Monash ABSOLUTE INVESTMENT FUND

Monthly Performance Report

August 2019

Monthly Update

For the month of August, the portfolio was up by 0.77% (after fees) compared to the S&P/ASX200 down -2.36% and the Small Ords which was down -3.85%.

It has been a good start to the financial year, the portfolio was up 5.64% (after fees) compared to the S&P/ASX200 up 0.52% and the Small Ords, up only 0.49%.

For the calendar year to date, the portfolio was up 31.90% (after fees) compared to the S&P/ASX200 up 20.34% and the Small Ords, which was up 17.38%

August is the financial year reporting month for most companies, and media coverage has quoted fund managers saying it was disappointing. Recent broker summaries have shown 14% of companies beating forecasts versus 30% missing. We are happy to report that the portfolio had a good reporting season, with 20% of the holdings beating expectations and only 5% missing.

Return Summary Since Inception[1] (after all fees)

Since Inception (p.a.)	10.28%
1 Month	0.77%
3 Months	6.84%
6 Months	18.01%
FYTD	5.64%
1 Year	13.62%
3 Years	5.68%
5 Years	5.55%
Cumulative	101.45%

Monthly Portfolio Metrics

Outlook Stocks (Long)	19 Positions: 82%
Outlook Stocks (Short)	2 Position: -4%
Event, Pair and Group (Long)	1 Position: 11%
Event, Pair and Group (Short)	0 Position: 0%
Cash	12%
Gross Exposure	97%
Net Exposure	88%
Beta	0.57

Portfolio Analytics Since Inception[2]

Sharpe Ratio	0.79
Sortino Ratio	1.45
Standard Deviation (p.a.)	10.23%
Positive Months	63%
Maximum Drawdown	-15.21%
Avg. Gross Exposure	89.60%
Avg. Net Exposure	77.70%
Avg. Beta	0.57
Avg. VAR	1.20%

[1] Inception date is 2 July 2012. Past performance is not indicative of future performance. Returns may differ due to different tax treatments.

[2] Glossary of terms can be found on the Fund's website at www.monashinvestors.com/glossary/

Despite holding a number of retail exposed stocks in the portfolio at time when many retailers are struggling we didn't find the reporting season disappointing, with Lovisa (ASX: LOV) and AfterPay (ASX: APT) among our top contributors.

Electro Optic Systems (ASX: EOS)

This month we review the EOS result. EOS is one of the portfolio's larger holdings.

Conservative Management + Conservative Guidance + Enormous Opportunities = Superior Shareholder Returns

There were three major pieces of information coming out of the EOS result[3]:

1. Management is moving into the next phase of its capacity expansion
2. Some details on the tenders in the Space division, and
3. EOS will still achieve its earnings guidance of CY19 EBIT of $20m and revenues of $230m and CY20 EBIT of $28m and revenues of $350m (representing EBIT growth of 170% and 40% respectively) despite extra Capex being required.

Capacity Expansion and Future Earnings Potential

EOS has provided guidance not only for this year but also for the following year. It is able to do this because it has already won the tenders to achieve its guidance. Just like any company involved in tendering, it needs to be in a position to win more work to replace the tenders it is currently delivering.

In this regard, EOS is in a very strong position as its earnings guidance is based on the $800m order book it has already won, but it is currently tendering for $2.0bn of work with around $300m per quarter expected to be awarded from early 2020. There are also many billions in additional work that EOS is working on (2 $1bn turret contracts, numerous counter-drone contracts etc.).

It should be noted that with EOS's current generation of remote weapons systems (RWS) it has not lost a single tender. Management believe that over the long term they will win 40% of tenders. However at this point in time, with EOS's technically superior RWS we would not be surprised to see a much higher win rate and management is simply being conservative.

Demonstrating management's confidence in its outlook, it is now moving ahead with plans to expand its production capacity from the current $300m in revenue to over $900m over the next 3 to 4 years. To be clear, management believe that they will in the future have a business generating up to $900m in revenues. As such, the pace of EOS's tender pipeline is such that it will drive significant earnings growth over and above the guidance it has already provided.

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[3] https://www.asx.com.au/asxpdf/20190830/pdf/448281z8c6vqt2.pdf

The other implication of the significant growth that EOS is experiencing is the steadily increasing number of RWS that EOS will also be doing the maintenance work on. The margins on maintenance work are higher than tendering and are long term in nature. Based on our modelling, in the future when the pace of tendering works drops off the earnings from maintenance will have grown to a point where they can offset the drop-off.

Space – a free option

We believe that the market places zero value on the Space Division, however, after many years of development, it is now participating in over $200m in potential procurements globally, which if successful will lead to significantly larger opportunities. EOS space technology has already demonstrated its capacities in space debris mitigation, space traffic management and space situation awareness. Management has indicated that by the end of September it expects to announce a major technical development.

The shareholder value that can be created by the Space division is material in our view, given the significantly higher margins in this division and the scale of the problems/issue that it is able to resolve.

Earnings Guidance

EOS has reiterated its earnings guidance of CY19 EBIT of $20m and revenue of $230m and CY20 EBIT of $28m and revenues of $350m (representing EBIT growth of 170% and 40% respectively). However, with this result it has indicated that this guidance now includes the extra expenses resulting from the plans to increase capacity, increase marketing and increase the number of tenders it is competing on. Obviously, the underlying performance of the business is better than what the headline numbers suggest.

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