



Auscap Newsletter

Auscap Long Short Australian Equities Fund

MAY 2020

AUSCAP ASSET MANAGEMENT

Will Anything Drive A Turnaround In Car Sales?

COVID-19 has materially impacted the way we conduct our lives. Some of the changes to our way of life will be temporary, some may be permanent, and some may simply accelerate trends that were already in place prior to the outbreak of the virus. These changes will affect numerous businesses across a range of industries, and we are spending considerable time thinking about how different companies and sectors may be impacted. In this newsletter we discuss our thoughts on the automotive sector and how it may be affected going forward.

Share prices of companies exposed to automotive demand have fallen considerably in response to the economic threat of COVID-19. AP Eagers, which is Australia’s largest automotive dealership group with over 11% market share of new vehicle sales nationally, experienced a significant fall in its share price in the first quarter of 2020. In reaction to the COVID-19 crisis it declined 74% from 21 February to 23 March. At its low, the stock (ASX: APE) was trading at prices not seen since 2012.

AP Eagers Share Price: 2010 to 2020



This has been due, in part, to the sharp deterioration in Australia’s new car sales as a result of COVID-19. In March new car sales were down 17.9% on the prior corresponding period, and in April they were down 48.5% on the prior corresponding period. Sales will most likely be down again in May, although we expect that this will be to a significantly lesser degree than in April.

In our view, however, the extent of the share price declines for AP Eagers and other Australian listed automotive companies has been less to do with these immediate impacts and more to do with investors’ assumptions about the future of these companies. Yet in many cases it is not entirely obvious how long term demand for consumer discretionary items such as cars and motorcycles will be affected. Even where long term impacts appear certain, it is still not easy to draw investment conclusions. Predictions of lower car sales on a go forward basis are premised on negative forecasts for Australia’s economic growth, house prices and the medium term unemployment rate. In addition, many are predicting that the shift to working from home as a result of COVID-19 will continue after the virus has been contained and that this will lead to a decline in long term automotive demand.

We think it is useful for our investors to understand how we think about the negative effects of COVID-19 on the automotive sector and the relevant companies within that sector.

First, economic activity is likely to fall and the unemployment rate in Australia will rise in the near term. In our experience though, when markets are focused on particular risks the affected stocks tend to be priced on the assumption that poor or worst-case outcomes will eventuate. If outcomes are better than expected, so in this circumstance if Australia’s future economic activity and unemployment rate are better than anticipated, then affected stocks tend to perform better as well.

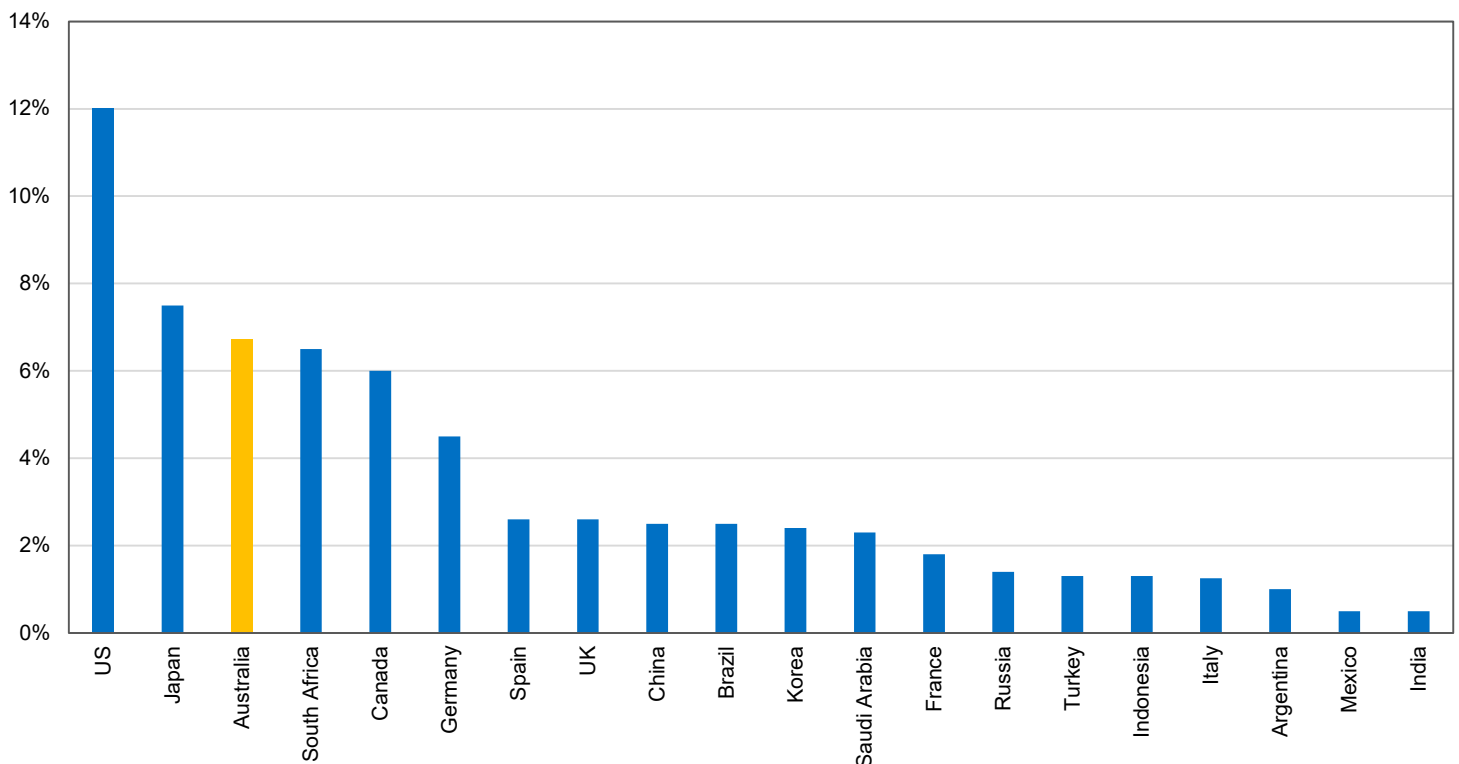
Secondly, bearish market earnings forecasts that rely on multiple assumptions can create opportunities for value investors. If one or more of the assumptions does not come to fruition, or if circumstances end up being better than anticipated, there is the possibility for strong investment outcomes for affected stocks. For example, weak economic activity and unemployment will not necessarily result in lower automotive sales. This outcome might be likely, but it is not a certainty. There are a multitude of economic and behavioural factors that influence expenditure by category, as is quickly becoming apparent in the current environment.

Thirdly, a heavy focus on negative risks often means that potential positive scenarios are ignored. In relation to the Australian automotive sector, the current focus on factors that might lead to a sustained decline in automotive sales means that very little attention is being given to factors which could be supportive of a rapid improvement in those sales.

At a high level, there are several factors which may result in a faster and more sustained economic recovery than is currently being forecast, including:

- If Australia continues to experience strong health outcomes in relation to the virus, the attendant restrictions may be eased more quickly than anticipated which could result in a significant rebound in economic activity.
- The Australian Federal and State Governments have provided unprecedented economic support to individuals and businesses in response to COVID-19, with Australia’s monetary stimulus one of the highest in the world as a percentage of GDP, which is likely to assist the country’s economy to recover.
- Australia’s relative success in containing the spread of COVID-19 to date suggests that it may have a greater likelihood of successfully containing the virus going forward. While the current medical advice is that future outbreaks are likely, the actions taken by the Federal and State Governments (including the roll-out of the COVIDSafe app, high testing levels per capita, contact tracing capabilities, and the bolstering of healthcare capabilities and equipment) indicate a preparedness to address such outbreaks and limit any further detrimental impact to the economy.

Revenue and Expenditure Measures (percent of national GDP)



Source: International Monetary Fund as of 13 May 2020. Australian expenditure adjusted for JobKeeper spend correction of \$60bn

There are also a number of potential positives for automotive sales in particular arising out of COVID-19, including:

- Social distancing restrictions being put in place on public transport, and personal preferences to avoid public transport while the virus remains uncontained, which may result in an increased demand for cars and motorcycles.
- Ongoing restrictions on air travel which may lead to a greater demand for ground travel and, in turn, an increase in demand for cars and other vehicles.
- A potential build-up of demand for new vehicles following 25 consecutive months of declines in new car sales.

If these potential positive factors turn out to be more pronounced over the medium term than those negatively impacting car sales, then there may be a more rapid return to pre-COVID-19 car sale levels than currently anticipated. This would be extremely positive for automotive companies, including AP Eagers and other listed automotive companies. Indeed our channel checks suggest a more rapid recovery in automotive sales during May than many had previously anticipated.

AP Eagers should also benefit from synergies coming from its recent acquisition of Automotive Holdings Group, increased finance and insurance sales penetration, the right-sizing of its cost base, AP Eagers' Brisbane Airport "Auto mall" development, unlocking the value within AP Eagers' significant property portfolio and continued organic and acquisitive growth leading to market share gains particularly in NSW and Victoria, where AP Eagers is currently underexposed.

We continue to re-evaluate all investments given the constantly changing nature of the economic environment both domestically and globally. We are focused on:

- Facts – ascertaining what is actually happening within the Australian and global economies right now.
- Risks – both current and future risks which might lead to a deterioration in conditions for investment companies.
- Upside surprises – an awareness of potential positive factors which could contribute to an improvement in conditions facing investment companies.

At all times we try to remain objective in this analysis. At moments of panic the human tendency is to focus solely on the risks, and possible positive outcomes can often be dismissed. During periods of euphoria the potentially positive outcomes are in focus and negative possibilities and risks can be overlooked. We believe a balanced view in the current environment supports our investments in the automotive sector and we are excited about the long term prospects for these businesses.

Investors please note - from time to time we communicate directly with our investors through Auscap's administrator, Link Fund Solutions. The most recent such communication was an investor letter sent in April 2020. If you are a unitholder and would like to receive such correspondence please email investors@auscapam.com

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
April 2020	25.0%	9.5%
Financial Year To Date	(33.5)%	(13.7)%
Since Inception	80.4%	68.7%
Annualised Returns	8.3%	7.3%

Fund Exposures

April 2020 Average	% NAV	Positions
Gross Long	129.5%	31
Gross Short	22.0%	6
Gross Total	151.5%	37
Net / Beta Adjusted Net	107.5%	140.0%

Portfolio Commentary

The Fund returned 25.0% net of fees during April 2020. This compares with the All Ordinaries Accumulation Index return of 9.5%. Average gross capital employed by the Fund was 129.5% long and 22.0% short. Average net exposure over the month was 107.5%. Over the month the Fund had on average 31 long positions and 6 short positions. The Fund's biggest exposures over the month were spread across the real estate, financials, consumer discretionary, communication services and materials sectors.

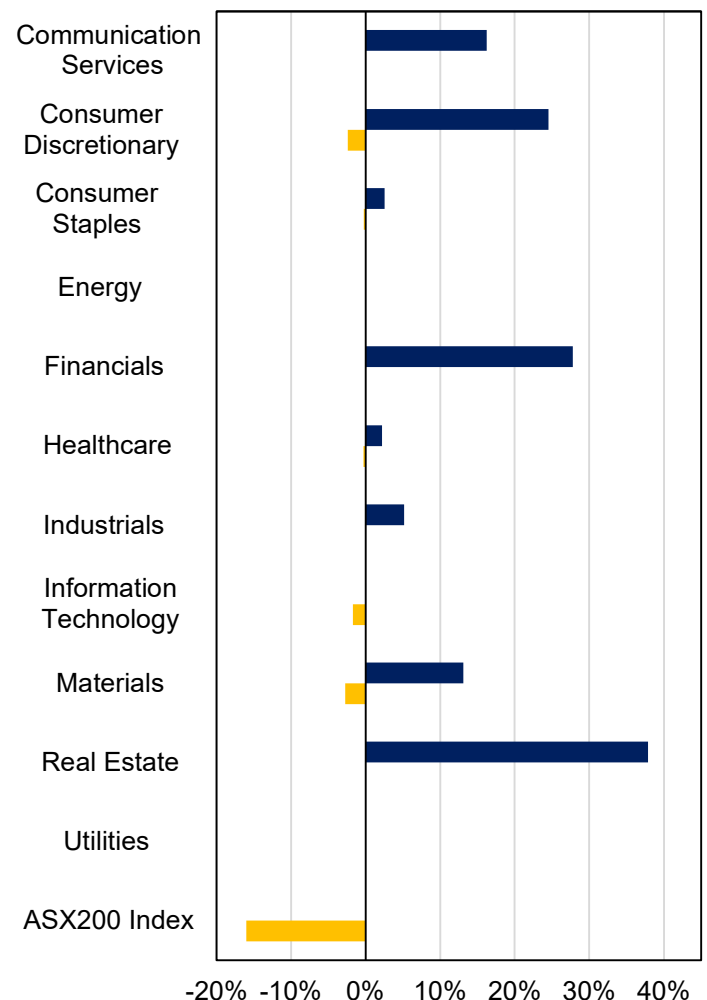
Top 10 Investments^

Adelaide Brighton	Nick Scali
AP Eagers	Nine Entertainment
GDI Property Group	Super Retail Group
Macquarie Group	Unibail-Rodamco-Westfield
Mineral Resources	Virgin Money UK

Fund Financial Year Returns*

FY13	19.7%	FY17	8.0%
FY14	46.0%	FY18	12.7%
FY15	16.8%	FY19	(9.2)%
FY16	20.1%	FY20 (YTD)	(33.5)%

Sector Exposure - April 2020



* Performance figures are calculated for the lead series net of all fees and expenses assuming the reinvestment of all distributions. Past performance is not a reliable indicator of future performance.

^ Top 10 long investments in alphabetical order as at 30 April 2020.

© Auscap Asset Management Limited

Disclaimer

This newsletter contains performance figures and information in relation to the Auscap Long Short Australian Equities Fund ARSN 615 542 213 (Fund) from inception of the Fund. The actual performance for your account will be provided in your monthly statement. Actual performance may differ for investments made in different classes or at different times throughout the year. This newsletter is intended to provide general background information only. It is not a Product Disclosure Statement under the Corporations Act 2001 (Cth), nor does it constitute investment, tax, legal or any other form of advice or recommendation to be relied upon when making an investment or other decision. The content of this document does not constitute an offer or solicitation to subscribe for units in the Fund or an offer to buy or sell any financial product. Past performance is not a reliable indicator of future performance. While all reasonable care has been taken to ensure that the information in this document is complete and correct, no representation or warranty is given as to the accuracy of any of the information provided, including any forecasts. To the maximum extent permitted by law, Auscap Asset Management Limited ACN 158 929 143 AFSL 428014, its related bodies corporate, directors, employees and representatives are not liable and take no responsibility for the accuracy or completeness of this document. No investment in the Fund should be made without fully reviewing the information, the disclosures and the disclaimers contained in the relevant disclosure document, a copy of which is available at www.auscapam.com, or any supplement to that document and obtaining investment, legal, tax and accounting advice appropriate to your circumstances. You are receiving this newsletter because we hold personal information about you, namely your contact details. You should view Auscap's Privacy Policy to understand how your personal information will be used and processed. No part of this material may be reproduced or disclosed, in whole or in part, without the prior written consent of Auscap Asset Management Limited.

Hong Kong

This newsletter has not been reviewed or approved by any regulatory authority in Hong Kong. This newsletter does not constitute an offer or invitation to the public in Hong Kong to acquire the units in the Fund. Accordingly, unless permitted by the securities laws of Hong Kong, no person may issue or have in its possession for the purposes of issue, this newsletter or any advertisement, invitation or document relating to the units in the Fund, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong other than in relation to the units of the Fund that are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" (as such term is defined in the Securities and Futures Ordinance of Hong Kong (Cap. 571) and the subsidiary legislation made thereunder).

Singapore

This newsletter is being furnished to you on the basis that you are an "institutional investor" (as defined in the Securities and Futures Act (Chapter 289) of Singapore) and on a confidential basis, solely for your information. This newsletter may not be reproduced, disclosed, or distributed to any other person in Singapore. Auscap Asset Management Limited, as the responsible entity and manager for the Fund has not taken any steps to ensure that the capital markets products referred to in this newsletter are suitable for any particular investor, and will not treat recipients as its customers by virtue of their receiving this document.

This newsletter has not been, and will not be, registered as a prospectus with the Monetary Authority of Singapore and this newsletter is not intended to constitute an offering, and is not regulated by any financial supervisory authority pursuant to any legislation in Singapore. The investments or services referred to in this newsletter may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this document constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to your individual circumstances or otherwise constitutes a personal recommendation to you.

United Kingdom

This newsletter may be distributed in the United Kingdom only to persons who: (i) have professional experience in matters relating to investments in accordance with Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended) ("FPO"); or (ii) to whom this document may otherwise be lawfully distributed (all such persons together being referred to as "Relevant Persons"). This newsletter is only directed at, or available to, Relevant Persons and must not be acted on or relied on by persons who are not Relevant Persons. Any investment or investment activity to which this document relates is available only to, and will be engaged in only with, Relevant Persons.

United States

This newsletter may not be distributed in the United States and does not constitute an offer to sell, or a solicitation of an offer to buy, securities in the United States. Any securities described in this newsletter have not been, and will not be, registered under the US Securities Act of 1933 and may not be offered or sold in the United States except in transactions exempt from the registration of the US Securities Act, the US Investment Company Act of 1940 and applicable US state securities laws.

If you do not currently receive the Auscap Newsletter automatically, we invite you to register. To register please go to the website www.auscapam.com and follow the registration link on the home page. Interested investors can download a copy of the PDS for the Auscap Long Short Australian Equities Fund at www.auscapam.com/auscap-fund/pds. We welcome any feedback, comments or enquiries. Please direct them to info@auscapam.com.

Auscap Asset Management Limited

ACN 158 929 143 AFSL 428014
Lvl 30, 9 Castlereagh St, Sydney

Email: info@auscapam.com
Web: www.auscapam.com

Service Providers

Prime Brokerage: Citi Global Markets
Administration: Link Fund Solutions

Tax & Audit: Ernst & Young