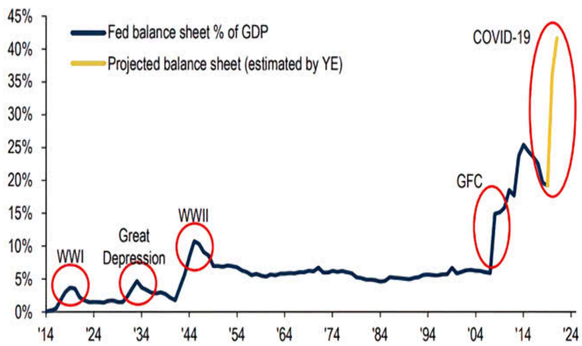
We remained reasonably fully invested over the December quarter but over the past few weeks have started to hedge through (1) indices and (2) increasing the number of smaller individual short sale positions where "price" and "value" live in different galaxies, let alone different planets BUT where there is a clear catalyst to at least partially align these bodies. Such catalysts include results, release of meaningful escrow restrictions over large holdings of stock, and probable regulatory intervention.

Of some concern is the near hyper-ventilating bullishness which pervades investors and especially investment strategists. Earnings forecasts are being increased in the near term despite extraordinary numbers of new COVID cases, to levels which strain credulity. Moreover, it appears like everyone is "all-in".

Some examples:

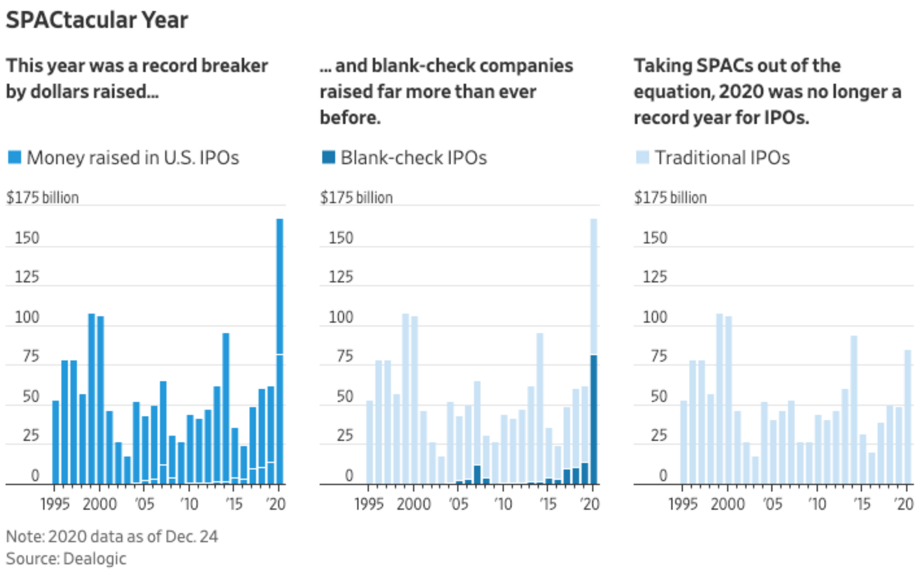
- Short interest in the median S&P500 stock is down to multi-year lows – see chart below[11];
- The average forecast of 14 well known Wall Street strategists is for an S&P500 level by end 2021 of 4055 (+8.6%) with none expecting a decline[12];
- The same strategists[13] expect a rebound in S&P500 EPS from COVID impacted 140 in 2020 to 173; that's 2.5% above the Factset consensus but also over 6% above 2019's earnings with no COVID issues;
- We accept with 23% of S&P500 in the top five technology stocks, their earnings will be stronger than "the economy", but that still leaves a lot of slack to be made up elsewhere;
- In any event, year end S&P 500 forecasts would represent nearly 23.5x P/E for 2021 – plenty of room for disappointment and compression (or higher tax rates); and
- Individual investors opened more than 10million new brokerage accounts in the US during 2020 whilst app downloads for Robinhood were over 500,000 in December alone[14].





[11] Isabelnet.com
[12] ibid
[13] ibid
[14] Wall Street Journal 30 December 2020 "New Army of Individual Investors Flexes its Muscle"

In addition to this, we have an IPO and SPAC boom[15].



A SPAC – special purpose acquisition corporation (or blank check company) is effectively a "shell" company floated on an exchange with the purpose of using the cash raised on floatation to acquire a company which is seeking a listing. The benefit to SPAC investors is that the common shares are usually issued with attaching warrants, there is a fixed time frame (usually a year) in which to execute a transaction, and that promotors of the SPAC usually have a significant low/nil cost stock and warrant exposure. Promotors tend to be hedge funds and other well networked and credentialled deal doers.

SPACs are not corporately illegal in Australia but are prevented by ASX rules[16]; "shell" companies engaging in reverse takeovers have been commonplace in Australian markets throughout history until recent years. SPAC equivalents did occur in Australia in the 1980s and there was a brief respite in 2006-7 with the then go-go investment banks Allco and Babcock and Brown trying their hand – unsuccessfully.

Those of us with grey and thinning hair know what these type of indicators mean. A greed frenzy[17]. Indeed, when share price performance alone, with no regard to any type of valuation metric or earnings growth is used as the arbiter of company quality, we are close to the point of no return. Every company HAS to be a disruptor, or its worthless; unprofitable disruptors are worth the earth as "investors" look further out into the future to find their return. Witness electric vehicles and battery technology. There is minimal risk pricing with regard to the competitive dynamics within these industries.

---

[15] Wall Street Journal 30 December 2020 "Record IPO Surge set to Roll on in 2021"
[16] Since ASX desire to make money knows few bounds, the rules might be changed – for their "friends" (then you'll definitely know it's the top of the market)
[17] If you want to know what a "greed frenzy" looks like, have a gander at the twitter account @chamath. It's the account of Chamath Palihapitiya, the CEO of Social Capital and promoter of numerous SPACs. It's fair to say Chamath is highly intelligent, successful, forthright but has a big trumpet of his own which he likes playing in public.

Our main changes over the quarter were:

- Sale of our Softbank Group Corp holding as the shares ran up in sync with the Doordash float, which on the first few days prices, was worth 5% accretion to Softbank's NAV;
- Hedging of our Xplore Wealth shares via short sale of HUB24 shares to 'lock-in" a guaranteed price around $0.20 against an entry price just above $0.05;
- Sale of Appen well before the unsurprising profit warning as a result of the strengthening A$;
- Sale of A2B – the share ran very hard with the growth in payments business yet to come close to replacing lost revenue in taxis from COVID, despite brilliant efforts from management;
- Adding new European holdings in SAP, Deutsche Borse, Robertet, Man Group and buying back into our favourite now much simplified Italian-Brazilian roadway owner ASTM (see QR#2 December 2016);
- The purchase of small holdings in three Canadian gold producers; and
- Obtaining and building a holding in Deterra Royalties (profiled below)

Royalties and streamers

As a quick introduction, royalty and streaming companies are commonplace in North America, especially Canada. There are at least 25 public listed oil and gas royalty owners in the US, usually structured as trusts. The thematic long established in the O&G industry has been adapted over recent years in the precious metals and base metals industries, most notably by the largest such company, Franco Nevada (FNV).

A royalty represents a share of revenue or profit share from a specific mine or mineral asset. There are contractual stipulations on how the royalty is calculated; revenue royalties are usually preferable since they represent a pure play on the physical price of the commodity, subject to production volume variations. Profit shares take away additional control from the royalty owner. Royalties have usually been created by mining/exploration companies selling an asset to a fellow explorer/developer but wishing to retain some upside "just in case". These royalties are often onsold.

A "stream" is a contract created from an agreement to purchase all or a proportion of the output from a mine, in exchange for an upfront payment which usually assists in building and making the mine operational. Streams are usually created by long established major royalty companies who have the requisite expertise to value and risk assess the likely cash flows from the relevant mine.

There are five North American precious metal royalty/streaming entities, with market capitalisations over US$1billion; additionally there are two listed iron ore royalty companies, presented in the tabulation below with the newest Australian "single purpose company" as a comparison. It should be noted that Labrador Iron also owns 15.1% of Iron Ore Company of Canada from whence its royalties are gleaned. IOCC is a subsidiary of Rio Tinto with significant ownership by Mitsubishi.

Selected global royalty companies and trusts

CY21		shares	US$ price	US$ mn Equity cap	Debt/ (cash)	EV (US$mn)	(E) 2021 EBITDA	EV/ EBITDA	Assessed NAV	P/NAV	
PRECIOUS METAL ROYALTY & STREAMERS											
Franco Nevada	FNV	190.3	125.33	23,850	-467	23,383	894	26.2x	45.67	2.74x	374
Wheaton Precious	WPM	449.1	41.74	18,745	278	19,023	893	21.3x	16.46	2.54x	29
Royal Gold	RGLD	65.5	106.36	6,971	-142	6,829	430	15.9x	50.00	2.13x	187
Osisko Gold	OR	166.3	12.68	2,109	205	2,314	135	17.1x	9.02	1.41x	135
Sandstorm Gold	SAND	191.1	7.17	1,370	-74	1,296	81	16.0x	5.06	1.42x	200
AVERAGE								**19.3x**		**2.0x**	
IRON ORE ROYALTIES											
Deterra	DRR	528.5	3.69	1,949	11	1,960	180	10.9x	3.63	1.02x	1
Labrador Iron	LIF	64.1	25.62	1,628	-14	1,628	268	6.1x			1
Mesabi Trust	MSB	13.1	28.05	358	-10	358	22	16.3x			1

Sources & notes: (E) 2021 EBITDA and NAV/share sourced from Iluka Resources "Deterra Royalties Demerger Booklet" 10 September 2020; other calculations by East 72.

Australia's "newest" royalty: another 1960s special

I have often been very publicly critical over the slapdash manner in which Australia throws away its corporate history - good and bad – especially in "industrial" type companies. Go try and research the great corporate boom and bust companies of the 1980's: Bond, Adsteam, Qintex, Brierley, Ariadne. Not easy. State and National libraries lack even annual reports, and you are reduced to scraps of newspaper articles. However, behaviour tends to be much better in the minerals industry for the simple reason that past data on discoveries is the exploration industry's stock in trade and is kept for multiple decades.

BHP has (eventually) been the ultimate credit risk behind three royalties listed on ASX:

- **Metals Exploration (MEX)**:
  MEX owned a 0.35% production royalty over the Mt. Keith nickel mine as well as a 1.35% royalty on the nearby Kambalda mine; MEX discovered Mt. Keith in 1969, but failed to develop it, selling for cash and a royalty to Australian Consolidated Minerals and Freeport. After co-ownerships with Seltrust and MIM, the mine ended up with Western Mining Corporation, acquired by BHP in June 2005; the MEX royalty was eventually sold to Franco-Nevada in October 2009 for $20million.

- **Weeks Petroleum (WPM):**
  WPM is one the GREAT stories of Australia, let alone the resources industry or stockmarket. Dr. Lewis Weeks, a retired American geologist provided advice to BHP (at US$250 a day plus travel in 1960)[18] on the likely areas of interest for drilling in Bass Strait. Weeks agreed a royalty of 2.5% (half the prevailing rate) of gross wellhead value of hydrocarbons which one-fifth went to a lawyer (Dr. Paul Temple)[19] who encouraged Weeks to increase the rate from 2% to 2.5%. Of the royalty, 55.1% (i.e 1.378% of wellhead value) was floated as Weeks Natural Resources in 1972, with the remainder dispersed amongst family and private investors, being administered by a Bermuda entity, Oil Basins Limited[20]. After numerous overtures, WPM was eventually acquired by Robert Holmes a Court's Bell Group and interred in Bell Resources (BRL). BRL – and 55.1% of the royalty - was eventually acquired through capital reduction by Brierley Investments Limited (BIL). BIL is now named GL Limited, listed in Singapore (SGX: B16) and the royalty resides alongside London hotel assets such as the Royal Horseguards, Tower and Grosvenor. B16 is 70% controlled by the Malaysian based Hong Leong group. The royalty STILL produces ~US$25million per annum revenue.

- **Deterra Royalties (DRR)[21]:**
  DRR is a newly listed company, spun off from Iluka Resources, in October 2020 which owns a 1.232% revenue royalty (plus production step-up payments) from Mining Area C in the Pilbara, operated by BHP (who own 85%, Itochu and Mitsui own the 15% balance) For this, investors can thank Mr. George Lloyd, Rension Goldfields Consolidated's exploration and development group general manager in 1994. DRR has a history steeped in 1960's mineral development starting from the public floation of 22.7% of Consolidated Gold Fields Limited's (CGFplc)[22] Australian assets (CGFA) in October 1966. The main asset of CGFA was a one-third stake with Cypress Mines and Utah International (acquired by BHP in 1983) in Goldsworthy Mining Limited. Mining Area C was explored in 1970 and a preliminary feasibility study completed in 1973. By 1977, the potential capital cost of exploitation was well beyond CGFA's resources and the majority of the interest, along with that of Cypress, was sold to the UK parent CGFplc. From here emanates Lloyd's royalty – originally being a one-off payment of $19.8m (to each of Cypress and CGFA) on the commencement of production of Mining Area C (**MAC**). In 1991, the Goldsworthy interests were acquired by BHP; in 1994, the one off payment obligation was renegotiated by Lloyd to a $2.5million one-off payment and perpetuity revenue royalty once production exceeded 5million tonnes.

[18] "The Big Fella" (Chapter 6) Thompson & Macklin (Heinemann 2009)
[19] "The $1billion oil royalty which slipped away" (AFR 6 March 1992)
[20] 1% of the royalty (i.e. 0.025% of well head value was acquired from one such investor by then ASX-listed Royalco Resources for $8.5million in March 2013
[21] The story of Consolidated Goldfields Australia has been painstakingly documented by Robert Porter in his 2020 book "Consolidated Gold Fields in Australia: The Rise and Decline of a British Mining House 1926 – 1988" (ANU Press) and has greatly assisted in compiling this piece
[22] Consolidated Gold Fields Limited is one of the two great South African originated companies along with DeBeers founded by Cecil Rhodes and Charles Rudd.

By this stage, CGFA is one of the great "gunna-be" stories of Australian mining; it merged with Renison Tin, Mount Lyall Copper and Associated Minerals Corp in 1981 to create Renison Consolidated; owned the world's largest mineral sands deposit, largest underground tine mine, one-third of the Porgera Gold Mine in PNG, and a string of other worthy assets. After its 49% controller CGFplc was acquired by Hanson plc in 1988, a clash of corporate cultures hampered development and the company merged with Westralian Sands in 1998. In the merger documentation the royalty is valued at...$10 - $14million[23]. Not any more.

Why is Deterra SO unique?

At present, DRR generates its 1.232% royalty only from the North flank of MAC with production running at an annual rate of ~58million tonnes of iron ore. Only three things impact on DRR's revenue, which largely flows through to the bottom line with only $7million per annum or so of administration costs:

- Volume of iron ore sold;
- Price at which the iron ore is sold; and
- A$/US$ exchange rate (weaker A$ is better).

DRR has a miniscule $14million level of debt and has committed to a dividend policy of paying out 100% of after tax profit. However, the most interesting aspect of DRR is the embedded growth in revenue from MAC as the South Flank commences production next year, commencing at ~40m tonnes per annum but expanding into calendar 2023 when DRR is programmed to have royalties on attributable production of 145million tonnes. As a guide, that's like taking a 1.232% REVENUE clip from about 80% of Fortescue Mining's (FMG)[24] current production, with insignificant costs.

MAC has a mine life of around 30 years and like many other royalty assets, has a fair chance of exceeding that; there is a strategic plan to continue operations to 2073 which would require the proving up of further resource.

As a guide, in the six months to 30 June 2020, DRR generated revenue of ~$48million from 28.6million tonnes sold at an average of US$87.40 a tonne and exchange rate of A$1=US$0.66. This would generate pre-tax profit on a pro-forma basis of $44.3million or 8.4c per share. Of course, iron ore prices are now WAY higher than this having touched a peak of US$174/tonne on 21 December; the average price for H2 CY2020 is around US$125/tonne – over 40% higher. Of course, the A$ has appreciated too, but we reckon on a pro-forma basis (before entity reconstruction costs), DRR would earn some $58millioon pre tax.

We have modelled the company using a long term iron ore price of US$90/tonne, exchange rate of A$1=US$0.75 and steady state production of 143million tonnes beyond 2023. At a 7.5% discount rate, we get a pre-tax net present value which roughly equates the current share price.

On our figuring, that's a steal. We have used reasonably conservative iron ore prices – which don't properly tie in with the exchange rate assumption – and a currently high discount rate.

[23] See Porter, note 21 above
[24] FMG has a current market capitalisation of about $74billion

With no gearing, one of the best credit ratings backing a royalty on the planet, mandated growth and one of the very few iron ore royalties around, we would be astonished if one of three players with a far lower cost of capital didn't seek to acquire DRR in the future: Franco Nevada, Wheaton Precious Metals, or even BHP itself. The range of possibilities are very wide, but it's not inconceivable that this could be an $8+ stock.

There are risks of course, other than the iron ore price, largely dictated by Chinese demand. The main one in our view would be "diworsification" – management investing the cash flow to buy other inferior royalties[25].

Conclusion

We have moved from being fairly fully invested to fully hedged, as signs of euphoric market conditions abound. With numerous uncertainties – not least the pending Georgia runoff vote for two Senators which could decide whether the equity market's preferred House-Senate "split" remains in place, or a more left leaning "taxing" administration is installed. One senses this is the first in a series of unpriced "speed bumps" for 2021.

For further information:

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

[25] DRR has four other small royalties, only one of which is producing

STATISTICAL APPENDIX: QUARTER & FYTD TO 31 DECEMBER 2020

1. Monthly performance, exposure and NAV

	Investment return[26]	Cost imposition[27]	Net Return[28]	R12 Return	NAV/share pre tax (c)	Gross Exposure[29]	Net Exposure[30]
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%
30 Jun 20				-68.0%	7.0	185%	122%
				R12 return			
31 Jul 20	(3.9%)	(1.0%)	(4.9%)	(68.7%)	6.6	231%	-20%
31 Aug 20	(7.1%)	(1.0%)	(8.1%)	(68.6%)	6.1	282%	-67%
30 Sep 20	11.7%	(1.0%)	10.7%	(65.3%)	6.7	192%	34%
31 Oct 20	10.7%	(1.0%)	9.7%	(61.9%)	7.4	202%	113%
30 Nov 20	12.8%	(0.9%)	11.9%	(56.0%)	8.3	273%	52%
31 Dec 20	2.1%	(0.8%)	1.3%	(53.0%)	7.4XD	386%	(1%)

2. Equity exposure as at 31 December 2020[31]
(as % month end pre-tax shareholders funds ex div):

	percent	exposures
LONG	192.6%	30
SHORT	(76.0%)	19
FUTURES/INDEX DERIVATIVES	(117.4%)	
PUT OPTIONS (delta adjusted)	-	
TOTAL	386.1%	49
NET	(0.8%)	

26 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
27 All accrued expenses for company administration (eg. listing fees, audit, registry) divided by opening period net asset value and time weighted for equity raisings
28 Calculated as 2 (above) minus 3 (above)
29 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
30 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
31 Figures may not sum due to rounding

Disclaimer

While East 72 Holdings Limited (**E72**) believes the information contained in this communication is based on reliable information, no warranty is given as to its accuracy and persons relying on this information do so at their own risk. E72 and its related companies, their officers, employees, representatives and agents expressly advise that they shall not be liable in any way whatsoever for loss or damage, whether direct, indirect, consequential or otherwise arising out of or in connection with the contents of an/or any omissions from this report except where a liability is made non-excludable by legislation.

Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of E72 and therefore may not be realised in the future.

This update is for general information purposes; it does not purport to provide recommendations or advice or opinions in relation to specific investments or securities. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should take relevant advice before acting on the commentary. The update is being supplied for information purposes only and not for any other purpose. The update and information contained in it do not constitute a prospectus and do not form part of any offer of, or invitation to apply for securities in any jurisdiction.

The information contained in this update is current as at 31 December 2020 or such other dates which are stipulated herein. All statements are based on E72's best information as at 31 December 2020. This presentation may include forward-looking statements regarding future events. All forward-looking statements are based on the beliefs of E72 management, and reflect their current views with respect to future events. These views are subject to various risks, uncertainties and assumptions which may or may not eventuate. E72 makes no representation nor gives any assurance that these statements will prove to be accurate as future circumstances or events may differ from those which have been anticipated by the Company.