AozoraStep

June 30th 2019

Dear Investor,

The 2nd Quarter of 2019 has boosted returns since inception to 56% after we have benefitted from the Brexit delay on March 31st and quarter on quarter we are up 36% after a 45% return in Q1.

The success of this quarter has mostly been due to exceptional returns in our small caps NBG, Reach plc and Renewi Plc, which all had returns between 20-38%. I decided to sell out of Reach Plc monetizing a 35% profit including dividends and kept on holding our positions in NBG and Renewi and will explain the details in our holdings section. On top of that, we kept our 332 shares in Covestro and doubled our position in Enquest Plc to make the oil producer our largest holding with 43% share.

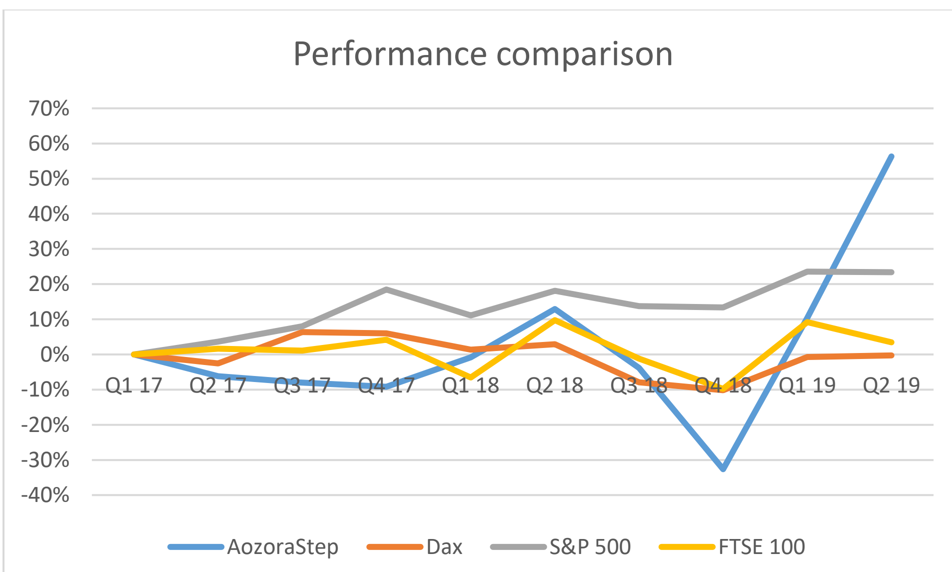
While the last two quarters have seen phenomenal returns, I become a little more pessimistic to continue to outperform this market in light of the trade war between the US and not only China, but the world, as well as the rising populism that could hurt capitalism and company profits. With Brexit delayed and the initial positive market reaction, I think we will see underperformance in the UK in the run up to the next Brexit date. Mainly for that reason and also because of the massive rally in bond yields in Europe (up to 20yr maturity German bonds yield negative), I think some German equity valuations look more attractive and a better port to invest currently. In particular, I like 3 German companies: Deutsche Bank, Lufthansa and Thyssenkrupp. Lufthansa seems to be the best choice for us, as apart from its current valuation, it's a great hedge against our oil producing Enquest Plc holding in case oil prices drop.

As usual, below you can find the results and I will then go into details of our holdings and the outlook.

In terms of operations, there was a small withdrawal in the 2nd Quarter. This withdrawal was tax related and helps me personally to save annual tax free allowance, as I needed to park that cash into my private pension. Without the withdrawal our market value would have increased further. In addition, I have closed down the Kölner Bank deposit and shifted the EUR shares to Flatex broker to lower costs, as there is no annual charge and much lower fees at Flatex compared to Kölner Bank.

Performance

		Portfolio	
Year	Quarter	% change by Quarter	% change from inception
2017	Q1	-	-
	Q2	-8.37%	-6.17%
	Q3	-4.92%	-7.98%
	Q4	-1.34%	-9.21%
2017		-9.21%	-9.21%
2018	Q1	8.60%	-0.79%
	Q2	18.91%	12.91%
	Q3	-16.20%	-3.86%
	Q4	-29.94%	-32.64%
2018		-30.79%	-32.64%
2019	Q1	45.41%	10.36%
	Q2	36.55%	56.31%

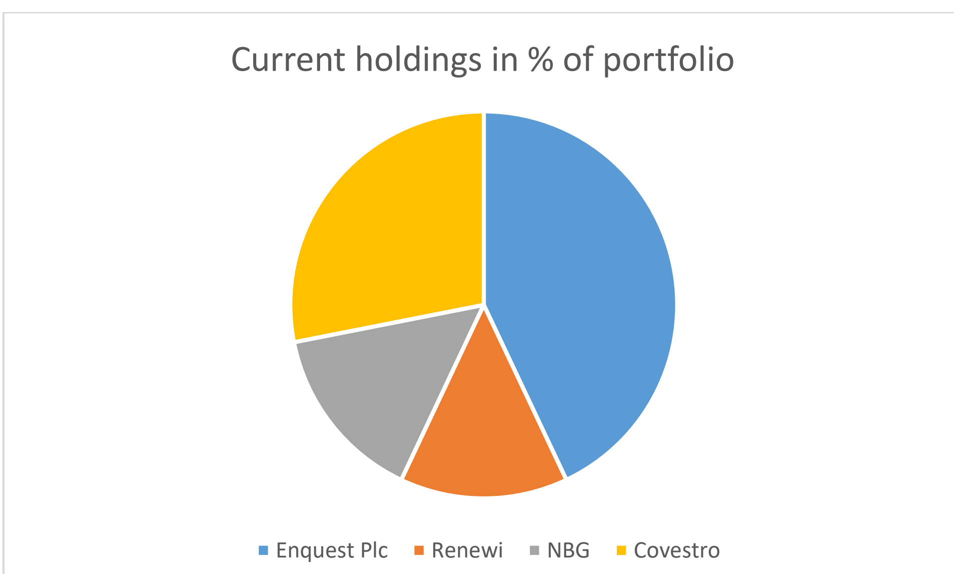


Dividend receipts

Dividends	Payment Date	Dividend per share	Currency
GKN	18th Sep 2017	0.03	GBP
Inmarsat	25th May 2018	0.06	GBP
Inmarsat	19th Oct 2018	0.06	GBP
Reach	7th June 2019	0.04	GBP
Covestro	17th Apr 2019	2.40	EUR

Current holdings

Company	Average Purchase Price	Current Market Price	Currency	% change	% of portfolio
Enquest Plc	0.1957	0.1975	GBP	0.92%	43%
Renewi	0.2395	0.2890	GBP	20.67%	14%
NBG	2.9090	2.4100	EUR	-17.15%	15%
Covestro	58.0910	44.7100	EUR	-23.03%	28%



Why we sold out of Reach Plc

Our value positions in the British market have all paid off beautifully and led us to exit our position in Reach Plc prematurely, capturing a 35% return. The decision to sell Reach plc so early was mostly based on their inflated balance sheet, as their intangible assets amount to 60% of total assets – an amount they would need to write off sooner or later. But there is a catch: Writing off goodwill is not affecting cash flows, and hence the company can continue to pay attractive 10% dividend yields. So the question is how come management doesn't just write off the goodwill? I believe the answer is that it sheds bad light on management, as the reason why Reach Plc has such high goodwill numbers is due to their takeovers of other news companies. This will raise questions in the future of whether Reach has been overpaying for some of their takeovers. Secondly, I think it will scare investors, as the headline will read Reach made a loss of xyz for the year, while adjusted figures show a profit. All in all, Reach plc has taught me a few important lessons, but one that is outstanding: Always invest in companies with trustworthy management. When there is something not right on a company's balance sheet and management is not tackling this problem, there should always be reason for concern.

Why we didn't monetize our 50% profit in Renewi Plc

Our position in Renewi at some point breached 50% in profits, but is now up at around 20% only. The decision of not selling at such fast and high returns were mostly led by seeing more potential behind the stock. In addition, Renewi has made significant changes by selling their Canada Waste Management unit and by investing more in the Benelux by buying up new food waste recycling facilities and mattress recycling facilities. The company continues to tackle their relatively high debt/EBITDA ratio of 3.5, which is positive as well. The cheap headline valuations made me wonder though whether the valuation is really fair. For that reason, I introduce a new method of valuing stocks and I call it valuing stocks based on total capital, i.e. equity + debt. This is done by adding the net debt of the company to its current share price to get the enterprise value. This enterprise value gives us a new share price from which we can recalculate the headline valuations of Price/earnings (P/E) and Price/Book (P/B) ratios. In this case, Renewi Plc has a share price of GBP 0.98 vs GBP 0.29, a P/E of 20.5 vs 6.02 and a P/B of 2.06 vs. 0.6 – dramatically different and not so cheap after all! Debtholders will always be primary to equity, hence, despite being mathematically somewhat incorrect, it is a useful measure to value one company against another. Given the large public support of recycling, however, I feel it is right to stick to our view of outperformance of Renewi and we hold our current position without adding more.

Why we doubled our shares in Enquest Plc

We doubled our position in the oil producer, Enquest Plc, to 43% of our portfolio this quarter. While Enquest does not pay dividends and has oil reserves for only around 12 years, the strategic location off the UK coast adds value during uncertain times in the Strait of Hormuz on back of Iranian tension. On top of that, current valuation considers their largest asset from which they generate close to 50% of their revenue, the Kraken oil field in the North Sea, to yield around 20% less than their estimated reserves. This estimation was given by their partner Cairn Energy, who own 29.5% in the field vs. 70% share owned by Enquest. However, Enquest disagrees on the reserves estimation and is on track to increase output by another 20%

this year. At the same time, the Trust of CEO and majority shareholder of Enquest, Amjad Bseisu, purchased close to 10% of shares outstanding around our average purchase price recently. In terms of valuation, I see Enquest to be one of the strongest companies in the oil industry at this stage. I do have some concerns, however, where the oil price goes from here. For that reason, it makes sense to pick up some of the currently cheaply valued European airlines stocks, such as Lufthansa and IAG, to somewhat hedge for a drag lower in oil prices.

In the appendix, you can find the valuation of our current holdings as well as potential new purchases in airline stocks. In terms of outlook, I believe there is a chance of an escalation of the US-China trade war and I think events such as Bretton woods and particularly Plaza Accord could give some guidance of what is to come. Plaza Accord has sometimes been named as the cause of the Japanese bubble burst, as the Bank of Japan needed to ease monetary policy dramatically to counter the 50% appreciation of the Yen. The depreciation of the USD agreed under the Plaza Accord has not caused turmoil, as it was a controlled depreciation, nonetheless, it did cause some long lasting effects and Trump is likely to look for something similar to manifest itself to counter the Chinese economic miracle. More to follow soon on this topic…

Thank you very much for entrusting me with your savings and I hope we continue to enjoy the returns of 2019 in the future and outperform the market. Feel free to contact me with feedback and questions.

Best wishes,

David Herrmann

Appendix

Covestro

Share Price	44.71
Revenue (in mio)	14,620
Earnings (in mio)	2,009
Assets (in mio)	11,084
Liabilities (in mio)	5,709
Market cap (in mio)	8,182
P/E	4.07
P/B	1.52
Div yield	5.37%
Net debt (in mio)	348
EV (in mio)	8,530
Share price (by EV)	46.61
Capital P/E	4.25
Capital P/B	1.59

National Bank of Greece (NBG)

Share Price	2.41
Revenue (in mio)	1,094
Earnings (in mio)	100
Assets (in mio)	64,217
Liabilities (in mio)	54,206
Market cap (in mio)	2,204
P/E	22.04
P/B	0.22
Div yield	0.00%
Net debt (in mio)	3,000
EV (in mio)	5,204
Share price (by EV)	5.69
Capital P/E	52.04
Capital P/B	0.52

Enquest

Share Price	0.20
Revenue (in mio)	1,201
Earnings (in mio)	78
Assets (in mio)	5,662
Liabilities (in mio)	4,678
Market cap (in mio)	335
P/E	4.28
P/B	0.34
Div yield	0.00%
Net debt (in mio)	3,056
EV (in mio)	3,391
Share price (by EV)	2.00
Capital P/E	43.36
Capital P/B	3.45

Renewi

Share Price	0.29
Revenue (in mio)	1,566
Earnings (in mio)	38
Assets (in mio)	1,823
Liabilities (in mio)	1,440
Market cap (in mio)	231
P/E	6.02
P/B	0.60
Div yield	5.02%
Net debt (in mio)	556
EV (in mio)	787
Share price (by EV)	0.98
Capital P/E	20.50
Capital P/B	2.06

Lufthansa

Share Price	14.82
Revenue (in mio)	35,920
Earnings (in mio)	2,163
Assets (in mio)	38,213
Liabilities (in mio)	28,640
Market cap (in mio)	7,042
P/E	3.26
P/B	0.74
Div yield	5.40%
Net debt (in mio)	3,553
EV (in mio)	10,595
Share price (by EV)	22.30
Capital P/E	4.90
Capital P/B	1.11