ORSARO
CAPITAL

8 April 2020

Dear Partners and Friends

There is an ancient proverb which is attributed to the Chinese - “may you live in interesting times”. It is an expression that is used ironically, that life is better in “uninteresting times” of peace and tranquillity versus what the world is currently faced with, as it comes to grip with the devastating humanitarian/health crisis, as well as the economic shock of the Coronavirus.

Whereas the first quarter started with an element of optimism in the wake of the resolution of the crippling trade war between the USA and China, as well as progress on the Brexit negotiations, this started to change in late January when China locked down the entire province of Hubei (with the city of Wuhan, at the epicentre), to contain the outbreak of a novel Coronavirus. Initially, similar to SARS in 2003, the Western world concluded that this was largely a discreet South East Asian event, and there was a calmness to markets outside of China/Asia. We too fell into this category of being slow to understand how quickly this would be transmitted to the rest of the world, given how interconnected the world has become in the last two decades. This was despite the initial best efforts of governments in restricting travel from China into their countries. Towards the latter part of February, it became very clear to us that this pandemic could not be contained to just China, and hence we started to take dramatic action within the Orsaro Global Fund, with the primary goal being survival/capital preservation.

We were fairly fortunate in that going into this downturn, we had very low exposure to cyclical stocks (we as a rule in the Fund do not invest in commodities like oil/energy and metals etc) but we were quick to cut stocks that we knew would be dramatically affected. Global travel and most of domestic travel was literally grinding to a halt, so we cut our entire position in MGM Resorts International (a stock that we owned as a play on the legalisation of sports betting in the USA, as well as being a key contender to win a casino licence in the Japan). We also cut our holding in Lennar Corporation, a large USA home builder that was transitioning to a capital light model and was benefitting from a secular shift as millennials moved out of home and began forming households. The last major course of action we took was to dramatically reduce our exposure to large US banks, as we started to fear a dramatic increase in their exposure to bad debts with both consumers and businesses facing a liquidity crunch.

As investors focused on the ultra-long term, we are always going to be early in our buy decisions, but we can live with this given that we are not leveraged, and hence can afford to be patient, as many around us panic. We are not smart enough to know how long it will take to bring an end to this crisis, but we do realise that this will not be a quick V-shaped recovery, as consumer confidence has been shattered, and many jobs will be lost globally in this fallout. To invest for the long term, you need to be cautiously optimistic, and thus there are a few things we do know:

(1) physical distancing does work in slowing the spread of a virus;
(2) the smartest minds across the globe are all focused on solving the same problem – finding a medical cure for this virus, and ultimately creating a vaccine against it; and
(3) central banks and governments around the world have unleashed monetary and fiscal shock and awe e.g. the US Fed has cut interest rates by 150bp and the government launched a $2 trillion stimulus package to inject cash into the hands of stricken consumers and small businesses. Whilst this will help soften the blow, unfortunately this is a health crisis that needs to be resolved, as this crisis is gradually morphing into an economic/financial crisis resulting from the forced shutdowns.

The volatility index (VIX) which is a measure of the level of fear in the market, had been in the low teens, and spiked to 85 as fear and panic took hold. By way of reference, in the GFC, this index hit a peak of 80, so whilst it does not mean stocks can't go down further, this level of panic in the market was the first indicator for us as investors, with some cash in the bank, that we had to start deploying capital into this market. Our buy decisions have been centred around the following key criteria:

(1) Strong balance sheet - will this company we are buying today survive this tragic event;
(2) Strong business model – structural tailwinds to compound wealth over the long term
(3) Valuation – we can buy these companies at significant discounts to their intrinsic value

All our work/effort of the last few weeks has gone into making sure that we use this fall in markets, as an opportunity to optimise the quality of our investments given the world is a very different place today. To this end we started buying stocks which had fallen dramatically, but that we were confident would survive, and thrive over the long-term e.g. Microsoft, Workday and McDonalds.

As at 31 March 2020, the Fund was 87.3% invested (with 12.7% cash exposure).

The table below illustrates the performance of the Fund at 31 March 2020 (net of fees) over various time periods versus the benchmark:

	March Quarter	YTD FY20	Since Inception*
Orsaro Global Fund	- 5.3%	3.6%	18.6%
MSCI World Index	- 21.4%	-14.9%	-12.8%

Inception date is 11 May 2018

Redemption Unit Price @ 31 March 2020	$1.1862

As regards our performance this quarter, we have investments predominantly in global companies and the Fund benefits when the Australian dollar falls relative to other currencies e.g. USD, Euros, etc. Since the inception of the Fund, we've had the view that we would not hedge this currency exposure. We have held this view as a hedge against Australia's interconnectedness with China i.e. resources exports, inbound tourism and education, etc. The decision not to hedge the currency has helped cushion the impact to the Fund in the quarter, as the currency fell from approximately 70c to 60c. However, during quarter there was a sharp and fast drop in the Australian Dollar to as low as 55c, and we took this opportunity to hedge approximately 40% of the Fund's currency exposure.

In the Appendix to this letter, we have discussed the investment case for two of the companies in the Fund. The first company is called Teladoc Health, which is the global leader in telehealth services, and was the Fund's strongest performer for the quarter. The second company is Microsoft, which as most of our investors will know from our recent Investor call, the Fund initiated a position in during the quarter.

To all our Investors, we wish you and your families good health in these uncertain times. Thank you for your continued support and may you all live in uninteresting times. It has been of great encouragement to us as Fund Managers, that during this recent bout of market volatility and stress, we have had new clients investing in the Fund, existing clients adding to their investments, and no investor redemptions.

As always, we would be more than happy to take any questions you may have individually, whether that be on the Fund, or wider macro-economic/business thoughts regarding the evolving landscape. Please feel free to contact us and to arrange a virtual meeting at any time.

Kind Regards

Gavin, Marc and Richard
Fund Managers of the Orsaro Global Fund

APPENDIX

Teladoc Health

Teladoc is the global virtual care leader, with 50,000 clinicians globally. They provide virtual care consults covering up to 450 sub-specialities. The service is provided predominately as a Business-to-Business service via private health plans, corporates and hospitals. Its Direct-to-Consumer offering includes Better Health, a Mental health service. It saves time and money for all parties involved and the growth in signups and usage prior to the outbreak of the Coronavirus has been very healthy. Total US memberships have grown from 12.2m in 2015 to 56m in 2019. At the same time revenue has grown from $77m to $553m.This revenue growth is partly due to organic growth and also from strategic acquisitions, the most recent being InTouch Health, a provider of telehealth services to hospitals. 84% of Teladoc's revenues are subscription based with the remainder made up of one-off visit fees. The global opportunity is large with Teladoc by their own admission having only penetrated around 1% of what it sees as its international Total Addressable Market.

Teladoc Health may not have been a household name before, but after the last month, it certainly has become one within the US. Teladoc is a company we have held in the Fund since inception. We made this investment based on the investment thesis that we believed there was a significant tailwind behind healthcare services moving to telehealth services over the next decade. The current Coronavirus crisis has, however, accelerated this timeframe dramatically.

The surge in telemedicine consults and its support via Government subsidies has led to a significant increase in virtual health consults over the last few weeks. CEOs of large corporates are publicly speaking about their provision of telehealth services to employees during this crisis. In one week alone ending March 13, Teladoc saw daily virtual medical visits jump 50%. In some case, up to 15,000 visits were requested per day. Importantly, this takes a large amount of pressure off an already overburdened healthcare system. While we know that this volume will drop back to normal seasonal levels post the Coronavirus, the adoption and acceptance of virtual care will remain. Globally people and governments are becoming comfortable with virtual care and those who never dreamed of using it, will realise it has an important place in a comprehensive health care system.

The effect of the Coronavirus crisis on the share price has been dramatic with the share price moving from around $78 before the crisis to hit an all-time high of $176 (this share price has fallen back a bit since this high). Whilst we see a very bright future for Teladoc over the long term, we felt that at this level the market was getting ahead of itself and had become to large a weighting in our Fund, and hence we took the opportunity to lighten our position to a more appropriate weighting.

Microsoft

Led by CEO, Satya Nadella, Microsoft has gone through one of the most successful business transformations since his appointment in 2014. He has transformed the business into a digital powerhouse both organically and through acquisitions, with a number of market leading business lines, including:

- Microsoft Azure, its public cloud platform, which is 2nd only to Amazon Web Services;
- Microsoft365 and Office365, its cloud-based subscription services offering Windows, Outlook, Excel, Word, and many other applications;
- Microsoft Teams, its workforce collaboration platform which has allowed businesses globally to work remotely from home, with its use skyrocketing during the Coronavirus outbreak to over 44 million users;
- LinkedIn, the leading social media platform for businesses, which it acquired in 2016 and has seen exceptional growth since acquisition;
- Xbox, the leading gaming console and Xbox Live, its subscription gaming service, which includes world class games like Minecraft, which Microsoft acquired in 2014.
- And many other high-quality business units.

Whilst the Coronavirus pandemic has destroyed value for many businesses across many industries, it has strengthened Microsoft's long-term business fundamentals. Businesses now realise that they have to digitally transform faster and will need to be prepared if an outbreak like this ever happens again. In February of this year, Microsoft's share price reached an all-time high of $190. During the Coronavirus share market rout, the Fund has been given the opportunity to buy shares as low as $135, which is almost a 30% discount and equates to a P/E multiple in the low 20s for a high quality business with excellent long-term fundamentals.

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