

AS AT 31 March 2017

## Market Commentary

In March, the fund recorded -1.4% net performance vs the S&P/ASX200 accumulation index return of 3.3%.

As a fellow shareholder, the last six months have been frustrating from a performance perspective. Six months ago the Fund was strongly outperforming its benchmark despite ~60% of assets being in cash and equivalents.

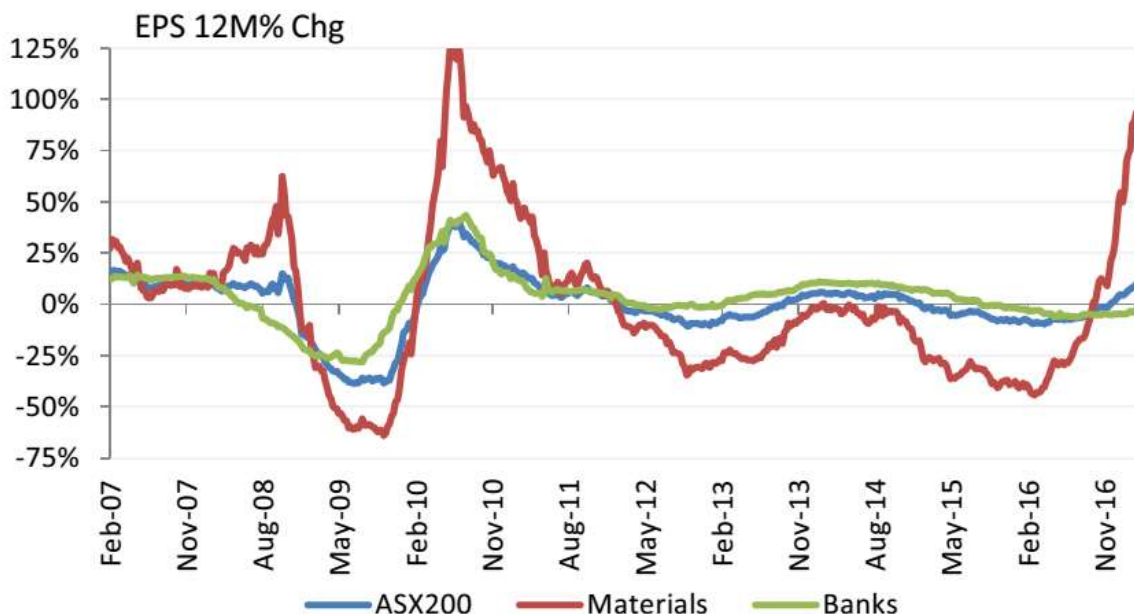
It is worth pointing out the performance we quote is *net* of all costs...many of the largest LICs<sup>1</sup> quote performance *before* costs. The two bases of comparison produce vastly different outcomes over long periods of time.

We have not helped our cause by holding an elevated level of cash and equivalents as the S&P/ASX200 Accumulation Index has rallied ~20% in the last twelve months.

Another conundrum we face is a difference in the Fund's Investment *Mandate* versus its Performance *Benchmark*.

- The Benchmark against which we compare our net performance is the S&P/ASX200 Accumulation Index. The Metals & Mining GICS sub-index represents ~12% of this index and has 23 constituent companies<sup>2</sup>; it is also the largest component of the S&P/ASX200 Materials Index
- Our Mandate *excludes* companies in the GICS Metals & Mining industry classification. An unfortunate reality we face is that this index was the biggest driver of S&P/ASX200 returns over the last 18 months and it's a sector we have not been able to invest in to date

**Exhibit 94:** Rolling 12M% Revisions in 12MF EPS - ASX 200 and Materials

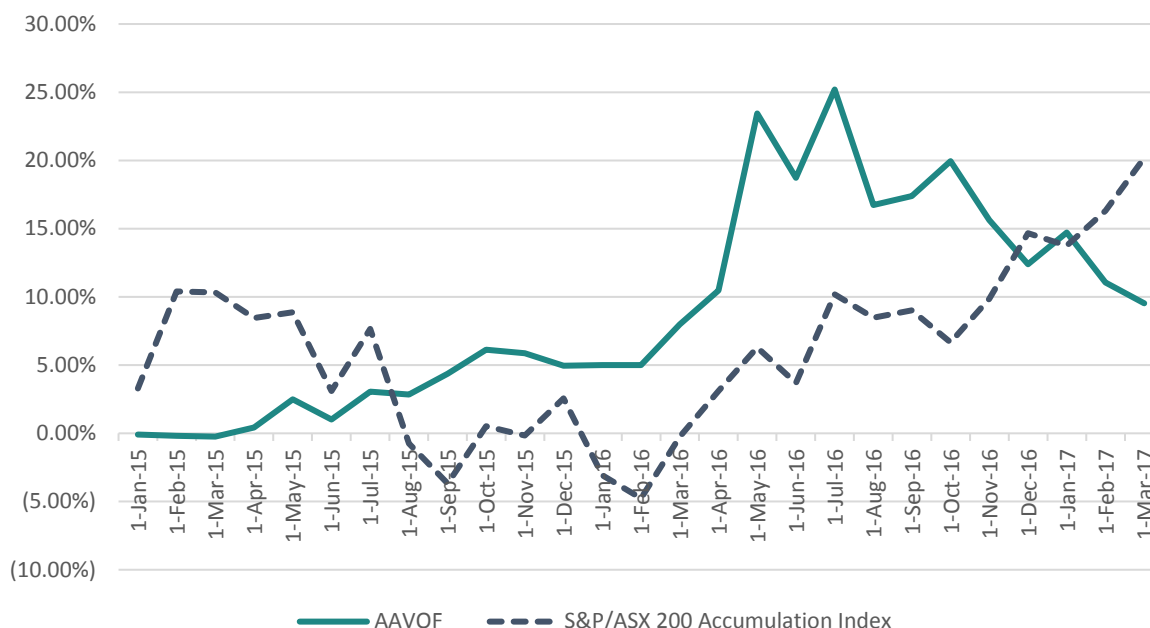


<sup>1</sup> Listed Investment Companies

<sup>2</sup> BHP, RIO, S32, BSL, NCM, AWC, MIN, NST, IGO, SMB, OZL, EVN, ORE, FMG, RSG, SGM, SYR, SAR, SFR, GXY, ILU, RRL, WSA.

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**AAVOF Returns vs S&P/ASX 200 Accumulation Index**



Source: Bloomberg and AWQ

Finally, even if we had no benchmark, negative net returns over the last six months are displeasing in the extreme. Here’s the thing: investment returns are never linear. This is especially the case in a concentrated or “high conviction” portfolio. We continue to believe that provided we stick with the investment process, it will produce results over time.

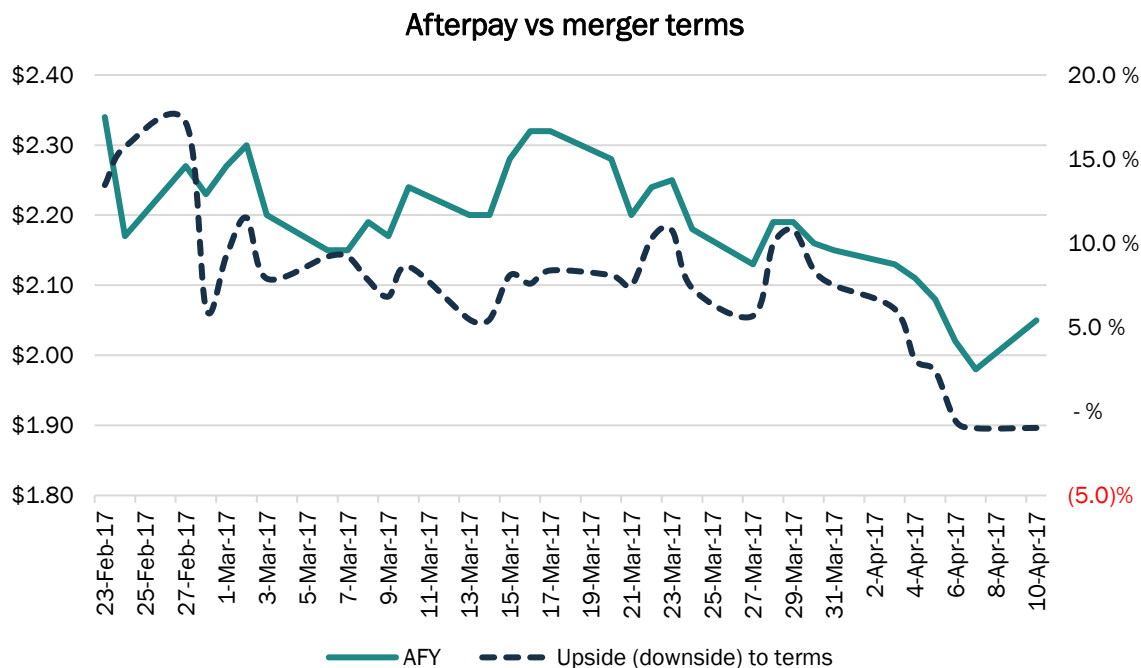
**Afterpay (AFY)** announced at the end of March that its merger with Touchcorp (**TCH**) would proceed. To recap, a merger was announced on 23 February between the two companies with a condition precedent being AFY concluding a successful due diligence process; that condition was satisfied on 30 March 2017.

The merger is 100% stock based, with TCH shareholders receiving 0.64 AFY shares for every TCH share held. Stock based mergers tend to create arbitrage opportunities. By way of example:

- On 23 February 2017, TCH shares closed at \$1.32
- On the same day, AFY shares closed at \$2.34
- An arbitrageur could thus:
  - Buy 1,000 shares of TCH for \$1,320.00,
  - Short sell 640 shares of AFY for \$1,497.60
  - Cover the AFY short on conclusion of the merger, given they would receive 640 AFY shares (equal to 1,000 TCH shares x the 0.64 merger ratio)
  - Make \$177.60 or a 13.5% return

We think this is pretty much what has occurred; some AFY shareholders sold and bought TCH, some arbitrageurs short sold AFY and bought TCH. The buyers strike / short selling has seen AFY languish despite positive business developments; now that both stocks are trading very close to merger terms, we expect this dynamic to reverse in due course (see chart below).

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Source: Bloomberg and AWQ

We continue to think that the market does not understand the Afterpay business model or its exceptionally high returns (on our math the unlevered return on invested capital on AFY’s receivables book is over 30% pa; notional levered returns should exceed 50%). Our leading indicator data shows an *acceleration* of AFY’s growth in the first quarter of Calendar 2017 and continued gains in market share.

Illustrating this point, what was most interesting about the Merger Implementation Agreement (MIA) released on 30 March is the Material Adverse Change (MAC) clause; inter alia this provides that should AFY process less than \$11.5 million of Gross Merchandise Value (GMV) a week on average over a rolling 4 week period, the merger may be terminated. If we borrow from a typical equity underwriting agreement, it is standard practice to have a MAC termination event of ~15% decline in equity markets. You wouldn’t set a MAC clause at your current performance level, it would be *materially* below it, otherwise, a deal gets terminated. If we use a 15% decline rate, it would imply current weekly GMV of ~\$13.5 million, or ~\$700m annualised GMV, which is well ahead of where most forecasts sit. At a 4.2% gross take rate it implies annualised run rate revenue of \$29 million. Our crude math implies AFY is cum revenue and earnings upgrades before merger implementation costs. It means the business should exit financial year 2017 at close to a **\$1 billion GMV annualised run rate on the current trajectory**.

For what it is worth we also expect cost out upside from the merger. Our knowledge of TCH, garnered via frustration at an inability of management to control costs, is that there is ample opportunity here. Once the merger does conclude, the Fund will hold ~8% of assets in Afterpay.

**Silver Chef (SIV)** during the month conducted a 1 for 12 non-renounceable entitlement offer, in effect to buffer the balance sheet before the proceeds of a securitisation facility become available. The key detail in the fund-raising disclosure on 23 March 2017 was slide 15, which showed arrears development in the GoGetta division’s receivables book. Influx of new arrears has slowed *significantly*, which is a core part of our investment thesis. The final area of risk from our perspective is impairment of Property Plant & Equipment (PPE) within GoGetta. Simply put, if

a customer leases a van and then becomes delinquent, after they stop paying, the van needs to be located, recovered, prepared for sale and then sold. Any loss and associated costs impact PPE. We have calculated possible outcomes based on book value at 31 December 2016, and we continue to monitor listings of GoGetta equipment offered for sale. All this leads us to believe provisioning is adequate, but the acid test is always going to be results for the half year to 30 June 2017. If we are right here (and sometimes we *are* wrong) there is significant upside ahead. Silver Chef is the Fund's largest position.

**Myer (MYR)** is a small position we hold, largely inspired by a management strategy that includes closing loss-making stores, which all else equal should see improvements in comparable store sales and earnings. On 29 March 2017, **Premier Investments (PMV)** announced that it had acquired a "*strategic investment of 10.77% in Myer*" and that it does "*not currently intend to make a takeover offer for Myer*". A takeover was never part of our thesis...we continue to think management's strategy should create value for shareholders.

During the month we initiated a position in **Weight Watchers International, Inc. (WTW.US)**. Weight Watchers is a household name with a product that is scientifically proven to work. Ravaged by the onset of competition, the Company's share price has declined from \$60+ to \$16.92 at the time of writing. In late 2015, Oprah Winfrey acquired a 10% holding in the company. As part of this, she has agreed to the provision of marketing services. The agreement has its genesis in Oprah's successful Weight Watchers experience, in which she lost 40 lbs. Oprah then went a step further and combined advocacy with investment, a creative take on the recent trend of shareholder activism. The Oprah Agreement is clever in that it results in a structural reduction in dollar advertising spend with no commensurate decline in advertising efficacy; Oprah is not paid to promote the company. Her advocacy clearly benefits her shareholding in the Company, and thus shareholders. For the first time in several years, member enrollments are growing again. We monitor a data series that tends to act as a leading indicator for enrolments and can clearly see year on year improvement. The great thing about this is that membership tends to run a fixed duration of time; in effect, we have good visibility on growth in revenue and earnings. What this means given a levered balance sheet with a highly accommodative covenant package is strong value accretion to shareholders.

AAVOF CORE OBJECTIVES



AAVOF Asset Allocation

Asset class	A\$m	%**
Australian Equities	30.9	46%
AUD cash and equivalent	26.1	39%
USD cash and equivalent	6.0	9%
Australian Hybrids & Bonds	-	0%
International Equities	5.3	8%
Hedges	(1.1)	(2)%
Portfolio Value*	67.2	100%

\* Totals may not sum due to rounding

\*\* Percentage of gross portfolio value

Top 5 Holdings

Ticker		%**
SIV	Silver Chef Limited	13%
IFN	Infigen Energy	9%
USD	USD ETF	7%
ELD	Elders Limited	6%
AFY	Afterpay Holdings	6%
Top 5 as % of Gross Portfolio		41%

Net performance

At 31 March 2017	1 Mth	3 Mths	6 Mths	1 year	Since Inception (5-Jan-15)
AAVOF (AWQ) Investment Portfolio*	(1.4)%	(2.5)%	(6.7)%	1.4%	9.5%
S&P/ASX 200 Accumulation Index	3.3%	4.8%	10.2%	20.5%	20.2%
Out/(under)performance V Index	(4.7)%	(7.3)%	(16.9)%	(19.1)%	(10.7)%

\* Net return after all fees, costs and company tax and before providing for estimated tax on unrealised gains.

## Net Tangible Assets (NTA) per Share

At 31 March 2017	Basic NTA per share (\$)
NTA after tax and before estimated tax on unrealised gains	0.95
NTA after tax and after estimated tax on unrealised gains*	0.95

\* 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

## About Arowana Australasian Value Opportunities Fund Limited (AAVOF)

AAVOF (ASX ticker: AWQ) 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, AAVOF 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

Ordinary Shares	
ASX ticker	AWQ
Last price	\$0.93
Number on issue	69,366,895
Pre-tax NTA per share	\$0.95
Market capitalisation	A\$64.5m
Gross portfolio value	A\$65.9m
Interim dividend*	\$0.02/share

\* Paid 30 March 2017 for the period ended 31 December 2016.