1H 2019 Results Conference Call Transcript

Tuesday 5 February 2019 at 10:30am

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Presenter:

Mr. Robert Luciano (Director of VGI Partners Global Investments Limited, Managing Partner and Portfolio Manager of VGI Partners Pty Limited, The Manager)

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Presentation:

Good morning and welcome to the first half 2019 results conference call and webcast for VGI Partners Global Investments Limited. Thank you for joining us today and for your ongoing support.

I'm Robert Luciano, the Managing Partner and Portfolio Manager of VGI Partners. With me in the room is Douglas Tynan and Robert Poiner, David Jones, our Chairman of VG1, and Victoria Arthur, VG1's Investor Relations Manager.

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2018 was the first calendar year since 2011 that most major global stock indices recorded negative returns in their local currency. In the last few months we have seen global equity markets sharply decline due to the fear of rising interest rates, global trade wars and slowing global growth.

Against this backdrop, we were very pleased to report that VG1's portfolio generated a post-tax return of **+10.8%** net of all fees for the calendar year.

As outlined on page 3 of the presentation, for the half year ended December, VG1 reported an operating profit before tax of $18 million, which equates to earnings per share after tax of 4.8 cents. Underpinning the half year result was a **+2.4%** increase in the value of the investment portfolio, after tax and all fees.

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The VG1 share price declined -**1.8%** from $2.27 as at June 30 to $2.23 as at 31 December 2018.

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Now please turn to page 5 for some background on VGI Partners, who is the Manager of VG1.

- VGI Partners is a specialist manager, focussing on global equities.
- We now have 21 professional staff across three offices in Sydney, New York and Tokyo. We recently established a Representative Office in Tokyo, to focus on Asian research. We hired a Head of Asian Research and a translator, who are both based in Tokyo, and look forward to growing our Investment team in the Asian region in the not-too-distant future.
- VGI Partners deploys a single investment strategy across all our Funds and managed accounts.
- Our investment strategy is closed to new investors. The only way to gain access to our strategy is via investing in VG1 shares on the Australian stock exchange. We believe that this not only differentiates VGI from other fund managers, but also creates substantial “scarcity” which should contribute to ongoing support for VG1 shares in the form of a modest share price premium.

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Turning to page 6 of the presentation.

VGI Partners invests primarily in global equities, comprising Long investments, Short positions and cash. Our investment philosophy reflects the following three key tenets:

Capital preservation – that is, do not lose money.

We are extremely focussed on avoiding any permanent loss of capital.

We aim to increase the likelihood of capital preservation through two means. First, by investing in high-quality businesses that are easy to understand and that trade at prices which we believe exhibit a sufficient ‘margin of safety’ – that is, trading at prices that are significantly below the intrinsic value of the business. And second, by using little or no leverage and keeping prudent cash buffers.

Long-term compound growth – we seek to deliver superior risk-adjusted returns over the long-term. Our target is to achieve compound returns of 10% to 15% per annum, after all fees and expenses, over the long term and through the investment cycle, which we deem to be typically 5 to 7 years.

We also aim to do this through **portfolio concentration** – that is, concentrating capital in a relatively small number of high-quality investments. The top 5 long investments will typically represent 40% to 50% of VGI's portfolio.

Importantly, we are not afraid to hold cash when attractive opportunities are not available.

That sums up our three key investment tenets.

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Turning to page 7. These charts are an intuitive way to demonstrate VGI Partners' focus on capital preservation and our conservative portfolio positioning.

As outlined in the VG1 Prospectus, we expect that VG1 will closely replicate the VGI Partners Master Fund over time. The VGI Partners Master Fund portfolio has delivered compound annual returns of **+14.7%** after all fees since it was established in January 2009. This compares to **+10.1%** for the MSCI World Total Return Index in Australian dollars, which we believe is an appropriate comparison.

Moving on to the right-hand chart on page 7. This chart shows that, since inception, the Portfolio has tended to outperform in periods of market weakness. In down market months, when the index fell **-2.2%** on average, the average decline for the VGI Portfolio was in comparison only **-0.8%**.

As you will see shortly, we maintained our tradition of outperforming in down market months during the most recent reporting period.

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The table on page 8 demonstrates that VGI Partners has been successful in achieving its performance objectives every year since inception. It is important to note that this has been achieved with an average cash weighting of approximately 30%.

Our investment philosophy of concentrating capital in our best ideas, complemented by selective short selling and holding strategic cash reserves when ideas are scarce, has been effective over the past ten years.

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Turning to Page 9. At VGI Partners, we take alignment of interest between ourselves and our investors very seriously.

All VGI Partners' staff are prohibited from purchasing securities outside the Fund and VG1. VGI Partners' Investment Team have the vast proportion of their net worth invested in our two Funds, shares of VG1 and VGI Partners itself. We all view these investments as our primary capital growth vehicle and therefore our most important financial investment.

VGI Partners, as the Manager of VG1, has committed to absorb all the upfront listing costs as well as the vast majority of VG1's ongoing operating costs. The only operating costs that VG1 shareholders incur are the three Independent Directors' fees and the Directors' insurance expense.

The owners of VGI Partners have committed to reinvesting 100% of the performance fees earned, after taxes, into new shares in VG1, and we have entered into long-term voluntary escrow arrangements for these shares. We were the first Australian fund manager to make such a strong commitment to alignment of interests with our investors.

At VGI Partners we pride ourselves on focussing all of our time and energy on managing your money.

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Now please turn to page 11.

VG1's post-tax NTA increased **+2.4%** during the reporting period to $2.24 per share at the end of December.

VG1 has traded at an average premium of approximately 5% since listing.

The VG1 Board has not declared a dividend for the first half. I would remind everyone, as outlined in the prospectus, paying a dividend is not a primary objective for the Company. We've had some investor queries regarding future dividends – all I can say today is that the timing of any future dividends is a matter for the VG1 Board and will be driven in part by the availability of profit reserves and franking credits which at this stage are rather de minimis.

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For the 2018 calendar year, VG1's performance was **+10.8%.** This compares to negative results from all major market indices, as shown in the table on page 12.

As I mentioned earlier, we see the MSCI World Total Return Index in Australian Dollars as possibly the most appropriate yardstick against which to measure VG1's performance over time. This index delivered a positive return of +1.3% in 2018, so VG1's +10.8% return represents a +9.5% outperformance for the period.

We also do welcome comparison of VG1's performance with the various Listed Investment Companies and Funds managed domestically but also globally.

In a challenging year, we are pleased that our unwavering application of VGI's long-established investment philosophy and process has meant that VG1's performance stands up to any comparative review.

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Now turning to page 13 of the presentation, VG1's Long investments fell in value by **-4.6%** during the period. This was largely offset by the by the **+4.1%** return delivered by VG1's Short investments, giving a total stock return of negative **-0.5%**. The contribution from our long-term currency positioning was **+2.9%**.

CME was the largest long contributor during the period.

The largest Long detractors were Zillow Group, Spotify Technology and General Electric. Now each of these investments remain in the portfolio today and in each instance, we have actively managed the position and added to our investment as share prices declined. This has now contributed positively to portfolio returns in January as these stocks have all started the new year strongly and I would note that General Electric is now up over 50% from its lows.

Moving onto our short portfolio, which contributed **+4.1%** to performance. As you all know, we make money on our short portfolio when share prices go down. The short portfolio decreased in value by **-15.8%** during the reporting period. In contrast, the MSCI World Total Return Index in Australian dollars declined by **-4.6%**. Now this means our short portfolio not only made money in absolute terms, but also fell a lot more than the market by a significant margin. I should note we do not always generate positive returns from our short portfolio. However, by focussing on structurally flawed businesses, fads and companies with substantial accounting irregularities, we believe our short positions will generate positive returns for VG1 investors over time.

Currency contributed **+2.9%** to VG1's net performance during the period. VG1 is denominated in Australian dollars but is very substantially exposed to the U.S. Dollar through both investments it owns, as well as its cash holdings, which we have decided to hold entirely in U.S. Dollars for now.

As you know, we have made the conscious decision to not have any U.S. Dollar currency hedges in place at the time of the IPO. We will actively manage currency hedging as our analysis of the economic outlook for Australia evolves relative to the US, but also Europe, the United Kingdom and Japan.

We continue to believe the U.S. Dollar remains attractive relative to the Australian dollar. The United States is seeing a sustained pickup in inflationary pressure and notwithstanding recent commentary, we believe the US Federal Reserve will continue to raise rates over time and it will also gradually unwind the excess assets accumulated on its balance sheet through 'Quantitative Easing'.

In contrast, the Reserve Bank of Australia is facing very little pressure to raise rates. In fact, with the recent housing slowdown, which is accelerating, stretched household balance sheets and weak wage growth, there is a real possibility, in our view, that the RBA will need to decrease rates.

At some point in the future we will progressively hedge VG1's U.S. Dollar exposure. However, this will not happen until our fundamental analysis suggests that the Australian Dollar is more fairly valued.

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Now please turn to page 15 for an update on the Portfolio.

The first table on the left sets out the top five Long investments as at 31 December. These collectively represent 39% of the VG1 portfolio.

As shown in the second table on the left, the portfolio had 49% net equity exposure at the end of December, with 74% long and 25% short. The cash weighting was therefore 51%. As discussed earlier, all cash is currently held in U.S. Dollars and this position is not hedged.

In terms of geographic split, 76% of the Long portfolio investments were listed in North America, 15% in Asia, which includes Australia, and 9% in the UK and Europe. Many of our Long investments which are listed in North America have material exposure to international growth. This is especially the case for Colgate Palmolive, Amazon, MasterCard and also Spotify.

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Please turn to page 16 for an update on portfolio deployment**.**

Up until recently, we were operating in a highly unusual investment environment, with most major global stock market indices reaching all time highs. As a result, and given VGI's focus on preservation of investors' capital, we have been patient in making investments on behalf of VG1.

Recent market volatility has provided VG1 the opportunity to purchase securities at more attractive prices, and at the end of December the portfolio was, on average, approximately **85%** of targeted individual stock weightings across the entire portfolio.

Where we have identified new Long and Short opportunities, the VG1 portfolio weighting has immediately mirrored the VGI Partners Master Fund weighting. However, as we have said before, it would have not been prudent to immediately replicate weightings in a number of Long positions which have been held by the VGI Partners Master Fund for many years, and these include Amazon and MasterCard.

In recent months, prices have come back a touch, and in some cases, such as Amazon, a little bit more. That has provided us the opportunity to add to our holdings in both of these companies. As a result, the weighting for Amazon has increased to 8% and the weighting for MasterCard has increased to 6%.

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Now please turn to page 18.

Even after the recent market sell-off, we feel that the vast majority of high-quality businesses continue to trade at valuations which imply unlikely levels of growth into perpetuity.

Market volatility has returned and we believe there will continue to be good opportunities in the future to make purchases for the VG1 portfolio. Thus, the VG1 portfolio continues to maintain a relatively sizeable cash holding which enhances our ability to execute in times of market uncertainty and extreme volatility. This strategic cash holding has come in handy particularly in recent months, allowing us to slowly add to some of our existing positions at what we believe to be attractive prices.

We remain confident that we will continue to generate superior risk-adjusted returns through the investment cycle, by concentrating our capital in a relatively small number of high-quality businesses that we believe are significantly undervalued, combined with selective short-selling and avoiding the use of leverage.

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Our shareholder engagement program is summarised on page 20, and by now most of you would be aware of the major events on our calendar and the independent research that's available on VG1.

What you might not know is how important it is to register your email address with our Investor Relations team if you are going to get the full benefits of being a VG1 shareholder.

We would love to be able to send you our meeting notes from the Berkshire Hathaway and Daily Journal Annual Meetings. The Daily Journal Annual Meeting is coming up and our notes will be prepared soon after. It's also other relevant material which we send out to our investors in the Funds and also VG1 shareholders. So – if you haven't done so already - please sign up, or ask your financial adviser to add your details to our register.

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So that brings us to the end of the presentation. We will now move to questions.

Operator, could we please have the first question? Thank you.

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