For personal use only

VGI PARTNERS Global Investments

VGI Partners
Global Investments Limited
ABN 91 619 660 721
39 Phillip Street
Sydney NSW 2000 Australia
T. +61 2 9237 8923
www.vgipartners.com/lics/vg1

15 July 2020

ASX Market Announcements
ASX Limited
Exchange Centre
20 Bridge Street
Sydney NSW 2000

BY ELECTRONIC LODGEMENT

Investor Letter from VGI Partners Limited

VGI Partners Global Investments Limited (ASX:VG1) is pleased to make available the enclosed Investor Letter prepared by VGI Partners Limited in relation to the performance of VG1 for the twelve months ended 30 June 2020.

Authorised for release by:

Ian Cameron
Company Secretary

For investor queries, please contact:

Ingrid Groer, CFA
Head of Investor Relations
VGI Partners Global Investments Limited
Phone: 1800 571 917 (inside Australia)
+61 2 9237 8923 (outside Australia)
Email: investor.relations@vgipartners.com

For personal use only

VGI PARTNERS

15th July 2020

Investor Letter

"You need patience, discipline, and an agility to take losses and adversity without going crazy."
- Charlie Munger

Dear Fellow Investors,

For the twelve months ended 30 June 2020 (FY20), the **VGI Partners Global Investments Limited (ASX:VG1)** generated a net AUD return of **-4.3%** after all fees. VG1's post-tax Net Tangible Assets (NTA) per share stood at **$2.27** at 30 June 2020.[1]

VG1's average monthly net exposure in FY20 was 60% (86% Long Investments less 26% Short Positions). This means that on average for every $100,000 you had invested with VGI Partners during FY20, we owned $86,000 of equities and sold short $26,000 of equities for a net equity exposure of $60,000.

VG1 seeks to replicate the VGI Partners Master Fund over the long term, but in previous letters we have reported that performance diverged somewhat as VG1's capital was deployed more conservatively. For FY20, VG1's performance was slightly better than that of the Master Fund. A number of core positions only reached their target weight for VG1 when the market sell-off in March provided an attractive opportunity and going forward VG1's performance will more closely replicate the Master Fund as originally intended.

[1] Post-tax NTA is calculated after tax on realised gains/losses, deferred tax assets and deferred tax liabilities, but before allowing for deferred tax liabilities/deferred tax assets on unrealised gains/losses.

SYDNEY
VGI Partners Limited
ABN 33 129 188 450
39 Phillip Street
Sydney NSW 2000
Australia
T. +61 2 9237 8900
www.vgipartners.com

AFSL No. 321789
SEC Registered

NEW YORK
VGI Partners, Inc.
600 Madison Avenue
Suite 2101, New York,
NY 10022, USA
T. +1 212 937 4700
www.vgipartners.com

TOKYO
VGI Partners Limited
Representative Office
Level 8 Tri-Seven Roppongi
7-7-7 Roppongi Minato-ku
Tokyo 106-0032, Japan
T. +81 3 6629 3515
www.vgipartners.jp

For personal use only

The overall net return was below our long-term objective to deliver average compound annual net returns of 10% to 15% per annum through the cycle. FY20 also represents the worst financial year return for the VGI Partners Global Strategy relative to the MSCI World Total Return Index (AUD) since the strategy's inception over a decade ago and the first year in which we have delivered a negative return.

We have reported to you previously on several factors that contributed to this disappointing performance. In our January 2020 letter, we noted that VG1 was cautiously positioned in 2019 as markets embraced a renewed low rate environment, pushing earnings multiples even higher than we had seen previously.

The second half of the financial year was marked by concerns over an unfolding public health crisis and its effect on the global economy. In a turbulent environment, VG1's returns have been shaped by strong outperformance in a falling equity market followed by underperformance as the market rebounded.

When indices started to move higher in late March we increased VG1's Short exposure as we anticipated that a broad-based consumer crisis would inevitably follow what had become a global economic shutdown. This decision has detracted significantly from the VG1's performance as equity markets violently rallied on the back of central bank stimulus and investors priced in a reopening of economies and a return to "business as usual" for consumers. We should have been faster to recognise that the announcement of unprecedented stimulus and wage-replacement programs around the world would defer negative consequences for a number of companies in which we held and initiated Short Positions.

The Australian Dollar also performed strongly in the June quarter. This created a further headwind as VG1 was predominantly exposed to the US Dollar.

These two factors more than offset the returns delivered by our portfolio of high-quality Long Investments, several of which are benefiting from an acceleration of themes that we have been observing for some time (more on this to follow).

While we do not invest with any particular twelve-month period in mind, and we believe returns need to be viewed over longer time-periods, this must not be used as an excuse to avoid acknowledging mistakes and learning from them.

VGI PARTNERS

For personal use only

We are now in a position of having delivered recent returns that we do not find satisfactory, which is largely attributable to the conservative approach that we have taken to VG1's portfolio over this period. There have also been changes in the composition of the VGI Partners Investment Team, which are discussed in the Operational Update towards the end of this letter. The confluence of these circumstances has provided the impetus to reflect on our investment processes and the way in which we apply the core VGI Partners investment philosophy, based firmly on the cornerstone principles of capital preservation and 'margin of safety'.

Following a detailed discussion of VG1's performance below, later sections of this letter will discuss the subtle changes we are making to managing our portfolio of high-quality Long Investments, to our Short Portfolio and to our currency positioning. We believe that these changes will only enhance our ability to deliver on our investment objectives over the long term.

VG1's **-4.3%** net return for FY20 consisted of a **+0.4%** positive return from the Long Portfolio, a **-5.6%** detraction from the Short Portfolio and a **+0.9%** contribution from our long-term strategic currency positioning. We will discuss our Short Portfolio as well as our currency management approach in detail later in this letter.

Since inception in September 2017, VG1 has generated a net return of **+15.2%** after all fees. This represents a compound annual net return to investors of **+5.3%** over this period.[2]

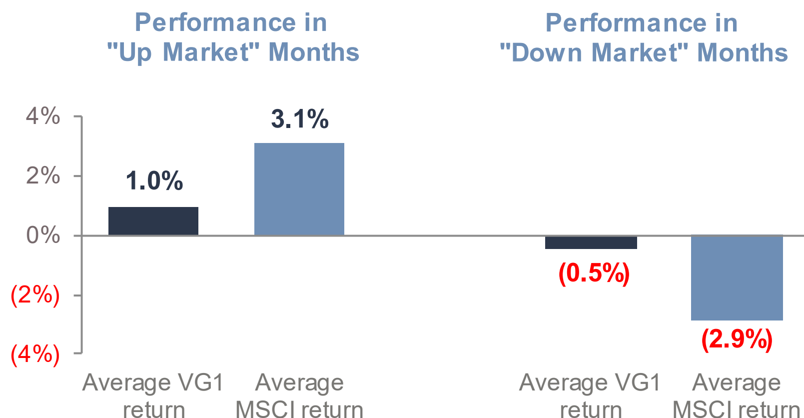
Put another way, $100,000 invested in VG1 in September 2017 grew to circa $115,200 at 30 June 2020 after all fees and charges.

We remain highly disciplined in our approach and believe the chart overleaf provides an intuitive way to demonstrate VGI Partners' strong focus on capital preservation and our conservative portfolio positioning. Since inception, VG1 has tended to outperform in periods of market weakness. The VG1 portfolio fell an average of just -0.5% in down market months, when the Index fell by -2.9% on average.

[2] Returns have been adjusted for VG1's capital raising in 2019.

VGI PARTNERS

VG1: Performance and Capital Preservation in Up / Down Months



Source: Citco Fund Administration and Bloomberg.
Note: The performance period includes 33 months since inception (21 "up market" months and 12 "down market" months).
MSCI = MSCI World Total Return Index (AUD).

Our investment philosophy of concentrating capital in our best ideas, complemented by selective short selling and holding strategic cash reserves when valuations are not attractive, has been effective since VGI Partners' inception twelve and a half years ago. This is seen in the track record of our VGI Partners Master Fund, which has delivered compound returns of +12.9% after all fees.

However, given the extraordinary change in the monetary and fiscal landscape globally we must now adjust how we manage the portfolio. While we will continue to focus on capital preservation and risk-adjusted return we cannot continue to maintain high cash balances over time, and nor can we assume traditional short-selling approaches will continue to work in a world of endless money printing and government stimulus.

This means that we need to embrace some volatility in order to extract returns.

❖❖❖❖❖❖❖❖❖❖

For personal use only

For personal use only

Performance Attribution for the Year to 30 June 2020

The table below lists the most significant stock contributors to the performance of our Long Portfolio for the twelve months to 30 June 2020.

Of course, there were also several detractors to the Long Portfolio and one key error was made in relation to **Spotify Technology SA (NYSE: SPOT)**. Spotify is the global market leader in the music streaming industry and had been a core holding for VG1 since 2018. We exited the position when stay-at-home orders were at their peak and usage data showed that consumers were using Spotify far less as they were no longer commuting.

As Spotify offers a free subscription tier, we were concerned that churn amongst paying subscribers, a key driver of earnings, was likely to increase as consumers under economic pressure traded down to the free offering in this unusual environment. This prompted us to exit the position. While this was a mistake, the real error was not to repurchase the investment when management subsequently announced that churn had not increased notwithstanding reduced usage. We had the opportunity to buy back the position around 10% above the price at which we sold. We did not do this, and the stock has subsequently almost doubled. Selling a long-term investment holding based on short-term issues is an error that we rarely make, and we will learn from this bitter experience.

Top Long Contributors to Returns in FY20	Contribution
Amazon.com Inc.	5.1%
Mastercard Inc	1.3%
La Française des Jeux	0.9%
Linde plc	0.7%
WD-40 Co.	0.7%
Total Contribution of Above	**8.7%**

Source: VGI Partners.

Amazon.com (NASDAQ: AMZN) contributed **+5.1%** to performance for the twelve months to 30 June 2020, with the share price increasing **43.5%** over the course of the year and it remains our largest portfolio position.

We believe that the recent global health crisis will only accelerate the secular trends that Amazon was already enjoying through its core businesses of online retail and cloud-computing services.

For personal use only

Over the past twenty-five years Amazon has built a global logistics network, which we believe would be almost impossible to replicate today. This has provided the company with a very wide and expanding economic moat in the rapidly growing online retail space. On the back of this logistics network Amazon effectively operates two retail businesses: firstly, they buy and sell goods themselves through the online store and secondly, independent third-party merchants utilise the Amazon customer base and logistics network to sell through Amazon's Marketplace. These independent merchants pay Amazon an ad valorem fee for access to their customer base and fulfilment capabilities.

Over time Amazon has leveraged its enormous audience of satisfied customers to attract more merchants to sell through the third-party marketplace platform. This increase in product choice for consumers not only attracts more customers to the platform but increases the attractiveness of an Amazon Prime membership as more and more products become available for free one day shipping (not to mention free video, music and other benefits). As Jeff Bezos wrote in Amazon's 2015 investor letter: *"we want Prime to be such a good value, you'd be irresponsible not to be a member."*

This is a great example of what Amazon call their 'flywheel' as the proceeds from the Prime membership are reinvested into the logistics platform to make it more efficient, cheaper for customers and of course faster. With over 150 million Prime subscribers globally (and growing) that is almost US$20bn that is being reinvested annually, which acts as an enormous barrier to entry for anyone trying to compete. Over the past few years retailers across the US have been investing heavily in an attempt to lower shipping time to two days in an attempt to match Amazon. With the move to free one day delivery in 2019, Amazon Prime continues to shift the goalposts for the competition.

Over the past ten years Amazon has increased the percentage of units sold through their third-party Marketplace from 30% of all units sold to 53% in 2019. We believe this has materially increased the business' quality given the higher returns that Amazon earns through the Marketplace business. We also believe it provides significant latent pricing power as Amazon is able to increase the ad valorem fee charged to the captive merchant. Amazon, through their first-party business will typically sell the same or similar products, such that if a third-party merchant gets too aggressive on price, Amazon will be more than happy to keep them in check!

For personal use only

Incredibly, Amazon has built this network over the past twenty-five years without raising material equity or net debt. This shows us that Amazon has been able to fund its growth through a highly cash generative core business. And while Amazon has a dominant share in US online retail, it still has only a mid-single digit share of the target retail market. Thus, we remain confident that Amazon's retail logistics business will enjoy many years of impressive revenue growth and margin expansion.

Another nascent business opportunity that we believe will be meaningful to earnings over the next five years is advertising. In the past few years Amazon has begun to offer merchants prominent product and brand placement near the top of the product search display. This is akin to consumer brands paying 'slotting fees' to a supermarket retailer for prominent shelf space positioning. In 2019, Amazon earned around US$14bn of revenues from advertising. While we do not know exactly how large this business line will be, this US$14bn in advertising revenue compares to US$140bn for Google, with arguably much higher return on investment for the advertiser on Amazon given the very high purchase intent of the customer. Most importantly, this revenue stream, while comparatively small today, is growing at ~40% and has a very high incremental margin.

Finally, Amazon is the leading global cloud computing provider through Amazon Web Services (AWS). This fast-growing market was effectively created by Amazon and, as a result, AWS benefits from significant first-mover advantage, scale benefits and network effects through its third-party partnership ecosystem. Corporations globally are rapidly shifting from using on-premise datacenters to using cloud computing solutions such as those offered by AWS. We believe this trend will only accelerate in a post-COVID world as employees increasingly work remotely. Over time we believe that the market for cloud infrastructure could be as much as US$1 trillion; as the strong market leader currently garnering only a low single digit share of that market opportunity, we believe AWS is poised for many years of strong growth.

Amazon is a core position for us and, while we do expect there to be significant share price volatility from time to time, we expect that over the long term we will continue to generate attractive returns on our investment.

Mastercard (NYSE: MA) contributed **+1.3%** to performance for the twelve months to 30 June 2020, with the share price increasing **10.9%** over the course of the year.

For personal use only

Mastercard is the world's second largest global payments processor, behind Visa. The industry is a duopoly with Mastercard and Visa controlling the majority of the world's electronic payments. We believe that a strong secular trend toward electronic payments over cash and cheques will continue to drive both the revenue and earnings of Mastercard. Significant growth opportunities exist in developing countries as well as in new payment technologies (such as PayPass) that enable the more frequent use of electronic payments. We also view Mastercard as an attractive hedge against inflation – a higher cost of goods purchased will benefit the company's bottom line as it charges an ad valorem fee and has significant pricing power.

At the time of Mastercard's IPO in 2006, 85% of the world's consumer payments by value were transacted in cash. Today, despite the widespread adoption of electronic payments in developed markets, the global share of cash transactions still stands at 85%. This has occurred as emerging market transaction growth has outpaced that of developed markets. In emerging markets, 92% of transactions are still carried out in cash. This dynamic provides Mastercard with an incredibly long runway of growth.

Over the past few months we have seen many merchants moving away from cash transactions due to health concerns associated with the handling of physical currency. While our long-term view on Mastercard is not dependent upon this phenomenon, we do believe it could provide a meaningful catalyst for the business over the medium term, particularly in the US, which is at the very early stages of adopting contactless payments.

On top of the secular tailwinds, attractive industry structure and inflation protection, Mastercard also has a high-quality management team that has maintained a debt-free balance sheet despite investing heavily in future growth projects.

La Française des Jeux (EPA: FDJ) contributed **+0.9%** to performance for the twelve months to 30 June 2020, with the share price increasing **38.0%** from the company's IPO in November 2019.

VGI Partners participated in the IPO of French monopoly lottery operator, La Française des Jeux, after members of the investment team travelled to London and Paris (from Sydney and New York) on two occasions to meet with FDJ management and representatives of the French government. Our efforts to thoroughly research the opportunity and present our credentials as investors were well-rewarded as we were allocated the fifth largest institutional allocation in the offering and the largest of any foreign institution (the top four were all French institutions).

For personal use only

FDJ has the exclusive license to operate lottery games in France, from traditional draw-based lotteries (EuroMillions, Lotto) to instant win games and scratch-cards. In addition, FDJ has the exclusive license to operate physical sports betting terminals (similar to Tabcorp in certain Australian states) and owns an online sports betting bookmaker.

Historically, FDJ has been owned by the French government. FDJ was the first asset to be privatised by the French government as part of President Emmanuel Macron's privatisation drive.

We view FDJ as an attractive asset because it has many of the characteristics we look for in high-quality businesses: an attractive industry structure (FDJ has a lottery monopoly), pricing power, a resilient revenue stream, high cash-flow generation, a strong balance sheet and the potential to steadily grow earnings.

As we have seen with other government privatisations, we expect FDJ to be run more efficiently as a private enterprise and therefore anticipate cost-out opportunities. In addition, as a highly cash-generative business, we expect FDJ to initiate meaningful shareholder return policies.

Market volatility associated with COVID-19 presented an opportunity to add to our investment at attractive prices. We believe the lockdown in France and the suspension of sports competitions represent temporary headwinds and we expect lotteries and wagering activity to normalise and recover quickly.

Linde plc (NYSE: LIN) contributed **+0.7%** to performance for the twelve months to 30 June 2020. While the share price increased just **4.5%** over the course of the year, we added to our position during the March sell-off and, as a consequence, achieved an enhanced return. The company also paid a dividend yield of **+1.7%** on top.

Linde plc is the result of a merger between two of the big four industrial gas providers, Praxair Inc. and Linde AG. The merger closed in March 2019 and the combined business, Linde plc, is now the largest industrial gas player in the world, further consolidating an already highly concentrated industry.

For personal use only

We believe several factors make the industrial gas industry an attractive place to invest. The product is a small proportion of their customers' total cost base but an essential input; coupled with the industry structure this provides substantial pricing power. Industrial gas facilities have significant initial capital requirements and often it will take three years to see any return on this investment. The industry has very long-term contracts with 'Take or Pay' provisions, improving earnings visibility. In addition, the industry has a highly consolidated market structure, with the top three players holding ~80% of the global market. Finally, the industry tends to form regional monopolies, as production must occur within 200km of the end customer.

The former Praxair management team have been in control of the merged business since March 2019 and we believe their best-in-class execution combined with Linde AG's assets will result in significant pricing opportunities and margin improvement over coming years.

While growth in the industrial gasses industry is broadly correlated to industrial production activity, which has been impacted by COVID-19 lockdowns, we believe Linde is well positioned due to its diverse end market exposure and backlog of new projects. For example, in 2019 18% of Linde's gasses revenues were derived from the Healthcare industry, which has secular growth and is highly defensive in nature. We believe 65% of Linde's business is exposed to end markets which have growth rates which are independent of industrial output.

In addition, Linde has a substantial backlog of new gasses and engineering projects which will come online over the next few years and result in incremental growth for the business.

As a result, we believe Linde is very well placed to continue to grow earnings despite the current economic environment and over the long term.

WD-40 Co. (NASDAQ: WDFC) contributed **+0.7%** to performance for the twelve months to 30 June 2020, with the share price increasing **24.7%** over the course of the year plus a dividend yield of **1.3%** on top.

WD-40 is a global consumer products and brand management company. The vast majority of WD-40's revenue is generated from selling cans of the world famous WD-40 branded industrial lubricant (WD-40 stands for Water Displacement - 40th attempt, which was the laboratory name used by the chemist who developed the product in 1953).

For personal use only

The Company manufactures the WD-40 concentrate internally (thereby protecting its intellectual property and secret formula). WD-40 then ships this concentrate to external 'aerosol fillers' and thus outsources the majority of the manufacturing of its product to third parties. This asset-light business model enables WD-40 to operate with very little capital and only 495 employees.

Long-standing VGI Partners investors will know that we originally purchased WD-40 back in 2011. VG1 held WD-40 as a core investment until July 2020 and enjoyed strong performance as the business expanded its powerful and very valuable brand into adjacent categories and new geographies. We sold down some of this position in March 2020 as the stock hit an all-time high and completely exited the holding this month when the price rallied back to these levels. We took this action due to concerns that the company is now more than fully valued with better opportunities to deploy capital elsewhere. WD-40 delivered shareholder returns in excess of 471% over the period it was held in the VGI Partners global strategy (representing a return of 20.1% p.a.).

Short Portfolio

Collectively our Short Portfolio detracted -5.6% from performance for the twelve months to 30 June 2020 after contributing +0.7% to returns in the twelve months to 30 June 2019. The Short Portfolio averaged 26% of total Portfolio capital throughout FY20 but peaked at around 47% in April 2020.

Of course, individual Short Positions made strong contributions, and we locked in substantial gains as we closed numerous Short Positions when markets were at their lows in March. The positions we exited included several of the Short Positions that we have disclosed publicly either at Ira Sohn conferences or in presentations shared with our investors. If we had closed more of our Short Positions at this time we would have locked in significant profits. Unfortunately we did not, given our fundamental views at the time.

In fact, in April and early May we added to Short Positions in companies, including a number that we had shorted in previous years, that we expected to be particularly hard-hit in a period of economic recession. We also maintained some long-standing high-conviction Shorts in sectors which we believe face structural headwinds. We took these actions in an effort to generate returns and in turn protect the portfolio.

For personal use only

As it happened, these Short Positions increased by more than the broader market when investors rapidly priced in a reopening of economies and a return to "business as usual" for consumers.

Notwithstanding the fact that the true underlying state of the economy is yet to be revealed, in the current environment even those businesses which we assess as being of low quality with fundamental issues are being supported by stimulus and access to cheap financing. It is hard to identify why there will be any near-term change to this situation. Given this backdrop investors have tended to give businesses the benefit of the doubt as unusual business conditions lead to a lack of clarity regarding underlying earnings and business quality.

Recognising this reality, during May we substantially reduced VG1's Short exposure and we do not intend to materially increase this exposure for some time. When the environment normalises we will have fewer Short Positions than we might have done before and there will be a number of new disciplines incorporated into our approach for selecting Short candidates. At the moment our Short Positions are largely a market hedge.

We continue to see a benefit from our work looking for potential Short candidates as everyone on the VGI Partners Investment Team is constantly on the lookout for what we call 'red flags'. Red flags can come in many forms, including key insiders selling stock, accounting issues or the competitive landscape of an industry shifting. The VGI Partners Investment Team analyses this data with a sceptical eye, a key skill which we believe adds value to our analysis of the Long Portfolio by helping us identify any early emerging red flags in our Long Investments.

❖❖❖❖❖❖❖❖❖❖

For personal use only

Portfolio Update and Current Positioning

The following table details our current Top 5 Long Investments and clearly demonstrates that we continue to concentrate capital in our best ideas. Today, our Top 5 Long Investments represent 47% of total Portfolio value. We do not diversify for diversification's sake – we believe that carefully concentrating investments remains the best strategy for preserving and growing our collective capital over time.

Top 5 Long Investments	% of VG1
1. Amazon.com Inc.	16%
2. Mastercard Inc.	12%
3. Linde plc	8%
4. CME Group Inc.	6%
5. Yakult Honsha Co. Ltd	5%
Total	**47%**

Source: VGI Partners.

There were two key changes to the portfolio of Long Investments during the June half.

The first of these was to reduce the weight of CME Group, a move prompted by concerns over zero rate interest policy and the potential consequences if the Federal Reserve moves to implement yield curve control. Under yield curve control the Federal Reserve would target a pre-determined interest rate and pledge to buy sufficient bonds to keep interest rates from rising above that level. Zero rate interest policy and yield curve control would then in turn reduce interest rate volatility and thus demand for interest rate hedging and speculation at the short end of the yield curve. This would have negative consequences for CME's interest rate complex which is their largest product complex.

We continue to maintain a meaningful position in CME however, as we remain optimistic that record levels of net debt issuance by the US Treasury in coming years will provide a tailwind for trading at the long end of the yield curve. The Chicago Mercantile Exchange is the only place in the world for market participants to hedge and trade the interest rate exposure associated with this issuance. The company is also well-diversified, and operates a number of other product complexes, including equities, commodities and foreign exchange.

For personal use only

We also believe an investment in CME provides a sound way to hedge against the risk of inflation and the inevitable volatility linked to money printing and endless fiscal deficits.

Reducing the weight of CME in the portfolio is part of our process of endeavouring to optimise return on capital and to be appropriately flexible in our investment positioning.

The second key change to the portfolio was the addition of **Otis Worldwide Corporation (NYSE: OTIS)** in April 2020 following its spin-out from United Technologies (now known as Raytheon Technologies).

Otis is the largest global manufacturer of elevators and escalators (E&E). The E&E industry has attractive attributes: it is an oligopoly with sticky customers, the cost of failure is high, and the equipment is mission-critical for asset owners.

Otis has the largest E&E installed base globally, with around two million of the 16 million units in use carrying the Otis brand. It is one of the most respected brands in the industry, as evidenced by its presence in some of the world's most notable buildings. These range from the Burj Khalifa skyscraper in Dubai to the Empire State Building in New York City, in addition to thousands of residential and commercial buildings around the world.

The E&E business model produces a stable and recurring earnings stream as a result of servicing contracts that are attached to the sale of new elevators and escalators. Local regulations require regular maintenance of elevators and escalators to ensure safety and compliance. Therefore, as Otis sells more new equipment, it also grows its installed base and its service business.

We believe the industry is exposed to attractive secular growth drivers due to a combination of population growth, urbanisation and verticalisation, particularly in emerging markets. China is the largest market for elevators and presents an opportunity for Otis as it builds scale and density in the country. In addition, there is a significant potential in markets such as India, Indonesia and Vietnam where urbanisation is still in its early stages.

Under the prior ownership structure we believe United Technologies underinvested in Otis, which led to steady market share losses and margin erosion. However, a more focused management team is now set to prioritise growth, which we believe will lead to superior long-term returns.

For personal use only

A renewed focus on growth will improve the density of the installed base and the scale of the business, which are key drivers of profit margins. We also see margin upside from increased digital investment enhancing areas such as predictive maintenance and remote monitoring.

Management is also seeking to optimise the Otis cost base, and has already outlined a cost savings plan.

While Otis does have debt on its balance sheet, we are encouraged by the highly cash generative nature of this business and comfortable with the company's commitment to steady debt repayment over the next two years. E&E companies outsource most of their manufacturing with the result that capital requirements are low, which in turn results in significant free cashflow generation and very attractive returns on capital.

We continue to be on the lookout for spin-offs in attractive industries.

Looking to the future, and as mentioned in the introduction to this letter, we have recently reassessed how we wish to manage the Long Portfolio and have arrived at two key conclusions.

We have previously made an error in holding on too long to situations that have performed well but offer modest incremental returns. There have also been occasions when we have foregone substantial gains by selling high-quality companies which are continuing to grow rather than staying the course. We need to avoid the error of "cutting the flowers and watering the weeds".

If we have extracted substantially all the value from a situation, particularly in a company that has a relatively modest growth outlook, we need to be disciplined about selling. As a result, there are a number of positions that are likely to be reduced or moved out of the portfolio in coming months.

Secondly, we will seek to have more of the portfolio invested in companies that have the potential to deliver higher growth for a very long period. We need to focus on finding situations like Amazon 6-7 years ago that can continue to grow while being unemotional about exiting situations that have capped upside. This simply means redoubling our commitment to the disciplines that have underpinned the strategy's long-term performance for over a decade.

VG1 currently has 69% net equity exposure, with 83% Long and 14% Short.

For personal use only

Currency

VG1 is denominated in Australian Dollars (AUD). We actively manage our currency exposure as our analysis of the economic outlook for Australia evolves relative to the US, Europe, the UK and Asia.

In FY20, VG1's strategic currency positioning, which is based on our proprietary fundamental analysis, contributed **+0.9%** to returns as the USD modestly strengthened relative to the AUD. For most of the year VG1 was unhedged to the USD and, in hindsight, our failure to substantially rehedge when the AUD was below 60 US Cents in March was a missed opportunity. However, at the time we had a very different view of the world and the value of US Dollars. We then did not change our minds quickly enough when the facts changed.

We subsequently decided to move to a 50% hedged position at higher levels in June. This decision was made after several months in which the performance of the AUD was highly correlated with global equity indices, with the consequence that currency exposure was a significant driver of VG1's underperformance in the June quarter.

It has become clear that currency is now unbounded from our fundamental view as liquidity is fuelling prices far more than underlying fundamentals. This momentum may continue for several more months, with unpalatable consequences for returns if we had chosen to remain fully exposed to the US Dollar. By being half hedged, and retaining US Dollar exposure, we will benefit if there is a break in current market conditions and perceptions of risk.

❖❖❖❖❖❖❖❖❖❖

VG1's Performance as a Listed Company

At VGI Partners our primary focus will always be the long-term performance of the investment portfolio. While we expect that over the long term the performance of VG1 as a listed security will closely track the performance of the portfolio, we are mindful that short-term factors may impact secondary trading of securities in a fashion that is counter to the interests of investors.

In this context, we note that VG1 generally traded at a premium to its Net Tangible Assets (NTA) for the first 19 months post listing. This moved to a discount in May-June 2019 when VG1 completed a substantial capital raising, and the discount has widened more recently. While a temporary discount may be viewed favourably by some new investors, we believe it is in the interests of all investors if VG1 generally trades at or around NTA.

For personal use only

In general, we believe the relationship between the trading price of a Listed Investment Company (LIC) and its NTA is driven by factors including the fund's performance, size and perceived scarcity of opportunity to access the investment strategy.

VG1 is one of the larger LICs listed on the ASX, and the on-market acquisition of shares in VG1 is the only means for new investors to access VGI Partners' global strategy, as our unlisted wholesale funds are closed to new investment. In addition, we have committed not to raise further capital into VG1 for the foreseeable future. This means that VG1's structure addresses two of the factors (size and scarcity of opportunity) that we believe are critical to closing the discount to NTA.

Unfortunately, however, VG1's performance has fallen short of our long-term objective over the last twelve months. This has coincided with a period where premiums across the LIC sector generally shrank and discounts increased.

From here, we believe the key to closing the discount in the shortest possible timeframe will be a combination of performance and investor education. Delivering the requisite performance is the primary focus of the VGI Partners Investment Team.

Our investor education efforts will be assisted by the recent expansion of the VGI Partners investor relations team. Previously we did not have resources dedicated to working with and educating financial advisers and investors who were new to VG1, but this has now been addressed.

With the universe of advisers who may be interested in the VG1 opportunity now largely emerging from COVID-19 lockdown, our team is resourced to engage with them appropriately.

❖❖❖❖❖❖❖❖❖❖

For personal use only

Alignment of Interests

As we have discussed in previous letters, we take alignment of interest between ourselves and you, our valued Investment Partners, very seriously.

VGI Partners' investment staff have the vast proportion of their net worth invested in our two Funds, our ASX listed investment companies (VGI Partners Global Investments Limited (VG1), VGI Partners Asian Investments Limited (VG8)) and VGI Partners itself. All staff are prohibited from purchasing securities outside the Funds, the listed investment companies and VGI Partners. We subscribe to the view that a manager should eat his or her own cooking and at VGI Partners that's exactly what we do. As a result, we and our families and close friends are the first ones to know if the cooking is not up to scratch – and at the moment we know our cooking has not been acceptable!

"In the building practices of ancient Rome, when scaffolding was removed from a completed Roman arch, the Roman engineer who built the arch stood beneath. If the arch came crashing down, he was the first to know! His concern for the quality of the arch was intensely personal, and it is not surprising that so many Roman arches have survived."

- Seth Klarman, 'Margin of Safety'

Over the past twelve and a half years (since inception of VGI Partners), all members of the VGI Partners Investment Team have consistently added to their investment in the Funds managed by VGI Partners. Further strengthening alignment, subsequent to the IPO of VGI Partners the manager itself has been investing in VG1 and VG8. We all view these investments, which includes $36 million invested in VG1 by VGI Partners and staff, as our primary capital growth vehicle and thus our most important financial investment.

As a result of the above, you should be confident that our Investment Team's energy and effort is focussed on a singular outcome – to maximise returns over the long term while preserving capital for our collective Portfolio.

At VGI Partners we focus all of our time and energy on managing your money.

❖❖❖❖❖❖❖❖❖❖

For personal use only

VGI PARTNERS

Company Meetings

Over the past twelve months the VGI Partners Investment Team conducted over 700 meetings and conference calls with company management teams and industry experts around the world. We met with companies such as PayPal, Nestlé, Prada, Quest Diagnostics, SoftBank, Ericsson, China Resources Beer, Facebook and LVMH, and spoke with a wide variety of industry experts.

Operational Update

We announced a significant operational change in late June, when **Douglas Tynan** unfortunately resigned as an Executive Director of the firm for personal reasons. Douglas had made a valuable contribution to the growth of VGI Partners over 12 years, particularly in relation to the development of the Investment Team in his role as Head of Research. Importantly, we will continue to access Douglas' knowledge and expertise in his ongoing role as a Non-Executive Director and we hope to have the opportunity to work with him more closely again in the future.

Douglas' departure prompted a re-examination of our investment processes and the way we work together. The response from the team has been everything we could have hoped for as they have seen this change as an opportunity for reinvigoration and a chance to further strengthen our investment process.

We are fortunate to have built good bench strength across our 12-person Investment Team. Three of our senior analysts – **Robert Poiner** (11 years' experience with VGI Partners)**, Thomas Davies** (8 years' experience with VGI Partners) and **Marco Anselmi** (7 years' experience with VGI Partners) – are now reporting directly to **Robert Luciano** on all portfolio activity. Each of these three were ready for a new challenge, and we now have a tighter and more collaborative investment team, with greater emphasis on peer review.

A further change that we made during the most recent half year was to move more of our core investment activity back to Sydney. We did this when the emergence of market volatility in February and March highlighted the benefit of a more streamlined investment process, with more of our key analysts located in Sydney headquarters. As part of this process, **Thomas Davies** returned to Sydney after a year in New York. We also hired a new Head of Trading, **William Bowler**, in Sydney.

VGI
PARTNERS

For personal use only

There have been no changes to our Tokyo office, which is expertly managed by **Andrew Chou** and provides us with localised fundamental research capabilities and infrastructure in Asia.

Investors may be aware that during the VGI Partners IPO process last year **Robert Luciano** made it clear that his commitment to VGI Partners and its investors would be unwavering and for the long term. Robert's commitment to the organisation and all our investors is undiminished.

Our Operations Team, spearheaded by **Adam Philippe** (Chief Operating Officer) and **Ian Cameron** (Chief Financial Officer) continues to maintain the highest standards across financial reporting, IT infrastructure and security, risk management capabilities, back office processing and investor relations. We invest heavily in our systems and infrastructure while carefully selecting and partnering with best in class experts and advisors in all operational areas. We have a robust business continuity plan (BCP) and remote connectivity platform in place, and our staff are used to communicating across multiple locations and time zones.

Any operational update would be incomplete without discussing the impact of COVID-19 on our business activities. The pandemic had practical ramifications for our business as we got used to many of our staff working from home in Sydney, while our staff in Tokyo and New York all worked remotely. Social distancing and twice daily temperature checks were a necessity for the investment team members who worked from our Sydney office through this period as we followed World Health Organisation and government guidelines and best practices.

All of our business activities functioned smoothly notwithstanding these exceptional circumstances. However, our annual Advisory Council meeting, which had been scheduled for Tokyo in May 2020, was an unfortunate casualty of the environment. The VGI Partners Advisory Council is an external and independent group of experienced investment management, finance and industry professionals.

❖❖❖❖❖❖❖❖❖❖

VGI
PARTNERS

In Closing

At VGI Partners we are entirely focussed on managing our portfolio. We are highly selective about what we include in our portfolio and unemotional about when we should divest an investment.

Our unwavering commitment is to preserve and grow your capital over the long term, regardless of the market environment, by owning high-quality assets which have been purchased with a margin of safety. We cannot eliminate short-term volatility from our returns, however we are confident our process and investment philosophy positions our portfolio to produce attractive returns over the long term and through the cycle.

We remain optimistic about our existing portfolio and will continue to take advantage of opportunities that present themselves. We are very grateful to all those long-term oriented investors who entrust us with their capital.

Since listing in September 2017, VG1 has increased its Net Tangible Assets per share from $2.00[3] to $2.27 and paid an inaugural dividend of 1c per share (fully franked) in April 2020. This performance has been achieved while holding an average cash balance of 52%. VG1's portfolio now replicates the VGI Partners Master Fund with a reduced cash balance that now stands at 31%.

Once again, we thank you for your investment with VGI Partners.

Yours faithfully,

VGI Partners

"To know and not to act is not to know."

- Wang Yangming, Chinese Philosopher

[3] Prior to adjusting for VG1's capital raising in 2019.

For personal use only

VGI PARTNERS

For personal use only

Disclaimer and confidentiality

VGI Partners Limited (ABN 33 129 188 450) (VGI Partners) is the holder of an Australian Financial Services Licence (No. 321789) and is SEC Registered.

The information in this document (Information) has been prepared for general information purposes only and without taking into account any recipient's investment objectives, financial situation or particular circumstances (including financial and taxation position). The Information does not (and does not intend to) contain a recommendation or statement of opinion intended to be investment advice or to influence a decision to deal with any financial product nor does it constitute an offer, solicitation or commitment by VGI Partners.

It is the sole responsibility of the recipient to consider the risks connected with any investment strategy contained in the Information. Neither VGI Partners nor any of its directors, employees, officers or agents accepts any liability for any loss or damage arising directly or indirectly from the use of all or any part of the Information. VGI Partners does not represent or warrant that the Information in this document is accurate, complete or up to date and accepts no liability if it is not.

The recipient agrees, for itself and on behalf of its related bodies corporate and each of their respective directors, officers, employees or agents, representative and advisers, to keep the Information confidential.

Past performance

The historical financial information and performance figures given in this document are given for illustrative purposes only and should not be relied upon as (and are not) an indication of VGI Partners views on the future performance of the Funds. You should note that past performance of the Funds cannot be relied upon as an indicator of (and provide no guidance as to) future performance.

Forward-looking statements

This document contains certain "forward-looking statements" that are based on management's beliefs, assumptions and expectations and on information currently available to management. Forward-looking statements can generally be identified by the use of forward-looking words such as, "expect", "anticipate", "likely", "intend", "should", "could", "may", "predict", "plan", "propose", "will", "believe", "forecast", "estimate", "target" "outlook", "guidance" and other similar expressions. Indications of, and guidance or outlook on, future earnings or financial performance are also forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements. Any such statements, opinions and estimates in this document speak only as of the date of this document and are based on assumptions and contingencies and are subject to change without notice, as are statements about market and industry trends, projections, guidance and estimates. Forward-looking statements are provided as a general guide only. The forward-looking statements contained in this document are not indications, guarantees or predictions of future performance and involve known and unknown risks and uncertainties and other factors, many of which are beyond the control of VGI Partners, and may involve significant elements of subjective judgement and assumptions as to future events which may or may not be correct. There can be no assurance that actual outcomes will not differ materially from these forward-looking statements. No representation, warranty or assurance (express or implied) is given or made in relation to any forward-looking statement by any person (including VGI Partners or any of its directors, officers, employees, agents or advisers). In particular, no representation, warranty or assurance (express or implied) is given that the occurrence of the events expressed or implied in any forward-looking statements in this document will actually occur. Except as required by law or regulation, VGI Partners disclaims any obligation or undertaking to update forward-looking statements in this document to reflect any changes in expectations in relation to any forward-looking statement or change in events, circumstances or conditions on which any statement is based.