PetersMacGregor
GLOBAL FUND

Quarterly Report June 2018

Peters MacGregor Capital Management Limited
ABN 77 087 181 600
AFSL 225984
APIR WPC0002AU
mFund PMW01

PetersMacGregor
GLOBAL INVESTING

Global Fund Snapshot

Fund Facts

Portfolio Managers	Wayne Peters Michael Haddad
Structure[1]	Global Equity Fund A$ unhedged
Inception Date	10 September 2004
Fund Size	A$101 million
Distributions	Annual, 30 June
Management Fee[2]	1.35% p.a.
Performance Fee	Nil
Buy / Sell Spread	0.10% / 0.10%

Fund Features

Investment Style	Value
Portfolio Composition	20-30 stocks
Cash Holding	0 - 20% cash
Benchmark	Unaware
Minimum Investment	$10,000 ($5,000 with a regular investment plan)
Recommended Investment Timeframe	5 years plus

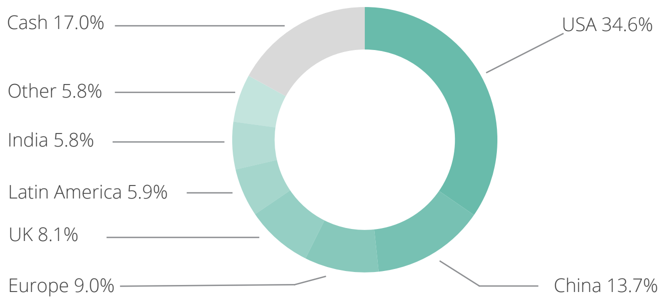
Portfolio Characteristics

Number of Holdings	21
Active Share[4]	99%
Up Market Capture Ratio	76% since inception
Down Market Capture Ratio	59% since inception

Top Holdings in Alphabetical Order

Stock	Sectors
Discovery	Broadcasting
Fairfax India	Investments
GCI Liberty	Cable
JD.com	Internet Retail
Liberty Broadband	Cable
Liberty Global	Cable
Liberty LiLAC	Cable
Liberty SiriusXM	Satelite Radio
Naspers	Internet Services
NVR	Homebuilding

Geographical Exposure by Revenue[3]



[1] Peters MacGregor may on occasion, hedge against movements in the Australian dollar and other currency exchange rates, but the default position is to remain unhedged.
[2] All fees are inclusive of the net effect of GST.
[3] Geographical exposure by revenue breakdowns are approximations.
[4] Active Share is the percentage of portfolio holdings that is different from the benchmark holdings.

Growth of $10,000 Since Inception

Fund Performance[1]

	Fund %	Index %[2]	Excess %
1 month	5.60	1.85	3.75
3 months	1.85	4.37	-2.52
1 year	4.75	14.95	-10.20
3 years (p.a.)	5.24	9.62	-4.38
5 years (p.a.)	9.67	14.20	-4.53
7 years (p.a.)	11.48	13.83	-2.35
10 years (p.a.)	9.66	8.60	1.06
Since inception (p.a.)	7.56	7.07	0.49
Total return since inception	173.60	157.06	16.54

Monthly Performance - Net %

Financial Year	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
2004-05			0.16	0.95	1.08	0.57	-0.36	0.51	0.06	-1.70	2.02	0.63	**3.94**
2005-06	1.02	-0.26	0.33	0.93	3.08	-1.76	-1.17	0.12	0.14	0.14	0.83	-0.32	**3.02**
2006-07	0.58	0.94	1.95	1.66	1.60	0.42	2.48	2.54	3.00	1.86	1.05	0.76	**20.52**
2007-08	-4.98	1.82	3.93	0.89	0.29	1.71	-5.42	-4.54	-2.49	2.70	-2.01	-8.03	**-15.66**
2008-09	1.55	5.28	-2.89	-14.76	-12.58	-2.26	-7.60	-11.11	8.79	17.70	6.27	-0.41	**-15.83**
2009-10	11.63	9.30	-1.28	-5.05	-0.18	4.37	-0.32	3.42	2.31	2.97	1.64	2.08	**34.26**
2010-11	-0.81	-2.86	0.87	5.45	-1.95	4.17	0.87	-0.25	0.33	-0.30	0.61	-1.88	**4.02**
2011-12	-1.50	-0.39	-3.66	2.59	-1.32	-0.83	1.11	3.07	6.64	-0.95	0.22	0.01	**4.67**
2012-13	-1.44	3.56	2.53	-0.09	-1.01	3.58	1.96	2.33	1.84	3.37	6.90	2.33	**28.83**
2013-14	4.41	-0.49	-1.71	1.38	2.26	2.74	0.02	0.86	-1.83	-0.05	1.27	-0.69	**8.28**
2014-15	-0.37	0.76	4.46	1.21	4.90	4.21	2.61	4.87	1.82	-3.59	4.52	-1.88	**25.70**
2015-16	6.53	-1.39	-2.03	3.38	-3.75	-1.70	-3.25	-1.29	-1.65	3.01	4.95	-5.20	**-3.09**
2016-17	3.69	3.37	-2.09	-0.44	4.59	2.25	-0.74	0.10	0.57	3.87	1.52	-2.46	**14.85**
2017-18	2.18	0.09	0.55	1.92	1.55	-1.83	2.78	-1.83	-2.43	0.58	-4.10	5.60	**4.75**

[1] Performance figures are calculated using exit unit price to exit unit price for the given period. Intra year performance figures are unaudited. The returns are net of management fees. They do not include franking credits.
[2] MSCI ACWI NR AUD

Quarterly Commentary

Introduction

The Peters MacGregor Global Fund increased 1.8% during the quarter ending 30 June 2018, trailing the MSCI's 4.4% gain. Over the past year, the fund produced a 4.7% return, trailing the MSCI's return of 14.9%.

General commentary

The global economy and markets have continued to tick along over the past quarter, but opportunities are being created in emerging markets as money flows towards safer assets as US interest rates increase. This is an expected consequence of the US draining liquidity from the system through quantitative tightening.

The share price of Latin American online travel agency Despegar.com has fallen 40% recently, for example, which we believe is an attractive price for a company with plenty of growth ahead as mobile and online travel bookings increase (see Stock in focus below).

The share price of our cable TV and broadband internet provider Liberty Latin America however remained almost unchanged.

Liberty Global, our European cable TV and internet provider, has also seen its share price slide due to the stronger US dollar, despite announcing the sale of its large German business and other smaller divisions for high prices. While in the short term the flow of money away from emerging markets depresses our performance, in the long term these types of macroeconomic fluctuations can provide wonderful opportunities.

Investors still need to be vigilant, though. We attended the Berkshire Hathaway meeting in Omaha on our US and Canadian trip this quarter where Warren Buffett discussed their $116bn cash hoard, 'We would much rather have closer to $20bn than to have $116bn... Our cash and cash equivalents has grown because the competition for acquisitions has become much stronger, both as money has piled up with the buyers of businesses, and because debt is so cheap, a variety of factors.'

Reminding people that cycles haven't gone the way of the dodo, 'I don't think those are necessarily permanent, in fact, I can be reasonably sure they aren't permanent. It's just a question of when they change.'

There are two main mistakes investors make deep into the business cycle. First, they overpay for the highest quality businesses. This is a lesser evil, because if you hold these businesses long enough your returns can be decent. But as investors in the Nifty Fifty stocks in the 1970s found out, it took over four decades to earn an ~8% annualised return. Few investors have that sort of patience, or mortality.

The worse mistake is paying over the odds for low quality or highly cyclical businesses masquerading as stable, high quality businesses. Though our portfolio is full of misfits that don't fit with the market's current infatuation with high growth companies or those producing consistent earnings growth, we believe their quality is being obscured by reasons that will prove temporary. This value will help support our portfolio when the market wakes to the dangers of owning overpriced stocks.

Referring to the private equity market in his 2018 annual letter, Buffett also warned about paying privileged prices for average businesses; 'prices for decent, but far from spectacular, businesses hit an all-time high. Indeed, price seemed almost irrelevant to an army of optimistic purchasers.'

As we believe price does matter, our portfolio is well prepared for the impact of higher interest rates and higher risk aversion.

Portfolio commentary

We sold our two Italian banks, Intesa Sanpaolo and UBI Banca, and Telecom Italia, at a small profit after the League and Five Star Movement parties formed a new Italian government and announced numerous policies that will make it harder for these companies to meet their business objectives.

Though it's disappointing selling these stocks where the fundamentals had improved so dramatically, for now we'd rather be invested elsewhere.

We've used some of the proceeds to establish smaller positions in Latin America's largest online travel agency Despegar.com (see Stock in focus below) and California's largest oil producer California Resources Corporation (CRC), whose fortunes have improved dramatically with higher oil prices.

Cable and content M&A heating up

Our portfolio got a boost after regulators approved AT&T's $85bn acquisition of content giant Time Warner, and Disney and Comcast battle it out for 21st Century Fox. These deals will likely trigger another round of consolidation across the telecommunications, cable and video content industries, where only a handful of giant companies will be left to compete with new players such as Netflix.

This is good news for our investments in cable companies Liberty Broadband and GCI Liberty, and unscripted content company Discovery Communications, which is up 53% since our initial purchase last November. Mr Market has rapidly reassessed Discovery's acquisition of Scripps, and liked Discovery's recent 12-year deal to broadcast PGA golf tournaments outside the US, in which it will invest $2bn.

The share prices of Liberty Broadband and GCI Liberty (our de facto holdings in Charter Communications) were still down during the quarter following the market's unforgiving response to Charter's quarterly numbers. While the numbers were generally positive, the market remains fixated on cable TV subscriber losses and impatient with the time it will take to fully implement 2016's acquisition of Time Warner Cable.

It's extremely rare to find a stock of this size and quality that could double over the next few years. We expect the company's free cashflow to increase quickly as capital expenditure falls, which is why it remains our largest (combined) position.

Liberty Global

Liberty Global's share price also fell in response to selling its German assets and other smaller businesses across Eastern Europe to Vodafone. It was somewhat surprising given the valuations were nearly 50% higher than what Liberty Global itself trades for, and that subject to regulatory approval the company will end up with a cash pile nearly equal to half Liberty Global's current valuation.

The valuation disparity does make some sense. Vodafone is willing to pay more as it can consolidate its number two position in Germany and compete more effectively against Deutsche Telekom. Liberty's Eastern European asset sales also reflect its small scale in those markets, which leaves Liberty owning networks in mature markets with low growth.

With the stock trading below our assessment of intrinsic value, though, we believe using the excess cash for share repurchases can add plenty of value. Alternatively, CEO Mike Fries may favour acquisitions, particularly as several peers are highly geared and could be easy prey in a less favourable economy.

Conclusion

THE WALL STREET JOURNAL.

MARKETS

Value Investors Face Existential Crisis After Long Market Rally

Shares of fast-growing companies such as Apple and Netflix find a spot in value portfolios. 'Our approach to value has evolved'

By Michael Wursthorn
June 4, 2018 5:30 a.m. ET

After the Wall Street Journal recently proclaimed that value investing is dead, we're reminded of UK investor Anthony Bolton's timeless wisdom in his book Investing Against the Tide: Lessons from a Life Running Money: 'Most investors want to do today what they should have done yesterday.'

The recent outperformance of growth stocks over value stocks has reached highs last seen right before the tech wreck in 2000. But even though many experienced investors and capital allocators are considering switching to more value-oriented strategies, doing so while US technology stocks, for example, are still performing so well makes it virtually impossible.

It's a real-life example of Pavlov's Dogs, where consistent stimulus over such a long period (in this case lower interest rates for nearly four decades) has conditioned investors to expect asset prices to continue going up – even though quantitative tightening demands a reassessment of investment strategies and return expectations, given such high starting valuations.

As Buffett rightly points out, valuations always matter, eventually. Our portfolio currently trades at a 30% discount to our estimate of fair value, and the impressive performance of Discovery's share price recently shows value investing is far from dead.

It just requires patience, which in an online world is in increasingly shorter supply. That's ok, though. With people's attention spans reportedly falling from 12 seconds to eight since 2000, one second lower than the nine-second attention span of a goldfish, that should mean more opportunities for long-term investors.

Stock in focus: Despegar.com

Despegar.com has had a wild ride since listing last November. The share price rocketed to $34 from its IPO price of $26 before sinking below $23 and then rebounding to $34 in March. It has since fallen in a straight line to $21, where we bought.

Despegar.com is Latin America's version of Booking Holdings (formerly Priceline) or Expedia, providing a website to compare and book hotels and airfares for 16m customers annually. Brazil and Argentina are the biggest markets, accounting for two thirds of revenue.

Each year Latin Americans book $100bn of travel with traditional travel agents and online travel agencies (OTAs), which is growing at 6-7% per year. Online bookings are growing at over 10% per year and are one third of total bookings, compared to 52% in Europe, 49% in the US and 36% across Asia Pacific.

Booking and Expedia have been investor favorites given their incredible shareholder returns since the GFC. Like REA Group and Seek in Australia, CTrip in China and MakeMyTrip in India, these online businesses dominate winner-take-all (or most) markets and face little competition, which is why they trade on such high earnings multiples.

In contrast, hotels have mixed feelings about OTAs. While OTAs offer the easiest way to sell a lot of rooms quickly, hotels are increasingly looking for alternatives to avoid large commissions, such as offering member loyalty discounts for booking direct. So far it hasn't had much impact, particularly in Europe, where the hotel market is highly fragmented and lacks the hotel chains that dominate the US. It's similar across Latin America.

Along with high margins, low ongoing capital expenditure requirements make these companies cashflow machines. Once the website is built, the biggest expense is marketing. Booking.com and Expedia have grown and protected their businesses by hoovering up smaller rivals, as we expect Despegar to do.

Higher commission packages and hotel bookings are currently 59% of revenue, up from 54% in 2017, which is the primary source of growth. Despegar currently earns 12% commissions, which is above most of its online peers and includes a 4-5% add-on 'consumer fee'. We expect this will decline over time, but the financial impact should be outweighed by higher bookings to keep earnings growing briskly.

Unlike Booking and Expedia, 55% of Despegar's bookings use credit. Banks offer instalment plans to credit card holders with no financial risk to Despegar. For now, it's a competitive advantage for Despegar, as competitors have no or limited financing plans. It also allows travelers to lock in prices, which is important given volatile exchange rate movements across Latin America.

The economic backdrop has soured for Despegar recently, and management slightly downgraded earnings forecasts. Investors have also punished investments across Latin America, as higher US interest rates and tighter global liquidity increases risk aversion. That's left the stock trading on 21x next year's earnings, or 12x 2018 EBITDA (earnings before interest, tax, depreciation and amortisation). For a profitable OTA that can grow annual revenue at 20%, that compares favourably with the multiples of 13 and 20 for Expedia and Booking, respectively, whose revenues are growing slower (much slower in Expedia's case).

With a current market value of $1.4bn, Despegar.com would also make easy prey for Expedia (14% shareholder) or Booking, which has a market value of $100bn, should 44% shareholder and renowned hedge fund Tiger Global want to sell.

Further reading

- Everything You Need to Know About 5G
  https://spectrum.ieee.org/video/telecom/wireless/everything-you-need-to-know-about-5g
- Investment Update Webcast – March 2018
  https://petersmacgregor.com/news-insights/videos/investment-update-webcast-march-2018/
- The investment case for Discovery Communications
  https://petersmacgregor.com/news-insights/investment-case-discovery-communications/