# INVESTMENT MANAGER'S LETTER

**Dear Shareholders,**

We have made a great deal of progress over the past year and whilst some things have changed, others have not. In reading last year's letter we are reminded that investing is sometimes a very frustrating pursuit. You can find interesting opportunities, do thorough analysis, and build a position into a diversified portfolio, but then you need to wait. The waiting is the hardest bit, especially when there's enormous pressure to deliver returns today. But delivering returns today isn't how markets work, particularly if you're a value investor buying things cheap. Value investing has been shown to deliver the best returns over the long-term, whereas growth investing has periods in the sun.

> *"It never was my thinking that made the big money for me. It always was my sitting. Got that? My sitting tight."*
>
> *EDWIN LEFÈVRE*[1]

We invest with a 5-year rolling horizon, and if the companies we have invested in are doing well, or improving, and we've bought them at an attractive price, this will eventually translate into higher valuations in the future. We believe that the big money will be made taking the longer-term view. Why? That has worked for us in the past, and we believe that it will work for us in the medium term – but there can be no guarantees.

## ARTIFICIAL INTELLIGENCE (A.I.) IS UPON US AND IS INCREDIBLY IMPORTANT

The most important theme to emerge over the past year is the rapid rise of machine learning and artificial intelligence. In simple terms, it means that machines will be able to combine functionality with the ability to learn and solve problems. Whilst the field has been around since the 1950s it is only recently that the hardware, software and availability of enormous data mines have co-existed, allowing machines to learn, and to learn rapidly.

We see the development as the Third phase of the internet. The First phase began with the rise of the PC based internet in the 1990's and the creation of the first internet business models. In the 2000s we moved to the Second phase, the mobile internet which was accelerated by the iPhone and Steve Job's vision, the birth of social media and virtual exchanges. We believe that we have now entered the Third phase – that of A.I. These developments have led to an accelerating rate of development and progress and we expect this phase to be both transformational and destructive.

A.I. will impact ALL business models. It is akin, in our mind, to past developments like the electrification of an entire economy. The challenge is that it is not easy to understand and whilst logic is useful in analysis, the steps between change are likely to be exponential rather than linear. We strongly believe that engineers,

---

[1] Edwin Lefèvre wrote the Wall Street classic Reminiscences of a Stock Operator, the thinly disguised biography of Jesse Lauriston Livermore, a legendary investor.

as we are, will have a competitive advantage to analyse and understand the Third phase. There are plenty of 'technologists' and 'futurists' out there but we believe that the ability to discern between companies will increasingly rely on university degrees founded in practical sciences (engineering, computer science etc) rather than business courses (economics, business studies, accounting etc.). Investors will need both, but the human skill set is overwhelmingly long business studies and short engineering. If you doubt this logic simply analyse what the leading CEOs of major internet companies have studied. You will find an overwhelming number of engineers and computer scientists. It is a myth to think, as it was in the first dotcom boom, that every 25 year old will be a tech investor and entrepreneur. A.I., in particular, is complex – it is not easy to understand and we expect that there will be a shortage of smart, highly technically educated talent.

We have begun to express our bullishness on A.I. in the company through some select investments and we are actively looking for other opportunities.

Let us give one such example of our thinking. The electrification of vehicles and introduction of autonomous (self-driving) capabilities could transform logistics businesses, dramatically lower the cost of delivery and accelerate online delivery. The best time to drive a truck full of freight is at 3am when the roads are empty. From an engineering perspective this is most fuel efficient and utilises the road network optimally. However, truck drivers fall asleep at the wheel at 3am and diesel driven engines are very noisy, waking people, so are not too popular. But imagine a fleet of driverless trucks, electric and silent, driven in convoy to reduce air friction, like the Tour de France riders. This is no longer a dream from science fiction movies, it is a reality that is rapidly coming towards us. The creative use of empty roads and lower fuel usage will, however, be destructive too. If you are a well-paid truck driver the advent of autonomy is terrible. A.I. will create increasing social tensions as it makes areas of the workforce redundant.

We look forward to investing in the opportunities that A.I. presents in the coming years.

Recall that we aim to invest in companies and areas that may be misunderstood, poorly analysed and/or off the radar of the mainstream investor. We seek to have a quantifiable edge where we invest and that can skews the odds in our favour. We seek asymmetry – as little downside and as much upside as possible. We will analyse an investment that we have in a cable company in Argentina below;

## GRUPO CLARIN – TOP 10 HOLDING – MARKET CAP $4.2BN US DOLLARS

- Tier 1 asset
- Undervalued
- Optionality galore

## GENESIS OF THE INVESTMENT IDEA

We became interested in Argentina in 2015 with the rise and eventual election of the market friendly, reformist Mauricio Macri. We hypothesized that the country could grow again, control inflation and re-enter world capital markets under Macri. However, since we are not global macro investors we investigated whether there were any listed companies that we could invest in that could give us an asymmetrical risk/reward profile. By this we mean that if Macri was unsuccessful in reform, we would have invested in a high quality asset with little downside (from an operational and valuation perspective), but benefit from large upside if his reforms boosted the economy.

As we looked through the listed stocks we came across Grupo Clarin (Clarin), 60% owner of Cablevision, the strongest cable operator in Argentina, but also owner of broadcasting & publishing and digital content assets. This perked our interest since we are bullish on the global cable industry because of the fast internet access it provides. As the web increasingly moves to video speed really matters, and if you can bundle your cable service with your mobile you have a very sticky and predictable business. Clarin was in in the process of building up its mobile offering for this reason.

We liked the assets, which exhibited pricing power in an inflationary environment, and the valuation was very cheap. The stock was under-covered and under-owned, something we always like, despite its size. As we dug deeper we found that it had an interesting investor in David Martinez through his Fintech Advisory business. Martinez has been described as 'the most influential Mexican on Wall street and as we've read into his background we think he is a very smart strategic investor. As it happens, his influence has begun to play out recently.

**Return on investment +44% so far...**
We first invested in Clarin at ~$18 per share, it closed at end of July at ~$26 up +44%.


Macri wins election with Cambiamos (let's change) party


## A MERGER OF GIANTS

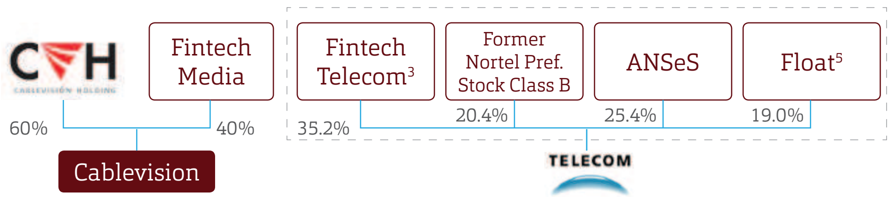
On 30 June, 2017 Clarin announced that it would merge its cable assets (Cablevision) with Telecom Argentina (TEO: ~$6bn USD market cap) subject to regulatory approval. Cablevision will hold 55% of the newco and TEO shareholders 45%. The combined company would be valued at $11-12bn USD.

## TRANSACTION SUMMARY

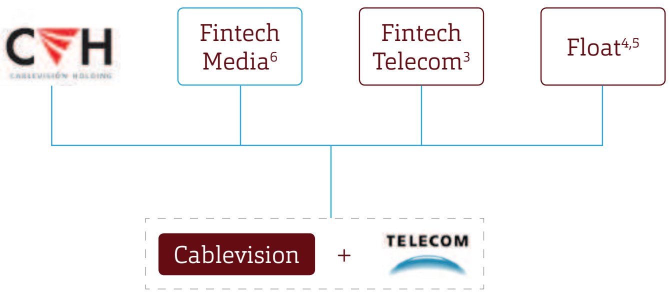
- Cablevision S.A., in an all stock transaction, will be absorbed by Telecom Argentina
- Cablevision S.A. shareholders will receive 1,184.5mm new shares of Telecom Argentina
- All resulting company share classes will have equal economic and voting rights
- Cablevision shareholders will receive 55% of the combined company shares
- Reference equity values of US$6.1bn for CV and US$5.0bn for TEO

## SIMPLIFIED OWNERSHIP STRUCTURE

Pre-transaction structure[1]




Post-transaction structure[1,2]




Source: Grupo Telcom Cablevision presentation material

We agree with the business logic. First, there are several key synergies and procurement savings will be substantial. We are interested in the reduction in 'churn' when telecom operators bundle multiple products. This synergy hasn't been called out in public presentation material, but since we follow the global cable industry we see this as significant benefit. TEO's premium mobile network will be combined with Clarin's premium cable network – making a very attractive product to sell to customers.

Despite Cablevision achieving a healthy ~7X EV/EBITDA multiple in the deal (a premium to where it was trading via Clarin's listing and LATAM peers) the stock fell almost 9% the month after the announcement! Even more incredible was that TEO's stock rallied by 4%. Considering that Clarin will be receiving shares in the newco, making up 33% of the shareholding, it should have rallied the same 4% if logic had prevailed. Sometimes we just scratch our heads with amazement, but, in our opinion, believe that in the long-term that Clarin is significantly undervalued.

## THIS BEGS THE QUESTION WHY?

TEO is covered by a few local analysts, but Clarin is not. This explains a lot of the price action. This certainly isn't enough to make a stock cheap but it does mean that it can be off the radar of many investors. Whilst Argentina is recovering it still hasn't been included in the MSCI Emerging markets index either, so many investors aren't even looking at Argentina as it isn't in their benchmark. We do not believe that the market appreciates Clarin's assets and what the bundling opportunities are with a strong player in mobile.

The stock isn't very liquid in the GDRs (global depositary receipts that we own) but we always hypothesized that would change as the company was transforming. Often, an illiquid name can suddenly become liquid as it is 'discovered' or there is a liquidity event. A merger with the liquid TEO, increased weighting in Argentinian index will be such a liquidity event. By combining with TEO the newco will a) be quite large ($11-12bn USD mcap) and b) have increased analyst coverage and therefore be discovered.

## CHURN AND SAVINGS

We estimate that the procurement synergies are worth about $2bn in PV terms. If we assume Clarin shares 33% of them then the increase in Clarin's value should be circa 20-25%. In the chart below we can see that Cable churn is running at circa 15%. If that is reduced through the mobile/content/broadband bundle the savings could be significant too. This is not in estimates.

## EXHIBIT 37: CABLE & INTERNET ACCESS STATISTICS

'000s

| | 1H17 | 1H16 | % CH, | 2Q17 | 1Q17 | 2Q16 | QoQ | YoY |
|---|---|---|---|---|---|---|---|---|
| Homes Passed (*) | 7,864,2 | 7,815.4 | 0.6% | 7,864.2 | 7,833.7 | 7,815.4 | 0.4% | 0.6% |
| Bidirectional Homes Passed | 76.6% | 73.4% | 4.4% | 77% | 76% | 73% | 0.8% | 4.4% |
| Total CATV Subscribers | 3,510.4 | 3,522.1 | (0.3%) | 3,510.4 | 3,510.4 | 3,522.1 | (0.0%) | (0.3%) |
| Churn Rate | 14.9% | 14.0% | 6.1% | 14.5% | 15.3% | 12.8% | (5.1%) | 13.3% |
| Digital Ready Pay TV Subs | 3,050.1 | 3,012.8 | 1.2% | 3,050.1 | 3,021.1 | 3,012.8 | 1.0% | 1.2% |
| Total Internet Subscribers | 2,254.8 | 2101.4 | 7.3% | 2,254.8 | 2,208.4 | 2,101.4 | 2.1% | 7.3% |
| Total ARPU | 735 | 522 | 40.7% | 755 | 715 | 527 | 5.5% | 43.3% |

Source: Grupo Clarin Q2 results

## UNDER-GEARED AND CHEAP

One other thing we like is that this is a share combination rather than a buyout, which would have left the newco heavily indebted. On the contrary, the newco has firepower and a flexible balance sheet, with a combined 0.3x net debt/EBITDA ratio. If we add in the synergies and forecast modest growth we arrive at an EV/EBITDA ratio of circa 4.5X for 2018. Latam peers trade on circa 6.3x despite slower growth prospects. We think that the combined entity will provide better bundled service quality to the customer and that will increase sales, reduce churn and lead to higher EBIT growth. Therefore, arguably the newco should trade at a premium due to a) low leverage b) a large/significant market cap and c) faster growth.

We believe that the shares could trade at closer to $40 in coming years, perhaps more if execution is good – that would be another 60% upside from here and more than 120% return from inception. If earnings growth was 12% higher than we expect and the stock traded at the high end of telco multiples in LATAM, the share price could potentially double from here.

Clarin being a top 10 position and why we are bullish on our portfolio holdings. We have other names where we are equally optimistic and think our best days are ahead.

## STOCKS FOR THE LONG-TERM

It is worth reminding ourselves that stock markets deliver the best returns of any asset class over the long-term, compounding at almost 10% per annum[2]. Therefore, in the long-term it makes sense to be bullish on stocks. Second, there are over 7 billion people in the world, and there will always be opportunities for companies to grow and for their value to increase.

[2] US large stocks increased by 9.8% per annum on average 1926-2012 Source: SBBI.