HARRINGTON PARTNERS
Investment Management

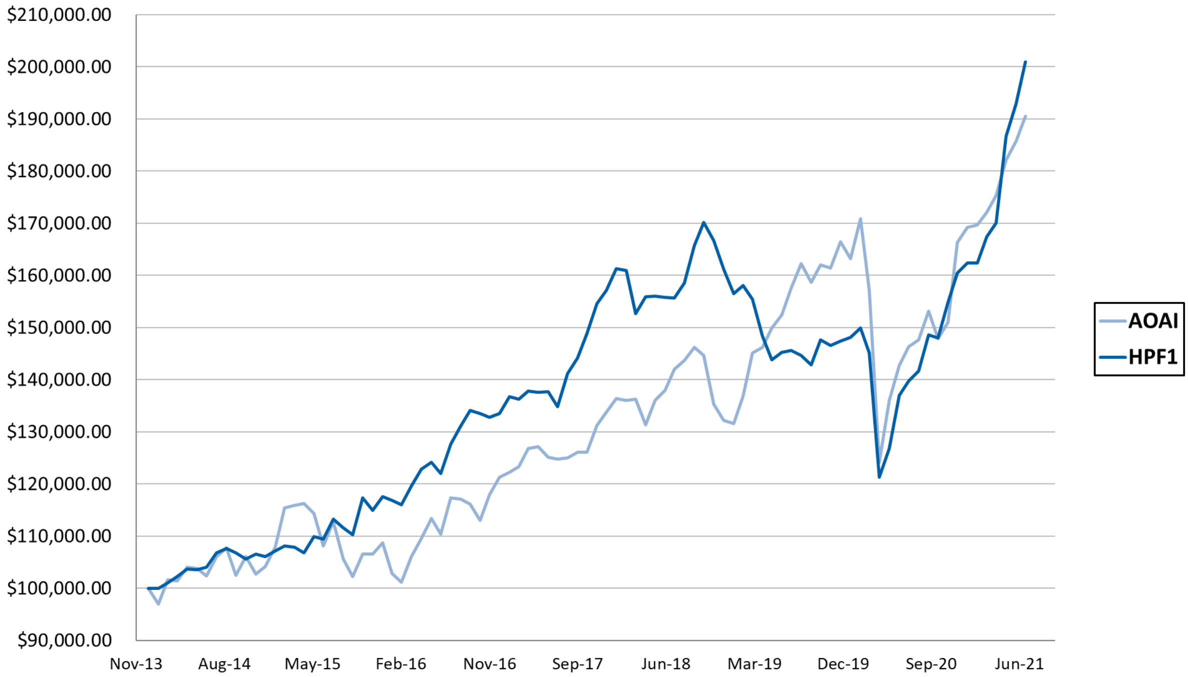
# Harrington Partners Fund 1 (HPF1) – 30 June 2021

Harrington Partners goal is to compound capital over the long term through concentrated investments in undervalued high-quality companies. The Fund managers have the majority of their investable assets in the Fund, this creates a very strong alignment of interests between the managers and investors.

| | HPF1 Net Return* | AOAI Return | Relative Performance |
|---|---|---|---|
| 6 Months to 30/06/2014 | **3.71%** | 2.36% | 1.35% |
| 30/06/2015 | **5.51%** | 5.67% | -0.16% |
| 30/06/2016 | **11.50%** | 2.01% | 9.49% |
| 30/06/2017 | **10.48%** | 13.12% | -2.64% |
| 30/06/2018 | **15.49%** | 13.73% | 1.76% |
| 30/06/2019 | **-6.45%** | 11.04% | -17.49% |
| 30/06/2020 | **-4.06%** | -7.20% | 3.14% |
| 30/06/2021 | **43.77%** | 30.24% | 13.53% |
| Annualised Performance | **9.75%** | 8.97% | **0.77%** |
| Cumulative Performance | **100.88%** | 90.51% | 10.37% |

*Net Return to investors which is less fees and charges but includes reinvested distributions.

**Change in Value of $100,000 invested in HPF1**
**vs All Ordinaries Accumulation Index (AOAI) Since Inception**




The Fund returned **43.77%** net of all fees over Financial Year 2021 (FY21), this compares to a return of **30.24%** for the All Ordinaries Accumulation Index over the same period.

FY21 was a fantastic year for Harrington Partners. We are thrilled for our partners to have exceeded the AOAI by 13.53% after all fees during what was an extraordinarily strong year for the broader market.

During the latter part of FY19 and into FY20 Harrington Partners went through a meaningful evolution in terms of way we implement our investment philosophy, and this was discussed in detail within our March 2020 Investor Letter. The main points were pivoting away from a concentration in 'deep value' catalyst style investments to an increased emphasis on an investment's inherent competitive capacity, compounding potential, and suitability of management as long-term partners. In addition, we have learned to be more patient and incremental in how we back our convictions, whilst being quicker to move on when we feel a company no longer meets our investment criteria.

The market volatility brought about by the onset of Coronavirus in late FY20 coincided with this sharpening of focus, and we were able to reposition the portfolio into higher quality businesses at attractive prices. This readjustment, along with several incremental and opportunistic investments made throughout the year, provided the foundation for the Funds FY21 performance. The results of the past twelve months reflect that the refinement of our approach appears to be working. More importantly, our analytical abilities and emotional awareness have advanced materially over the last couple of years, and we are as well positioned as ever to keep generating superior performance in years to come.

That being said, we are mindful not to become complacent or overly hubristic about our abilities and matching our return for FY21 over the next twelve months is not going to be easy task. The current market environment is vastly different to where it was in July last year as share markets are reaching new highs fuelled by government stimulus and record low interest rates.  We are confident that the current companies in the portfolio will continue perform well over the coming years and we are ready to take advantage of any new opportunities that will inevitably arise. As always, we are eager and ready for this challenge and look forward to sharing this with our investors over the coming months.

## Portfolio

The top 10 holdings as at June 30, 2021 were:

| Rank | Holding | Total Equity Weighting | Total Portfolio Weighting |
|---|---|---|---|
| 1 | Field Solutions Group (ASX:FSG) | 15.50% | 12.89% |
| 2 | PPK Group Limited (ASX:PPK) | 12.74% | 10.59% |
| 3 | Kelly Partners Group (ASX:KPG) | 11.88% | 9.88% |
| 4 | Dicker Data (ASX:DDR) | 7.27% | 6.04% |
| 5 | Servcorp Limited (ASX:SRV) | 6.56% | 5.45% |
| 6 | Gowing Brothers Limited (ASX:GOW) | 5.76% | 4.79% |
| 7 | United Overseas Australia (ASX:UOS) | 5.44% | 4.52% |
| 8 | 360 Capital REIT (ASX:TOT) | 5.03% | 4.18% |
| 9 | Wotso Property (ASX:WOT) | 4.68% | 3.89% |
| 10 | 360 Capital Group (ASX:TGP) | 4.12% | 3.42% |

The top ten holdings made up **65.65%** of the total portfolio and cash allocation was **16.86%** at the end of the period.

## Tuas Limited (ASX: TUA)

TUA is business we have previously not discussed but showed up in our top ten positions at Dec 31, 2020. We recently decided to sell our entire position in TUA with the rationale for this decision detailed below.

TUA own and operate a brand new nationwide 4G mobile network in Singapore. Our investment in TUA originated when it was spun out of our shareholding in TPG Australia (ASX: TPG) as part of the latter's merger with Vodafone Australia in mid-2020. Since that time, we had been progressively increasing our investment on the basis that TUA exuded many of the characteristics we seek, namely: competent and aligned management, competitively advantaged business model, a long runway of compounding potential, and a seemingly very underappreciated valuation.

However, after many hours of reflection, we simply couldn't reconcile why the Singaporean government did not award TUA with the radio-wave spectrum necessary to upgrade their network to 5G on a nationwide basis. Over time, this became particularly irreconcilable given the governments generally pro-competition agenda and TUA's proven ability and willingness to roll the technology out faster than competitors. It is now our *opinion* that this decision was primarily political and designed to effectively block the use of equipment from Huawei, which is a Chinese telecommunications company, without announcing an official ban.

The TUA storey began when TPG Australia began rolling out 4G radio access network (RAN) in both Australia and Singapore back in 2017, and both networks were built almost entirely with Huawei equipment. The decision to use Huawei was initially thought of as a meaningful competitive advantage because it is considered superior to competitors in terms of performance, price, and the ability for a seamless upgrade mechanism to 5G. As a result, TUA's entire competitive strategy relied upon the ability to upgrade its 4G network to 5G using Huawei equipment, along with receiving a competitively fair share of nationwide 5G spectrum[1].

However, since TPG Australia made these fated decisions back in 2017, tensions between China & several western democracies, in addition to many of its southeast Asian neighbours, have escalated. One of the most notable by-products of this relationship deterioration, has been the widespread banning of Huawei RAN and user interface devices across large parts of the western world. The official ban is extensive and already includes countries such as the US, UK, Australia, New Zealand, Japan, Taiwan, France, India, with Canada and Germany looking likely to follow.

We believe this dynamic is likely to get worse before it gets better, and the duration of this tit-for-tat has the potential to significantly undermine TUA's business model and economic value.

To consider how bad this could become for TUA we only have to look at what happened to TPG Australia who in January 2019 announced they had ceased investment in their mobile network because the government ban on Huawei equipment. The company subsequently decided to fully write-down this abandoned network to the tune of $228 million which included the physical assets, spectrum holdings, and capitalised interest relating to construction costs. The write-down announcement was made whilst the now consummated merger with Vodafone Australia was being assessed by the Australian Competition and Consumer Commission (ACCC). The ACCC subsequently blocked the merger and TPG successfully appealed the decision in the federal court. TPG put forward

[1] TUA were the only applicant to the 5G spectrum auction whose proposal revolved entirely upon the use of a Huawei equipment for their networks core infrastructure.

their decision to abandon an independent mobile network as a central argument that the merger would not significantly hinder competition, and this appears to have had a meaningful influence to their successful outcome. Looked at another way, TPG were able to utilise the Australian governments snap ban on Huawei as a key bargaining chip for progressing the vastly more important merger with Vodafone. Unfortunately, such a broader strategic benefit is not available to TUA when it comes to pushing back against the Singaporean government's decision to not award them nationwide 5G spectrum.

This decision has the potential to be a fatal blow for TUA because the market is likely to rapidly migrate to 5G as the minimum expected standard in coming years, especially given the unique geographic density and level of digital adoption across Singapore. TUA could opt to retrofit their network with Nokia or Ericsson equipment but the cost is likely to be exorbitant as evidenced by the case of British Telecom who are in the process of ripping out all Huawei equipment from their UK networks. In addition, this action would also remove TUA's superior capital expenditure (capex) and operating expense position (opex), and cost advantaged pathway to 5G, leaving them with minimal competitive differentiation. This creates a high likelihood that TUA may have to significantly impair their RAN infrastructure and spectrum holdings, and reconsider what benefit can be extracted out of a network that is essentially stranded to 4G technology.

As a result, our original thesis that centred around their substantial capex and opex advantages in a rapidly expanding 5G future, no longer holds. Given this reality, we decided to sell our entire position and reassess when we have more clarity around the above factors and TUA's operating performance due to be reported later in the year.

Unfortunately, reliable and timely information on TUA's has proven difficult to obtain, as such it may be likely that we are missing a vital piece to this fascinating puzzle. The board and management team are definitely first class telecommunications operators, and if there is anyone who can pull a rabbit out the hat, it is them. We wish them the best of luck and remain keenly interested in the future of TUA.

We also ask that readers please contact us on: enquiries@harringtonpartners.net.au if you can spot flaws in our rationale or offer any key inputs or insight we have not considered.

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We are privileged that you have chosen to partner with us on this journey. As always, we welcome any feedback and if you have any questions, comments or investment ideas please do not hesitate to contact us.

Yours Sincerely,

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