AROWANA CVF

Net Tangible Asset release and Monthly Newsletter

As at 30 April 2018

About Arowana Contrarian Value Fund (CVF)

ACVF (ASX ticker: CVF) offers investors an opportunity to gain exposure to a concentrated portfolio of securities built from a bottom-up research process. Whilst the majority of the portfolio is built around Australian listed securities, CVF is able to invest in overseas listed securities and to hedge its portfolio.

The core objectives of the fund are to:

1. Generate superior returns over the medium to long-term,
2. Provide shareholders a rising stream of dividends, and
3. Grow Net Tangible Assets per share

Net Tangible Assets (NTA) per Share

At 30 April 2018 (see also 10 May 2018 Update, below)	Basic NTA per share ($)
NTA after tax and before estimated tax on unrealised gains	1.21*
NTA after tax and after estimated tax on unrealised gains[1]	1.13*

1.The Company is required to estimate the tax that may arise should the entire portfolio be disposed of on the above date and show the result per share after deducting this theoretical provision. Any such tax would generate franking credits, whose value would not be lost but rather transferred to shareholders on payment of franked dividends.

**After payment on 5 April 2018, of 4 cents per share, fully franked dividend.*

Net Tangible Assets (NTA) per Share - UPDATE AT 10 MAY 2018

Due to strong performance across the investment portfolio in the current month to date and to ensure an orderly and well-informed market in its securities, the Company believes that an additional update on NTA backing per share is warranted as at 10 May 2018. Month to date performance, net of all costs and fees was 6.5% as at 10 May 2018.

At 10 May 2018	Basic NTA per share ($)
NTA after tax and before estimated tax on unrealised gains	1.29
NTA after tax and after estimated tax on unrealised gains[1]	1.19

1.The Company is required to estimate the tax that may arise should the entire portfolio be disposed of on the above date and show the result per share after deducting this theoretical provision. Any such tax would generate franking credits, whose value would not be lost but rather transferred to shareholders on payment of franked dividends.

Ordinary Shares

ASX ticker	CVF
Last price	$1.04
Number on issue	69,672,141
NTA per share*	$1.21

Market capitalisation	A$72.1m
Gross portfolio value	A$88.0m
Interim dividend 2018**	$0.04/share

** Before estimated tax on unrealised gains*
*** Interim dividend paid 5 April 2018, fully franked*

Investment Performance

At 30 April 2018	1 mth	3 mths	6 mths	12 mths	*Since inception (5 Jan 2015)* Annualised	Cumulative
Arowana CVF Gross performance	**0.8 %**	**(2.4) %**	**11.0 %**	**39.4 %**	**17.2 %**	**69.7 %**
S&P/ASX200 Accumulation Index	3.9 %	0.3 %	3.4 %	5.5 %	7.7 %	28.1 %
Gross outperformance	(3.1) %	(2.7) %	7.6 %	33.9 %	9.5 %	41.6 %

At 30 April 2018	1 mth	3 mths	6 mths	12 mths	*Since inception (5 Jan 2015)* Annualised	Cumulative
Arowana CVF Net performance*	**0.6 %**	**(2.2) %**	**7.3 %**	**33.3 %**	**13.8 %**	**53.7 %**
S&P/ASX200 Accumulation Index	3.9 %	0.3 %	3.4 %	5.5 %	7.7 %	28.1 %
Net outperformance	(3.3) %	(2.5) %	3.9 %	27.8 %	6.1 %	25.6 %

** Net return after all costs and fees (including estimated performance fee accrued) and before tax.*

Arowana CVF Asset Allocation

Asset class	A$m	%**
Australian Equities	37.2	42%
International Equities	31.7	36%
AUD cash and equivalent	18.1	21%
USD cash and equivalent	3.0	3%
CAD cash and equivalent	5.6	6%
JPY cash and equivalent	0.7	1%
Australian Hybrids & Bonds	-	0%
Hedges	(8.3)	(9%)
Gross Portfolio Value*	**88.0**	**100%**

* *Totals may not sum due to rounding*

** *Percentage of gross portfolio value*

Top 5 Equity Holdings

Ticker		%**
APT	Afterpay Touch Group Limited	17%
TSGI.CA	Stars Group Inc	11%
CMG.US	Chipotle Mexican Grill Inc	6%
FB.US	Facebook Inc Class A	6%
ELD	Elders Limited	5%
Top 5 as % of Gross Portfolio		**45%**

* *Totals may not sum due to rounding*

** *Percentage of gross portfolio value*

Net Tangible Asset release and Monthly Newsletter

As at 30 April 2018

In April the Fund recorded +0.6%% performance, net of all costs and fees, versus the S&P/ASX Accumulation 200 Index return of +3.9%.

Our international holdings contributed over 2% to performance in April 2018, however negative unrealised performance from our Australian holdings, notably our large holdings in *Afterpay Touch Group (APT.AU)* and *Bellamy's Australia (BAL.AU)* essentially cancelled that out.

Our performance in the month of April was lacklustre relative to the benchmark index. Despite this, the Fund remains firmly in outperformance territory. For the six and twelve months ended 30 April 2018, the Fund recorded performances of 7.3% and 33.3% respectively versus the benchmark Index returns of 3.4% and 5.5%, for the same periods. Returns are quoted net of all costs and fees. Gross exposure (longs + hedges) has remained below 100% during the entirety of this period.

NTA per share was $1.21 at the end of April. Cash represented 22% of the total gross portfolio but at the time of writing this had fallen to 15% as we have added several new holdings recently and continue to find opportunity worthy of capital deployment.

The largest positive contributors in April were *The Stars Group (TSGI.CN)* and *Chipotle Mexican Grill (CMG.US)* which generated a combined ~260 bps of performance in the month.

Chipotle (CMG.US) was trading on 50x+ P/E in 2014 after operating margins had doubled over the preceding eight years; the stock was the archetypal market darling. Buying high P/E stocks on near peak margins typically doesn't end well – the trade in 2014 was to buy Chipotle's food, not its stock.

2015 and 2016 brought a series of food scares; multiple instances of E. coli and Norovirus battered the brand and sales fell heavily. We dipped our toes into the water initially in May 2017.

Chipotle's stock has gone from $700+/share in 2015 to $251/share at its nadir in early 2018, to $423/share at the time of writing. Our cost base is $348/share. We continue to think there is solid upside to average unit sales, margins and earnings, all of which tend to correlate in a recovery.

Chipotle's store margins have collapsed from 27% in 2014 to 17% in 2017. A large driver of that is average unit value (AUV) or sales per store, falling from $2.4m in 2014 to $1.9m in 2017. Part of that decline is due to new stores having lower sales productivity, which in turn drags down the average, but it's not the whole story.

Labour costs were 22% of sales in 2014, but have jumped to 27% of sales in 2017. Apart from rent, labour is the closest thing to fixed cost leverage Chipotle offers in a recovery scenario.

In April when Chipotle announced its first quarter results, the stock rose 24% on the day, and closed the month up 31%. The results surprised on same store sales, total sales and margins.

There are inklings of mean reversion here. Chipotle's new CEO had his feet under the desk for less than a month at quarter end, so it is implausible that new management drove the result. More likely Chipotle is experiencing a natural sales rebound from an unsustainably depressed level. This is what a study of historical Quick Serve Restaurant ("QSR") food scares seems to bear out.

Chipotle's new CEO has highlighted food COGS or cost of goods sold as another area ripe for improvement.

If new management execute well, and there is credible cause for optimism here, then we may be fortunate enough to have a veritable coiled earnings spring on our hands. Because of Chipotle's store roll out business model and the equity markets penchant for extrapolation, that hopefully augurs well for the latent upside in the stock. Chipotle is our 3rd largest position with a 6% weighting at month end.

The Stars Group (TSGI.CN) rose 12.3% during the month, driven by the announcement of its acquisition of Sky Betting & Gaming for $4.7 billion. Whist the transaction ramps up *The Stars Group's* leverage again to ~6x net debt to EBITDA, the extremely strong cash flow of the business should be able to deleverage by ~1x EBITDA per annum, with the resultant reduction in debt flowing straight to accretion in equity value. Since its acquisition of Rational Group in 2014, this has been an exercise in financial bootstrapping.

The stock has historically traded cheaply despite its strong cashflow (free cashflow yield on market cap is almost 15%!), as the risk of a new regulation or tax in some far-flung market was ever-present and the core poker business has high customer churn and low earnings growth.

The Sky acquisition changes all of that. Revenue mix from already regulated markets will rise substantially, as will group exposure to the structural growth areas of mobile and sports betting. Becoming a fully integrated online gaming company also means that cross selling their leading Poker and Casino products to the new Sports Betting customers and vice versa is also a large source of potential upside.

Finally, a pending ruling in the US offers material potential upside which we don't think is in the price. As such we continue to like the positive risk asymmetry on offer here despite the stock being up 36% calendar year to date. The stock is our 2nd largest position with an 11% weighting at month end.

Facebook (FB.US) Class A shares entered the portfolio during the month.

We typically don't buy so called "mega caps". Facebook is a US$500+ billion market cap company. If you're targeting high returns, it's a pretty big call to think you can double your money on Facebook when no listed company in history has attained a US$1 trillion market cap[1].

We do, however, invest in what we call "injured athletes"; great companies that stumble.

A well-publicised privacy scandal involving a questionable political advocacy group provided the opportunity in Facebook's case.

After our research work, two things stood out.

First, we were not the last possible buyer of the stock. Listening to the Congressional hearings that saw Mark Zuckerberg grilled over two days, it was apparent that some very well-resourced people didn't have a basic understanding of the company's business model and were perfectly content to display that on national TV.

Second and more importantly, there's a reason why Cambridge Analytica focused on Facebook and not another platforms data and targeting capabilities: Facebook is the best.

The only way Cambridge Analytica could credibly threaten democratic process was if A) Facebook's audience data and targeting capacity were utterly exceptional and B) Facebook were lax in allowing improper access. B) can be fixed. A) is nigh impossible to create.

Facebook allows advertisers to target spend based on user demographics, interests and behaviours. This is incredibly powerful.

Traditional media advertising is scatter gun. TV doesn't allow you to target 18-35 yr olds who watch basketball without also paying for every other age and interest group present in a particular TV time slot. Facebook does. Because of this, smaller companies can afford to advertise effectively.

Facebook isn't just taking advertising market share from traditional media, it is growing the market and increasing return on advertising dollar. In all of this, we are in the early stages of yield monetisation.

We see significant upside in yield as Facebook's auction system drives higher pricing and active users continues to grow.

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[1] Petrochina's A-Shares hit a price level in 2007 that if applied to all A and H shares outstanding implied a $1 trillion market cap. However, the discrete market caps of A and H shares summed never attained this level.

Facebook is more than its eponymous social media platform. Messenger and WhatsApp are yet to be substantially monetised; each has over 1.3 billion monthly active users. To illustrate the potential, WeChat has ~950 million users and is generating ~$7 billion in annualised revenue.

The #deletefacebook campaign had more impact on Facebook's stock price than the underlying franchise. Whilst there was a decline in US daily active users in the 4th quarter of calendar 2017, this grew in the 1st quarter calendar 2018, in all geographies including the US.

Whilst Facebook will introduce an opt in/out option (driven by new regulations in the EU known as GDPR); this is an industry wide regulation, not unique to Facebook. It is also in the price; the sell side analyst model's we've seen assume margin compression. What if this isn't the case? What if margins hold up and revenues continue to grow rapidly? Facebook is our 4th largest position with a 6% weighting at month end.

Emeco Holdings (EHL.AU) announced the acquisition of Matilda Equipment and an equity raising at the end of April. The transactions have the benefits of lowering the age of Emeco's fleet and lowering the company's financial leverage. The stock closed down 3.45% for the month but has since made new highs. Emeco is our 6th largest position with a 5% weighting at month end.

Zillow Group (ZG.US) A Class shares fell 10% during the month, on the announcement of a new business segment which lowered 2018 earnings guidance as a result of upfront expenses. Since month end, Zillow reported 1Q18 earnings, and drilling into the result, it is clear the core business is strengthening, not weakening, whilst the earnings potential of the new business is much greater than we initially thought.

Revenue and EBITDA outcomes were both ahead of expectations. Profit and forward profit guidance were lower due to a stronger stock price (options expense) and investment in a new business.

On the assessment that the core business was strengthening. the new business was misunderstood and the market had over-reacted - we bought more stock during April, increasing the position size by 30%.

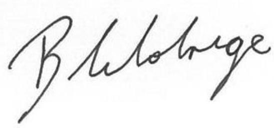
Since month end the stock has rebounded 15%. We see Zillow as a compounder with significant upside.

The only existential threat we could identify in the US has flopped. There are around 500 MLS or Multiple Listing Services in the US. They generate the initial listings; i.e. the crucial content. Like the stock brokers of old, they long ago handed this market power away.

We think at some point Zillow will see a margin surge and we own it for this reason. For now, however, management are justifiably focused on the land grab opportunity of building dominance in their vertical.

History has shown that the greater the dominance of the largest player in a vertical, the greater the ultimate returns enjoyed by that player. Zillow was our 8th largest position with a 5% weighting at month end.

We added two new stocks during the month. One was Facebook. The other is a company leveraged to rising Lithium-Ion battery demand. We see significant upside in the stock and continue to build the position at the time of writing.



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