QUARTERLY REPORT #19: PERIOD TO 31 MARCH 2021[1]

Performance and net asset value[2]

Quarterly portfolio return: 9.1%

Our return over the quarter (12.0% before expenses) is pleasing since we commenced January with near zero **net** exposure; we ran a net negative equity exposure throughout the quarter, mixing individual company short positions to an increasing hedge in the S&P 500 index. Hence the positive investment return has come about predominantly from stock selection, with contributions from a number of our larger positive positions but also from a number of our stock short positions. Over the year to 31 March 2021, we returned 42.7% before expenses, despite an average net equity exposure of only 28% (range: +121% to -67%).

Of short positions that we noted at the AGM in January, securities such as Trupanion (-36% over the quarter), Tesla (-5%) and Afterpay (-14%) have all been contributors during the quarter. On the long side, Virtu Financial (+23%), Vahli (featured below +35%), Exor (+8.6%) and yet again E-L Financial which rose 21% during the quarter as the Jackman family initiate the third equity retirement scheme in the last twelve months (and ever) with the share price pitched at an approximate 45 - 50% discount to assessed NAV at the time of announcement.

We benefitted from a distribution of Australian Rural Capital's stake in Namoi Cotton (+39% over the quarter) and so now have a significant direct exposure to Namoi as well as an interesting shell company proposition in ARC, which has attracted a new 20% shareholder via a placement of new shares. If we glued the two shares back together, the combined package rose 58.5% over the quarter.

Portfolio structure

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

Deterra Royalties	Prime Media Limited
E-L Financial Corp	Treasure ASA
EXOR NV	Vahli
HAL Trust	Virtu Financial
Namoi Cotton Limited	Yellow Brick Road Limited

Our main changes over the quarter were:

- sale of our stake in Xplore Wealth on conclusion of the takeover from Hub 24;
- purchase of new holdings in Australian bathroom accessories business GWA Group;
- purchase of a new holding in another family controlled holding company HAL Trust listed in Amsterdam, which is profiled later in this quarterly;

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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 17 - 22 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 16.

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

- purchase of shares in Franco Nevada, the precious metals royalty company after weakness in the gold price; and
- paring back some of our European Holdings after a strong run in markets on that continent but have retained core positions in Bayer, Exor and Robertet.

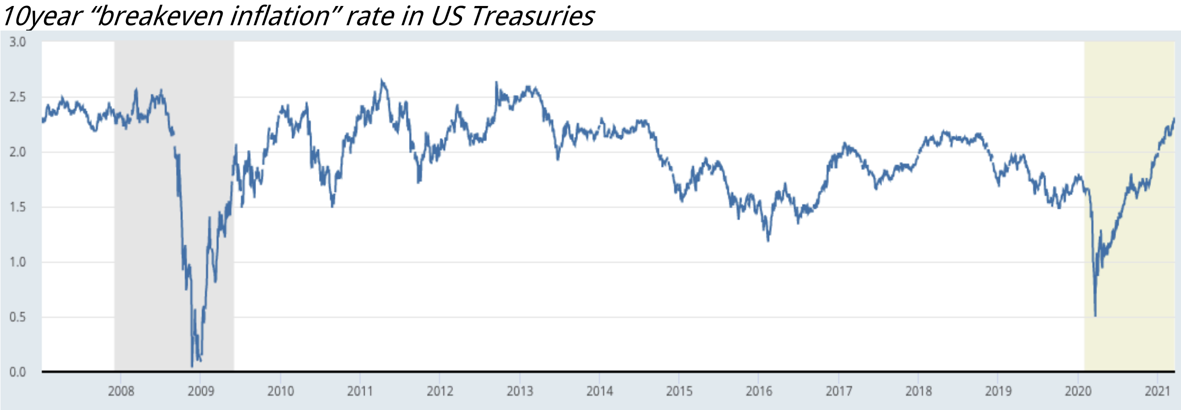
The key market thread in this report concerns the potential for higher inflation to permeate into the economic system, partly arising from bottlenecks which have come about due to COVID-19 but also as a result of potentially excessive monetary and fiscal policy. The former seems to do little to generate job growth, highly desired by central banks and the latter assuredly has assisted a number of economies (think Jobkeeper in Australia) the withdrawal of which appears to be causing significant angst amongst both economists and politicians.

Why might the current cycle be different to recent times?

The quarter, especially the past two months, have been characterised by a four-way flip-flop between expectations of higher inflation and intrigue over the direction of bond rates in the 10year duration area in the US, and also within Australia.

A different way to illustrate this is to make use of the sophistication of US credit markets. The US Treasury has issued significant amounts of TIPS: Treasury Inflation Protected Securities which are US Government bonds which pay a **real** rate of interest. By pricing the yield to maturity of a those bonds in the ten year area, and deducting that yield from the pricing of the normal 10year US Treasury, we can deduce the level of inflation priced into such securities over a ten year period. We can do similar calculation for 2year and 5year maturities, which not surprisingly, show rather higher expected "breakeven" inflation than the 10year bonds, which are illustrated in the chart below:

10year "breakeven inflation" rate in US Treasuries



Source: Federal Reserve Board of St Louis

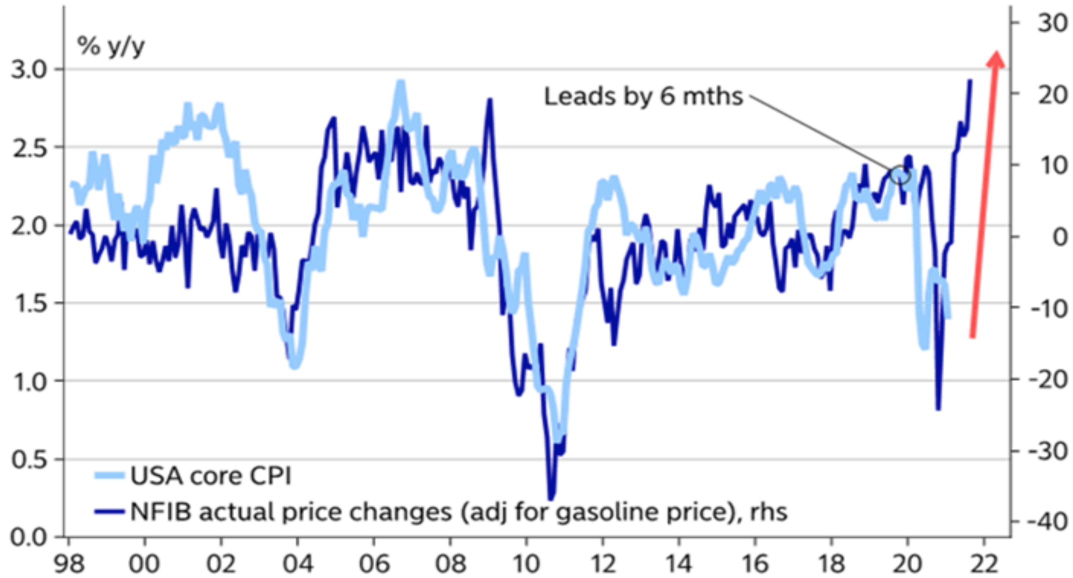
It is very noticeable that every time the future expected rate has reached 2.25-2.5% in recent years, it has then fallen back. In the main this has been by Treasury yields (10 year rates) falling away, reflecting a lack of emergence of real "cost push" type inflation; the phenomenon have tended to be credit market, rather than "real world" events. This time, there are real world forces at work:

Empire prices paid versus CPI (lagged six months)

Source: Bloomberg; Federal Reserve Board of New York

In 2011, there was something of a genuine inflation scare. In the chart above, the prices paid component of the NY Fed monthly Empire State Manufacturing Survey which shows the percentage of firms reporting price increases less those reporting lower. As the chart above shows, there is a strong correlation – with a six month lag between this diffusion index and the CPI in USA.

This ties in closely with another survey of prices made by the National Federation of Independent Business (effectively a small business federation in the US) where the diffusion index of firms raising prices is illustrated in the graph below:



Source: NFIB/Nordea Bank

Somewhat more concerning are very real world examples of heightened inflation in areas where prices have been suppressed for some time. There are classic examples in basic materials such as lumber, copper, oil and non-traded examples such as DRAM chips and container freight. The Freightos Baltic Index illustrated below is a **global** figure, which covers rates one-fifth of the average (eg. East Coast US to China or Europe) but others rather higher (eg. China to West Coast US) and averages them out. The trend is obvious:

Freightos FBX Baltic Index: Container Freight Index

Source: Freightos

These signs lead us to a genuine belief that the 40 year bull market in bonds - starting with FRB head Volker when your correspondent was a young broker in New York City -might have already concluded. That doesn't automatically mean a fearsome rise in yields, but does give rise to a reasonable questioning of the type of discount rates being imputed into stock pricing, especially of growth companies and perceived growth companies that really aren't - those where free cash flow production is unlikely or that there is a massive level of investment to perform simple tasks that don't require it. Does a company really have a business model spending $100million a year to roll out fridges to accommodate fresh pet-food in a wider variety of shops? (Is that a real distribution model or are they going to securitise them as vending machines.)

In the US, however, consumers can actually stand some level of rate rises across the curve; in Australia, not the case. Australia's far more indebted personal sector will start to encounter issues not seen since the early 1990's. As with many economic mishaps, they staggeringly occur in plain site where the consensus view of "it can't/won't happen" obscures deeper assessments. Given the pay scale of Australia's foremost central banker, there is an expectation that in tandem with the least talented group of politicians (on both sides) seen in generations, they will find a way forward.

Optimism abounds. The vaccine will save everyone, travel and its robust multiplier effect will put folks properly back to work without reliance on Government subsidy. The wealth effect of recent rises in house prices at low interest rates, will have the population optimistically spending their new housing equity. If all this were to happen, interest rates <u>should</u> be rising across the curve to reflect increased demand for credit. But some commentators would have you believe that the RBA will use it new toy of "yield curve control" to prevent this, by buying Australian Government, semi-Government and even RMBS at key places on the curve (3 year yields at present). They can do so by "printing money" to load up their effective "pop-gun" against global bond investors.

All the RBA succeeds in doing is inflating asset prices to ludicrous levels, **not** promoting wage growth or capital spending. About time Dr. Lowe explained this lunacy in simple terms. He can't, because in our opinion, it doesn't work, and merely creates debt laden economic imbalance which will end in the tears of higher rates.

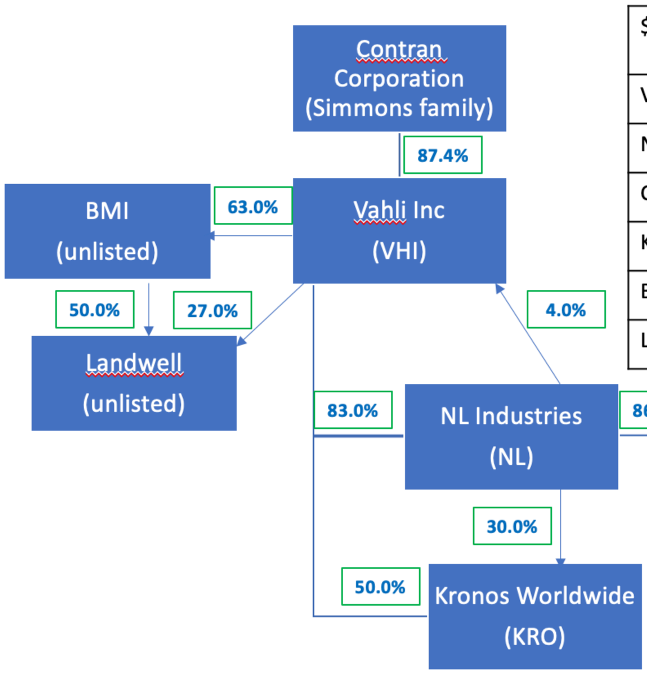
Under the radar billionaire family edition

This quarterly report features two very tightly held listed companies, both controlled by families. In many cases, family controlled listed entities frighten off conventional institutional investors. Even in Australia, it took many years for institutions to become comfortable with investing alongside one of Australia's richest – Kerry Stokes and family. That always seemed insane to me as his wealth was not inherited – it was made from scratch. It's annoying that the share price of Seven Group Holdings is now so high, as it's not always been the case.

In the past, we have looked at family controlled entities such as ASTM, Exor, Wilhelmsen, Treasure ASA, Vulcan International. With the exception of Vulcan which wasn't a disclosing entity, we've never looked at two quite as secret or tightly held as the two in this report: the US listed Vahli (VHI) and the tax haven incorporated/managed HAL Trust (HAL.AS).

Vahli: TL; DR[3] provided a great opportunity (the Simmons family, Dallas)

In October 2020, we invested in a US company which we KNOW is unlikely to ever reach its full value in the listed market. But when the **discount** to your assessed value is **around two-thirds**, (and the schematic below gives a clue why) there is an obvious rationale to at least dip the toe.



$mn	Equity value	Gross debt	Cash
VHI	585	301	9
NL	363	-	95
CIX	224	-	71
KRO	1,770	486	362
BMI	unl	16	21
LW	unl	14	20

[3] Too long; didn't read

Many value based investors will be familiar with the concept of "trading the discount" – a not uncommon situation in listed investment companies, where there are often constraints such as restrictive management contracts – which may prevent full realisation. Hence, buying at (say) a 40% discount to NTA and selling at 15% is a reasonable strategy which would yield a 42% return plus/minus dividends and movements in NTA.

To some degree, this is **Vahli** (NYSE: VHI) - one of the most intriguing companies we have analysed in some years. It is utterly controlled by the Simmons family based in Dallas, TX – they control 92% of the equity (87.4% directly and 4.5% via Treasury stock held in two subsidiaries), provide a US$320million debt facility (drawn to $271mn) to this parent entity and have a tax sharing facility with VHI. But VHI sits atop a four listed company structure (plus controlling interests in two relevant subsidiaries), which might have been pieced together almost anarchically, <u>but now has a logical structure which is unlikely to be collapsed in the near future</u>.

So Vahli has a free float of only around 2.4million shares (priced at ~US$54million) of which the famous Renaissance Technologies owns around 7%.

This is a real outlier. Contran is a private company control of which was bequeathed in 2014 to two of his daughters by Harold Simmons, a Dallas based businessman, political activist, philanthropist and keen tax planner. Why only two of his four daughters? The other two challenged his trust structure in court in 1997[4] and settled out of court in 1998 for US$50million each[5].

This left the corporate structure to the two remaining daughters, one of whom, Serena, unfortunately died in April 2020. Control is therefore strongly vested in the other daughter, Lisa Simmons, together with Serena's husband.

Vahli is close to the ultimate conceptual "this MUST be mispriced" equity I have ever come across, since within the four company structure, it has:

- Insignificant free float, family control and family credit supply;
- Ownership by two listed subsidiaries (NL & in a small way Kronos) of parent company stock;
- Operates across four industries: titanium dioxide (Kronos), locking devices, recreational marine accessories (CompX) and a master planned community development in Henderson, Nevada[6] (BMI, but land held by Landwell);
- Joint venture with a competitor (Kronos 50% holding of Louisiana Pigment LP with a major competitor Venator);
- Environmental remediation liabilities relating to a prior activity of manufacturing lead pigment for paint (NL);
- Litigation liabilities related to lead-based paint (NL) based on one successful case[7]; and
- Pension fund shortfalls (Kronos).

[4] NY Times "Daughters do battle with a Corporate King Lear" 18 May 1997
[5] Private Wealth magazine "Hidden Billionaire Daughters emerge from Simmons Estate" 7 February 2014
[6] Home of the NFL's Las Vegas Raiders practice facility
[7] County of Santa Clara versus Atlantic Richfield et al Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657

How did it get like this?

The current structure really emanates from the residue of Harold Simmons corporate career, which started in his late twenties, focused initially around the drugstore industry; from 1973 onwards, he began to invest actively in listed securities, being prepared to acquire control, and with a focus on maximising shareholder value. Contran effectively acquired control of Vahli in 1979, but has engineered a series of acquisitions and disposals across industries such as insurance and waste management.

Titanium dioxide

It is clear from the initial flow chart and table that the key "value" within Vahli lies with Kronos Worldwide, where the group owns 80% of this titanium dioxide producer which was spun off in 2003-2005 (50% VHI; 30% NL).

Kronos is the fifth largest global manufacturer of titanium dioxide (TiO_2) with around 7% of global sales where the top five players hold ~52% market share of a 7.4million tonne industry; based on prevailing prices, the global industry has production valued at ~US$23billion.

TiO_2 has multiple uses as a whitening pigment in coatings (paint), plastics, paper, cosmetics etc; coatings are generally ~60% of end use. KRO has six plants of which four are in Europe (one USA and one Canada) which gives the company a bias to the German market, where it is the largest player. 66% of production is at the four European plants.

Major listed players in the global TiO_2 Industry and selected statistics (at 31/3/2021):

(US$mn unless stated)	Chemours	Tronox	Lomon Billions†	Venator	Kronos
Listing code	CC	TROX	002601.SHE	VNTR	KRO
Est global market share	15%	13%	9%	8%	7%
2020 Sales	2402	2176	na	1431	1639
2019 sales	2345	2374	1,726	1614	1731
2020 EBITDA	510	688	na	127	174
2019 EBITDA	505	615	632	197	194
Equity value US$mn	4,687	2,694	9,872	494	1,770
Net debt (excl. leases)	2,921	2,673	(391)	754	124
EV (US$mn)	7,608	5,367	9,481	1,248	1,894
EV/adj av. 2020/19 EBITDA	15.0x	8.2x	15.0x	7.7x	10.3x

Source: company accounts, East 72 † converted at CNY6.58 = US$1.00

Kronos trades at a middle rank to the other producers, in our opinion partly attributable to the thin float, but also the low debt load, and consistent margins over recent years:

The TiO_2 demand environment seems to be improving – sharply. Tronox noted in their 2020 results presentation[8] that they expected sequential sales volumes of TiO_2 to increase 11-15% in Q1 2021 with an implication of some price increases in the $100/tonne area (3%). Venator also noted demand recovery and price/margin improvement likely in their near term outlook.

[8] Tronox Holdings plc Q4 and 2020 Conference Call slide 10

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KRONOS WORLDWIDE: SELECTED QUARTERLY FINANCIALS

US$million	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Sales (t)	106,000	143,000	158,000	144,000	121,000	136,000	124,000	136,000	135,000
Production (t)	136,000	134,000	136,000	136,000	140,000	132,000	133,000	122,000	130,000
price/tonne	$3,296	$3,052	$3,066	$3,038	$3,080	$3,096	$3,113	$3,065	$3,073
GM%	27.6%	25.0%	22.6%	20.1%	21.4%	20.9%	24.8%	19.3%	20.9%
Sales	349.4	436.5	484.5	437.4	372.7	421	386	416.9	414.9
COGS	(252.9)	(327.2)	(375.0)	(349.7)	(293.0)	(332.9)	(290.2)	(336.3)	(328.2)
Margin	96.5	109.3	109.5	87.7	79.7	88.1	95.8	80.6	86.7
OPERATING PFT	44.6	49	46.5	33.1	17.2	43.5	33	19.3	20.4
EBITDA	57.4	59.6	58.4	44.9	31	58.4	47.6	33.1	35.2

Source: Company accounts compiled by East 72

As a guide, Kronos should be capable of earning a minimum $192million EBITDA (before pension costs) at sales levels of 530,000 tonnes of TiO_2 at prices around $3,100 a tonne and 22.5% gross margin. Past peak earnings occurred in 2011 with an average selling price above $3,860/tonne.

Realising value from the corporate structure?

It is highly unlikely that the corporate structure will be collapsed into a single company. This does NOT mean that the Simmons family are poor capital managers or antagonistic towards minority shareholders; indeed, it's arguably the opposite.

In August 2020, the family **CANCELLED WITHOUT PAYMENT**, US$600million worth of preference shares which had previously been issued in March 2007 to deal with a taxation settlement across the group. Hence, there was an instant $600m uplift in equity value to common shareholders (admittedly, the Simmons family are ~ 92% of that).

Secondly, the corporate structure acts as a benefit to Vahli, with NL acting as a "corporate shield" keeping potentially adverse legal judgements and payments away from the parent in an effective "non-recourse" style structure.

The innocuous initials "NL" hide past activities – they once stood for "National Lead" and manufactured lead pigments which went into paint. This leaves two potential areas of difficulty: potential liability for the impact of consumers handling articles coated with paint incorporating lead based pigment, and the potential environmental issues at previous plant locations. NL has significant cash, and a dividend paying 30% stake in Kronos as well as control of CompX. However, it has on-balance sheet liabilities for environmental remediation of ~$93million plus litigation settlement reserves of $61million, relating to the sole settled judgement against the company[9].

[9] County of Santa Clara versus Atlantic Richfield et al Superior Court of the State of California, County of Santa Clara, Case No. 1-00-CV-788657

Whatever NL's directors views – and the wording in relation to these matters in all the relevant 10-K's is VERY tight – the equity market takes a different view; NL shares trade at an approximate 45% discount to NTA when the CompX stake is deconsolidated and replaced at market value (~1.6x BV) which has gained significantly in the past month.

There are possibilities of NL distributing some of its assets down the track, especially noting the environmental liability figures have barely moved in the past three years, but that can't figure as a core tenet for this argument.

Hidden asset emerging: Henderson, Nevada

Henderson is around 20minutes drive south-east of the Las Vegas Strip and half an hour west of the Hoover Dam. VHI, through two majority owned subsidiaries, BMI and Landwell, supply water utility to parts of the city (BMI) and owned 2,100 acres of residential development site (plus 100 acres of other development land) predominantly to the NW of town.

The land comes from the location of old magnesium manufacturing plants, closed down after WWII, and remediated over a twenty year period. Thanks to the bankruptcy of Tronox, one of the other owners, in 2013, Vahli moved to controlling the two relevant companies. Over the seven subsequent years, Landwell has sold off 1,000 of the 2,100 acres to builders and others at an average price over the whole period of around US$250,000 per acre. Due to past accounting, the acreage sales do not yield profit, but cash.

Based on the 2014 transaction value of BMI ($40m for 100%) and our assessment of cash flow production from land sales over a ten year future period discounted at 10%, giving an estimated value of $160m for 100% of Landwell, we believe VHI's stake in the two companies to be worth ~ US$119million or $4.20/VHI share. This aspect of Valhi's valuation has been brought into focus by a large sale of ~220acres for $55million in the final quarter of 2020 (likely to builder D.R. Horton).

What is Vahli potentially worth at the present time?

Vahli has appreciated sharply since our purchases, and at end March, we are around 41% ahead on our entry price. There are a myriad of catalysts for further re-rating ranging from the TiO_2 market to further Nevada land sales, let alone any unexpected corporate reorganisation and buy-back.

In our tabular analysis (below), which is composed on a "see-through" basis, at its end March 2021 price of $20.51 per share, Vahli trades at **a 54% discount** to our assessed NAV of $44.50/share.

It should be noted that the NL share price at $7.45 trades at a <u>45% discount</u> to its NTA after deconsolidating CompX; if we were to substitute this into the table below and remove the see-through values of Kronos and Compx, Vahli would <u>still</u> have an assessed NAV of $35.92 a share, leaving the shares at a mere 43% discount!

Our valuation of Vahli, which takes no account of the (negative) necessity to retain NL as a liability shield, is as follows:

		US$mn	At 31/3/2021 prices
Kronos direct	58.0mn shares	887	At $15.30 share price
Kronos via NL	28.7mn shares	439	83% of 30% at $15.30
CompX via NL	8.89mn shares	160	83% of 86% at $18.01
BMI (unlisted) (63%)		26	Based on 100% at $41m excluding Landwell stake
Landwell direct (27%)		43	Based on 100% at $160m valuation
Landwell via BMI		50	Effective 31.5% (63% x 50%) at $160m valuation
Parent cash ex BMI/Landwell		9	
NL net liabilities		(55)	83% after excluding CIX & KRO stakes
Parent debt		(271)	Draw of $320m facility from Contran
Debt to CompX		(30)	
TOTAL		**1,258**	**= $44.50/share** (28.27 non-Treasury shares)

Whilst there are obvious negatives, we view these as being captured in the egregious price/asset discounts.

HAL Trust: starting to put itself to the fullest possible use[10] (The van der Vorm family).

HAL Trust is listed in Amsterdam and is the sole owner of HAL Holding NV, based in Curacao. The background of the entity and owners is perfectly aligned with such a structure. Our thesis is that there is limited downside due to the underpricing of HAL's unlisted businesses, many of which have cyclical upside, but that there is significant upside potential via a sale and partial sale of two businesses, which will leave the company with over €6billion (you read it right) in cash and enormous flexibility. We do not rule out a privatisation (we would if we were them....).

The logo of HAL Holding – a green and white horizontally striped flag with "NASM:" across the middle - gives the clue as to the background: Nederlandsch-Amerikaansche StoomvartMaatschappij (Netherlands American Steamship Company) which became the more famous "Holland America Line" until the operations were sold in 1989 to Carnival Cruise Lines for the equivalent of €530million. This turned HAL into an investment company, from which time the results have been stellar.

HAL Trust is effectively controlled by the van der Vorm family. The van der Vorms are particularly private which results in HAL divulging little other than is required from a regulatory standpoint. There are no analyst briefings for results or investor days and the company does not return phone calls.

[10] With sincere apologies to Stanley Kubrick. (HAL 9000 "I am putting myself to the fullest possible use which is all I think that any conscious entity can ever hope to do" from the 1968 movie "2001: A Space Odyssey"

Why is this the case? The van de Vorm family control approximately 68% of HAL but a further 17% is controlled by Hans Melchers, another Dutch (octogenarian) billionaire who made his money in chemicals. Mr Melchers' daughter Claudia was kidnapped for two days in September 2005[11]; given the Melchers and van der Vorms families' wealth and other profile Dutch kidnappings in the past (eg. Freddie Heineken) hints at the degree of privacy which the two families seek. As a consequence, only 15% of HAL's share capital is available as free float.

Despite this secrecy and privacy it has not stopped the company growing at a rapid rate; the €530million equivalent proceeds of the cruise line in 1989 are now worth approximately €13 billion, with share issuance only for dividend reinvestment purposes. For many years the company paid a 6% dividend based on the net asset value at the start of the year; this has been reduced to approximately 4% given the decline in interest rates.

HAL is made up of a holding company which consolidates two other listed companies: Vopak (VPK.AS) which is a gas terminal storage business and Safilo (SFL.MI) an eyewear manufacturing company, which is in the midst of a corporate turnaround. In addition to this, HAL owns and consolidates (but now as an asset and liability for sale) a 76% stake in GrandVision (GVNV.AS), a €7billion listed eyewear retailer across Europe. HAL owns significant stakes in two listed associate companies, Boskalis (BOSK.AS) a listed dredging company and also the floating production and mooring system (oil and gas rigs) manufacturer, SBM Offshore (SBMO.AS). We deliberately don't focus on these business in this analysis.

HAL segment the company into optical retail, quoted minority interests, unquoted, real estate and "liquidity". Within that, there is sufficient detail to use our preferred method of evaluating HAL.

We:

1. deconsolidate the controlling shareholdings in Vopak, Safilo and GrandVision;
2. replace them with the equivalent equity market values;
3. revalue the associate companies Boskalis and SBM to prevailing market prices;
4. By removing all of these assets from the equity capitalisation and adjusted net debt, we can ascertain the equity market's pricing of the <u>unlisted</u> company and small real estate business, together with one other unlisted associate, CoolBlue.

As a guide, the unlisted businesses have revenues of €3.3billion and operating profit margins consistently around 8% (although only 6.7% in 2020 due to COVID).

As we will discuss shortly, whilst the controlling family may be very private, that has not stopped management from being active in acquiring and disposing of a number of smaller companies within their unlisted company stable. For example, in 2019 HAL through its Broadview subsidiary was the acquirer of Formica from Fletcher Building for €745m when the letter company was hamstrung by financial constraints. This facet is now being manifested in two <u>key</u> businesses which should add <u>significant value</u> to HAL shareholders which we believe has not yet being adequately captured in the share price.

[11] "Kidnappers release multimillionaire's daughter" 16 Sept 2005 (https://www.nbcnews.com/id/wbna9357853)

The smaller of the two initiatives is a proposed IPO of a highly successful e-commerce business which also has 14 physical locations across Holland and Belgium called CoolBlue. As a guide CoolBlue had sales of €2 billion in 2020 with an EBITDA of €114 million; CoolBlue is effectively a JV between HAL (with 49%) and its founder Pieter Zwart with the controlling 51%. The business is looking to an IPO this year, with analysts modelling that the enterprise value of the business could be as high as €5 billion without any additional injections of capital[12]. HAL's share of CoolBlue is explicitly carried in the HAL accounts at €250million[13]

The much larger initiative is the company concluding a 25 year investment in optical supply and retailing which was initiated in 1996 with the acquisition of Pearle Vision in Belgium and Netherlands. This has been progressively grown through Europe and in early 2015, a 24% stake in GrandVision was floated at €26/share. Observers of the optical retailing sector would be aware of progressive consolidation particularly by Essilor, which merged with Luxottica in 2018 to create a vertically integrated lens, frame and manufacturing behemoth, owning brands such as RayBan and Oakley but manufacturing under licence for numerous luxury brands.

The combined company, has an equity market value of ~€59billion and entered into an agreement in 2019 to acquire HAL's 76% shareholding in GrandVision (GV) after which it will takeover the 24% minority. COVID and other regulatory issues have wreaked delays on the transaction, which is now slated to close on 31 July 2021 at a price of €28.42/GV share. Hardly surprisingly, there is still an 8% risk arbitrage given the GV share price of €26.30.

The regulators have been relatively light-touch; Essilor's 11,000 stores are added to 7,260 of GV and only a 350 store divestment is required by the EU Commission, announced on 23 March this year.

The completion price – if achieved – will provide a gross injection of €5.5billion into HAL; added to the deconsolidated cash balance, HAL will have pro-forma cash of €6.1billion (€72+ per share) by end July.

Of course, this presents an interesting capital management question for the controlling board, in that it is exactly half the prevailing market capitalisation of HAL at end March 2021 of €12.3billion. Do they husband the cash, make a significant special dividend payment, or do the board take steps to privatise the trust either with, or without the second largest shareholder? There's enough liquid resource to easily do so and remain free of net debt. Alternatively, as the our later table shows, they have been active at acquiring unlisted businesses over recent years – but the pricing of the equity suggests investors have very little interest in this strategy, or the earnings which emerge (and will emerge) from these transactions.

We are being PAID to own >€3.4billion of turnover and >€400million of EBITDA!!!

The 15% public float of HAL Trust and lack of investor relations initiatives have now produced a significant valuation anomaly, whereby if CoolBlue is floated at even a €3billion valuation, owners of HAL Trust are receiving the unlisted businesses at a value below zero. As we have noted, even more absurd, is the fact that if the GrandVision deal settles in July 2021 as expected, HAL will have deconsolidated net cash of €6.2billion, or over half its equity market value.

[12] https://www.news1.news/news/2021/02/the-ipo-can-value-coolblue-at-5-billion-euros.html
[13] HAL Trust 2020 Annual Report page 9

The table below shows that deconsolidated enterprise value of €6.2billion post the GV transaction closing will be made up of €4.8billion of listed associates and subsidiaries, leaving €1.4billion to account for the HAL share of CoolBlue and the entire unlisted businesses. With a €3billion valuation for all of CoolBlue (1.5x sales), <u>we are being paid to own the unlisted businesses</u> and real estate, at a very low valuation:

	shares held	price at 31/3/21	€million
Equity capitalisation: 85.3m shares/units		€145.20	12,387
Deconsolidated debt/(cash)			(624)
GrandVision (76.7%)	195.2m	€28.42†	(5,548)
ENTERPRISE VALUE POST GV SETTLEMENT			**6,215**
Vopak ownership (48.2%)	60.4m	€42.45	(2,563)
Safilo ownership (49.8%)	137.5m	€0.91	(125)
Boskalis ownership (45.5%)	54.7m	€27.38	(1,498)
SBM Offshore ownership (21.9%)	41.3m	€15.62	(645)
LISTED SHAREHOLDINGS			**(4,831)**
IMPLIED VALUE OF UNLISTED BUSINESSES/REAL ESTATE			**1,384**
"blue sky" value of CoolBlue (49%) – book value €250m		€3,000	(1,470)
IMPLIED VALUE OF UNLISTED BUSINESSES/REAL ESTATE			**(86)**
c.f "Management valuation" of unlisted business in 2020 annual report			1,988
c.f management valuation of real estate in 2020 annual report			248

† assumed settlement price on 31 July 2021

The conservatism of the accounting within HAL is illustrated by the carrying values – even at a revalued level – of the unlisted businesses. Each year, in the annual report, management show the carrying values of unlisted businesses and then an "estimated value"[14]

But it's not difficult to see that the "estimated value" in the accounts of just shy of €2billion is arguably conservative. In the past two full years, HAL has spent the equivalent of €900million on three businesses, and acquired two so far in fiscal 2021:

Business	**date**	**industry**	**2020 sales**	**Cost €mn**
Formica	4 Jun 2019	Branded design surfacing	€630mn	€725mn
Direct Online Services	4 May 2020	Online kitchen products & worktops	€54mn	€49mn
Van Wijnen	20 Aug 2020	NL residential construction	€1,062mn	€127mn
INCORPORATED INTO 2020 ACCOUNTS				**€901mn**
Stoze (60%) & Prins (24%)	4 Jan 2021	Greenhouse buildings & horticulture systems	€150mn (100%)	131
Top Employers Institute	11 Feb 2021	HR certification	€24mn	n.d.

In 2020, operating profit for the <u>entire</u> unlisted non real-estate business was €228million; EBITDA was €419million. But by dissecting the accounts, we can see operating profit contributions for Formica (lots of D&A) were €26m, DOS €5m and van Wijnen, a maximum of €21million. Deducting this combined €52million from the total of €228million leaves the other businesses producing €176m of operating profit <u>in a heavily COVID depressed year</u>.

[14] page 128 of 2020 Annual Report. Carrying value €1,628m; estimated value €1,988m

But based on the purchase prices of these businesses, the estimated value in the accounts of Formica €620m (written down from the acquisition price, using the same EBITDA multiple of 10x) management are estimating the value of the residual businesses[15] at €1,192million - a mere 6.8x depressed operating profit of €176million.

If we re-work the analysis, it suggests HAL to be worth around €176 per share:

	shares held	price at 31/3/21	€million
Deconsolidated debt/(cash)			624
GrandVision (76.7%) - settlement	195.2m	€28.42†	5,548
CASH POST SETTLEMENT OF GV (A)			**6,172**
Vopak ownership (48.2%)	60.4m	€42.45	2,563
Safilo ownership (49.8%)	137.5m	€0.91	125
Boskalis ownership (45.5%)	54.7m	€27.38	1,498
SBM Offshore ownership (21.9%)	41.3m	€15.62	645
LISTED SHAREHOLDINGS (B)			**4,831**
"blue sky" value of CoolBlue (49%) – book value €250m (C)		€3,000	1,470
Formica/DOS/van Wijnen			796
Other Unlisted businesses at 8.5x profit (~4.7x EV/EBITDA)			1,496
Seattle real estate (book value €152m) at market value††			215
Dutch retail real estate			33
UNLISTED & REAL ESTATE (D)			**2,540**
TOTAL VALUE (A+B+C+D)			**15,013**
Estimated Value Per share	**85.3m**		**€176**

† assumed settlement price on 31 July 2021; †† per page 18 (2020 annual report)

Based on our assessment, we believe the unlisted businesses, including the three acquisitions before end 2020 tabulated above and real estate in Seattle and the Netherlands are worth ~ $2.3billion – over $300million more than estimated values and €660m over book value. Based on our analysis, we are getting this for less than zero.

The discount of around 17% to NAV of €176/share seems small[16]; however, this is against a conservatively assessed NAV; on an ex-cash basis, the discount of 29% is far higher (€73.85 adjusted price versus €103.65/share non cash NAV).

To get rid of the 32% minorities, including the Melchers and public shareholders at our valuation, would cost €4.8billion, well within the likely cash levels of HAL after July 2021. Given the cyclical upside within the listed and unlisted businesses, we view HAL as having constrained downside but intriguing upside, with catalysts.

For further information:

Andrew Brown
Executive Director
0418 215 255

[15] Media, staffing, orthopedic devices, timber and building material supply, hearing aids, shipping, office furniture
[16] Our entry price is ~ €130/share

STATISTICAL APPENDIX: QUARTER & FYTD TO 31 DECEMBER 2020

1. Monthly performance, exposure and NAV

	Investment return[17]	**Cost imposition[18]**	**Net Return[19]**	**R12 Return**	**NAV/share pre tax (c)**	**Gross Exposure[20]**	**Net Exposure[21]**
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 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%)
31 Jan 21	-2.3%	(0.9%)	(3.2%)	(43.5%)	7.1	365%	(4%)
28 Feb 21	7.6%	(1.1%)	6.4%	(29.8%)	7.6	310%	(11%)
31 Mar 21	6.6%	(0.7%)	5.9%	28.2%	8.0	319%	(5%)

2. Equity exposure as at 31 March 2021[22]
(as % month end pre-tax shareholders funds):

	percent	exposures
LONG	157.0%	26
SHORT	(48.8%)	13
FUTURES/INDEX DERIVATIVES	(113.2%)	
PUT OPTIONS (delta adjusted)	-	
TOTAL	319.0%	39
NET	(5.0%)	

[17] 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
[18] All accrued expenses for company administration (eg. listing fees, audit, registry) divided by opening period net asset value and time weighted for equity raisings
[19] Calculated as 2 (above) minus 3 (above)
[20] 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
[21] 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
[22] Figures may not sum due to rounding

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