

Ash Park on Tobacco & Transformation

Tobacco is a controversial industry, and our performance in recent years has felt the negative effects of selling driven at least in part by the rising popularity of ESG investing. We think engagement delivers far better long-term outcomes for all stakeholders compared to divestment, hence our participation in consultations for the Tobacco Transformation Index and regular dialogue with a wide variety of industry and public health protagonists. For the second time in our careers, Tobacco valuations have been driven to extreme and illogical levels: credit markets will lend at 40 years for less than 4%, but the equity is so lowly-rated that a number of companies could buy themselves back in 8-9 years. In reality, the financial attractions of the Tobacco business model haven't been impaired; we have written to the boards of our Tobacco holdings to highlight the 'self-help' opportunity and very considerable value they could create via share repurchases – if necessary by rebasing the dividend payout ratio, at least temporarily. We have equally high conviction that the industry, by accelerating the consumer shift into tobacco and nicotine products which are far less dangerous than cigarettes, can contribute to enormous public health gains in the next 10-20 years.

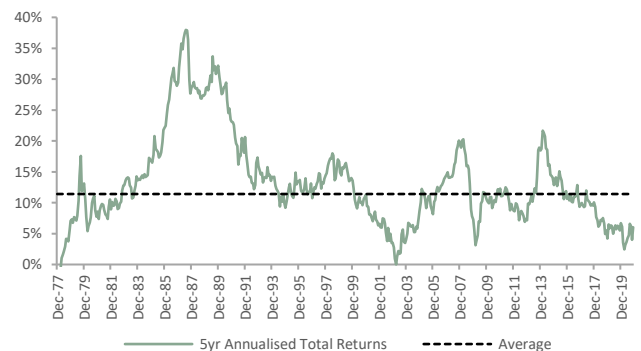
The Ash Park proposition

- Concentrated portfolio of high-quality consumer franchises
- Attractive long-term returns with lower downside risk
- Managed by experts in the Consumer industry
- Team co-invested with over 90% of their available assets

What Ash Park stands for

1. Excellence: Intellectual rigour in everything we do
2. A partnership approach: Sharing knowledge and networks
3. Shared ownership: Fully invested in the business and fund
4. Transparency: As open about mistakes as successes

Global Staples have never lost money in any 5yr period



Returns in USD for Ash Park Global Consumer Staples index, since 1977
Source: Ash Park, Refinitiv Datastream

Ash Park Global Consumer Franchise Strategy Returns (USD, net of all fees and expenses)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2020	-1.0%	-10.8%	-7.1%	9.4%	3.0%	1.0%	2.6%	1.5%	1.3%	-5.9%	9.4%		1.4%
2019	4.1%	4.2%	6.6%	-1.1%	-3.3%	2.6%	-0.2%	-0.3%	-0.5%	-0.8%	4.0%	3.5%	20.0%
2018	1.8%	-9.3%	1.9%	-2.5%	-2.9%	2.7%	4.0%	-2.5%	-0.3%	-5.0%	-2.3%	-6.8%	-19.9%
2017	2.1%	6.6%	2.7%	1.9%	8.0%	-2.3%	-0.4%	-0.3%	-0.8%	0.3%	2.1%	3.7%	25.7%
2016	-1.9%	-0.1%	6.5%	0.8%	-0.5%	2.7%	-0.3%	-1.3%	-0.3%	-5.1%	-6.3%	1.5%	-4.6%
2015	2.3%	4.7%	-4.3%	2.4%	0.8%	-2.7%	5.1%	-6.5%	1.5%	7.6%	-1.5%	-0.5%	8.2%

2020 to 30 th Nov	CY 2019	CY 2018	CY 2017	Cumulative			Annualised	
				12m to 30 th Nov	3 yrs to 30 th Nov	Since Inception	3 yrs to 30 th Nov	Since Inception
1.4%	20.0%	-19.9%	25.7%	4.9%	1.0%	29.4%	0.3%	4.3%

The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not a guide to future performance.

Source: Ash Park. This table illustrates the returns of the Ash Park Strategy. The Ash Park Strategy returns from October 14, 2014 to January 11, 2016 are the net asset value per share of Class A GBP shares of the Ash Park Global Consumer Franchise UCITS Fund translated into USD at the relevant daily exchange rate; and from January 11, 2016 to date the returns are the net asset value per share of the Ash Park Global Consumer Franchise Fund's Class A1 USD shares (net of all fees and expenses, all dividends reinvested). Past performance is not an indicator or guarantee of future results. Returns experienced by individual investors in different share classes of the Fund may vary from the performance shown, depending upon factors including date of investment and fees. The performance and NAV per share of each share class is available upon request.

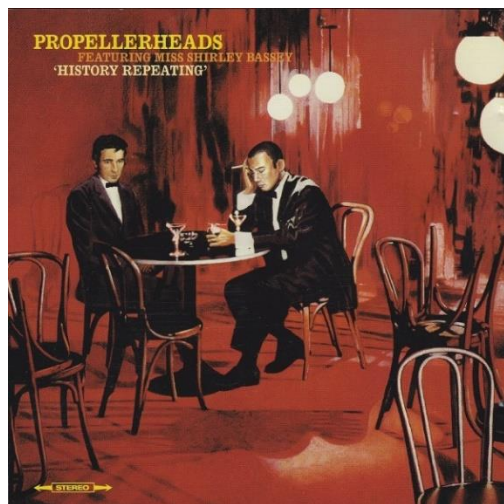


Ash Park on Tobacco & Transformation

Be careful what you wish for

*“They say the next big thing is here,
That the revolution’s near,
But to me it seems quite clear,
That’s it’s all just a little bit of history repeating”*

Figure 1: Propellerheads & Shirley Bassey: History Repeating



Source: Propellerheads / Wall of Sound

At the end of 1997 Propellerheads released *History Repeating*, a song which went to number 1 in the UK Indie charts, and also propelled its co-star, Shirley Bassey, to her first appearance in the US charts since 1973.¹

At about the same time Dame Shirley and the band were in the recording studio, the British tobacco company Gallaher was being spun out of American Brands. The financial media investment columns were not very enthusiastic:

“Cheap, because this is an industry gripped by siege which is beginning to bite”.

“The domestic market is falling 3pc a year, [the government] is pledged to cutting consumption, litigation lurks...”

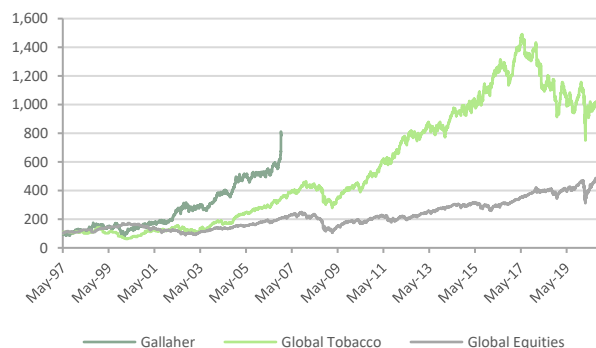
“[the] share price will continue to suffer jolts with the threat of lawsuits and anti-smoking legislation never far away.”²

None of that analysis – which sounds like it could also have been written yesterday – was wrong, but it was a hopeless guide to the returns outcome: since the effective date of Gallaher’s spin, global Tobacco has produced total returns of 997% (10.7% annualised), more than double the global market’s 420% (7.3% annualised).³

¹ <https://shirleybassey.wordpress.com/2019/08/03/history-repeating-with-the-propellerheads/> The youth of today would probably have described this as ‘a banger’; it was a favourite track on our mix tapes from that period.

² From the ‘Comment’ section of the *Financial Times*, the ‘*Questor*’ column of the *Daily Telegraph*, and the ‘*Tempus*’ column of *The Times*, respectively, on 15th May 1997.

Figure 2: Global Tobacco outperformance since May 1997



Total returns with dividends reinvested, in USD. 29th May 1997 = 100
Source: Refinitiv Datastream

The sector’s ride hasn’t always been smooth: from the end of November 1998 to early March 2000, global Tobacco fell 62% while the market rose 25%. At that point Tobacco’s forward P/E was about 7x. In the early days of Ash Park we used to lament that we could have made enormous returns from Tobacco if only we’d been launching our fund in the early 2000s, thinking we had missed a once-in-a-career opportunity. We should have been careful what we wished for.

Figure 3: A FinTwit cynic speaks



Source: twitter.com/88888sAccount/status/1331726922447941633?s=20

A twice-in-a-career opportunity

Amidst a rocketing in both enthusiasm and prices for the ‘next big things’, we’ve seen a degree of underperformance from Tobacco similar to 1999; the sector has fallen 39% since mid-June 2017, compared to +34% for global equities. We didn’t know that the undemanding multiple at which we bought the sector at launch would end up quite so cheap six years later. The sentiment expressed by a sharp FinTwit wit in Figure 3 is looking a little close to the bone.

Sentiment has been damaged by concerns over regulation and the role of cigarette alternatives such as vapes, and one of the important mechanisms for the creation of value, share repurchases, has jammed. A lot of people in the fund management community

³ Source: Refinitiv Datastream, to 9th December 2020. In the 9½ years from the spin to Gallaher’s board accepting a bid from Japan Tobacco in December 2006, Gallaher’s stock returned 685% (24% pa), more than six times the global market’s 111% (8.1% pa).



ASH PARK

still seem to recognise that Tobacco stocks have made excellent long-term investments, and that they currently look quite astonishingly cheap. But whether it's due to ESG-driven divestment, or because a spiral of controversy and falling stock prices has dumped Tobacco into the 'too difficult' or very unfashionable value buckets, whatever private convictions fund managers might have don't currently seem to be mirrored in the products they are selling to their customers.

The effect of Tobacco's slump on our overall performance has been profound (Figure 4), and prompted much self-reflection amongst the Ash Park team. We recognise that this has been painful for our investors too, but we are far from being the despondent characters depicted in the *History Repeating* cover art.

We clearly underestimated the potential de-rating of Tobacco, but we take some comfort from the fact that our stock selection elsewhere has been good, particularly for the 'Monsters of Tomorrow' – what we call the smaller and mid-cap companies which have been accounting for a growing portion of the portfolio.

Moreover, the value in Tobacco has not permanently been impaired: operational progress has been solid and future prospects for the industry if anything look better than they did three years ago, given more examples of the harm reduction concept in action and the likelihood of self-help from share repurchases at compelling prices. In the remainder of this letter we revisit the Tobacco business model, the key issues around the ESG and divestment theme, and the significant opportunity today's companies have to create a huge amount of value for both shareholders and public health. We are very excited about our Tobacco holdings and the prospect that history might be repeated once again.

Figure 4: Our ex-Tobacco performance is markedly better

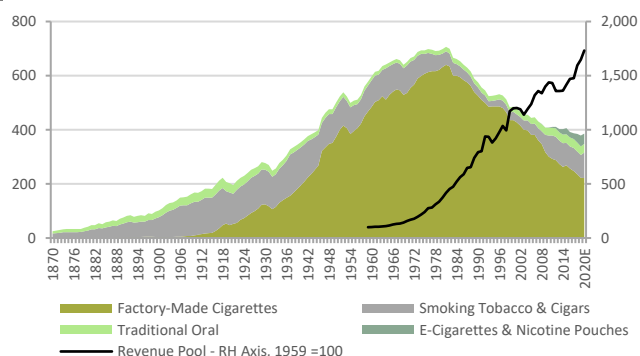


Returns in EUR of the AIF vehicle, calculated gross of mgmt fees and costs. The data is shown for illustrative purposes only and is derived from a model that retroactively removes Tobacco stocks from the performance of the Ash Park fund. To 30th September 2020
Source: Ash Park and Refinitiv Datastream

Fighting the fade

Commentators have been predicting an eventual shrinking of the tobacco industry profit pool for as long as we have followed the sector. That's been the source of excess returns for Tobacco investors over time, because the point at which DCF models build in a profit decline keeps shifting into the future.⁴

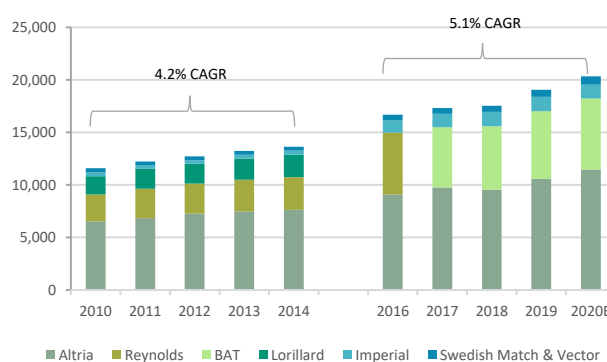
Figure 5: Long-term US tobacco consumption, cig equivs bn



Revenue pool is calculated net of excise taxes and payments for the Master Settlement Agreement
Source: Ash Park, Bureau of Economic Analysis, CDC, USDA

After more than a century of growth, US tobacco consumption peaked in 1981 (Figure 5), but the industry revenue and profit (Figure 6) pools are still growing. Tobacco is the only Staples industry in which prices can consistently rise higher than inflation, and excise structures create a further advantage for manufacturers in disguising the level of price increase they themselves take. To the extent that some of the tax burden is specific (based on the number of cigarettes per pack) rather than ad valorem (based on the selling price), manufacturers can obtain a bigger price increase of their own relative to any given level of retail price increase. That excise multiplier effect is very important when tax accounts for 60-80% of the retail price.

Figure 6: Estimated US tobacco manufacturer profit pool \$m⁵



Source: Ash Park, company data

⁴ This underestimation of the longevity of a company's cash flows is arguably most pronounced in Tobacco, but is prevalent across all the consumer franchise stocks and is at the core of why we think our strategy works over the long term. See this pair of insightful blog posts from Investors Master Class: [Fight the Fade - Round 1](#) and [Fight the Fade -](#)

Round 2 We were amused (and flattered) to see one of our charts from a previous letter reproduced third-hand, via someone else's book, in the second post.

⁵ Likely to be a slight underestimate of the size and growth of the profit pool since it excludes smaller tobacco companies and independent vaping



ASH PARK

Not every market behaves like the US, but it is the largest tobacco profit pool outside China, and we have no reason to believe that it's not broadly representative of the rest of the world. Global earnings for the Tobacco sector have grown at nearly 5% a year in USD over the last decade, nearly three times the rate of the market (Figure 7). As Figure 19 in the Appendix shows, this is not a recent phenomenon.

Figure 7: Tobacco earnings growth has beaten the market

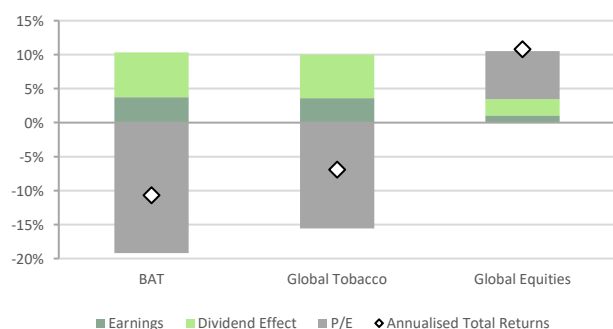


12m forward earnings estimates in USD, 31st Dec 2010 = 100
Source: Ash Park, Refinitiv Datastream

Tobacco equity has been significantly de-rated...

A private company exhibiting the same earnings growth profile as one of the Tobacco businesses in Figure 7 would be very likely to have seen its valuation marked higher over the last three years. Instead, the sector has been dramatically de-rated by equity markets over that period, causing an annual drag on returns of 19% for BAT, and 16% for the overall sector. That has much more than offset the effects of earnings growth and dividends, to produce heavily negative total returns (Figure 8).

Figure 8: Tobacco equity has been significantly de-rated



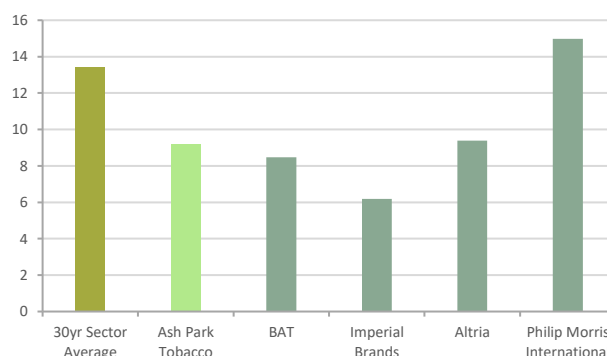
Disaggregated USD annualised total returns over 3 years to 9th Dec 2020
Source: Ash Park, Refinitiv Datastream

Three of our four Tobacco holdings are trading on forward P/E's of well under 10x, and our overall Tobacco exposure is one third cheaper than the average sector P/E for the last 30 years (Figure 9). Last time the sector's valuation was this low in the 1999-2004 period, 10-year US treasury yields were in the 4-6% range,

businesses (including JUUL). 2015 data is missing because Reynolds American and Imperial split ownership of Lorillard in the middle of the year.

compared to today's ~1% (see Figure 20 in the Appendix for a longer-run view of the sector's valuation).

Figure 9: Consensus 12m Forward P/E's



At 9th December 2020

Source: Ash Park, Refinitiv Datastream

...while Tobacco debt has been significantly re-rated

A curious accompaniment to the equity market's slamming of Tobacco valuations has been a significant re-rating of the company's debt by credit markets. Bond and dividend yields have diverged spectacularly since December 2018 (Figure 10). It's been a while since we've seen a sell-side note calling these stocks bond proxies.

Figure 10: Tobacco debt re-rated while the equity has de-rated



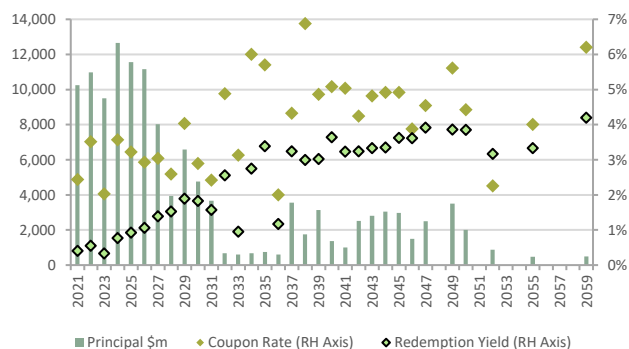
Shows USD yield on the iBoxx Global Tobacco bond index and 12m forward dividend yield for Global Tobacco

Source: Ash Park, Refinitiv Datastream

In aggregate, the four companies in our Tobacco holdings have \$130bn of bond principal outstanding over the next 40 years. Virtually all Tobacco bonds now offer a yield a lot lower than the coupon; 70% of the outstanding debt yields less than 2%, and 99% yields under 4% (Figure 11). A fairly frequent cry from commentators is that investors are worried about the level of gearing in Tobacco stocks, but that's not what credit markets are saying.

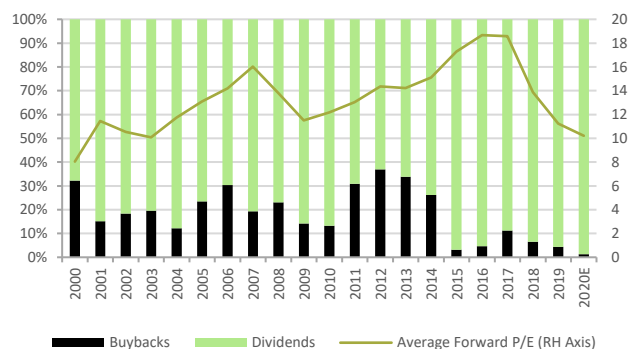


Figure 11: Aggregate Tobacco bond maturity, yield and coupon



Outstanding bonds for BAT, Imperial, Altria and PMI, converted into USD at 9th December 2020
 Source: Ash Park, Refinitiv Datastream

Figure 12: Mix of cash returns has been important for ratings



Dividends and buybacks shows simple average for Altria, BAT, Imperial Brands and PMI. P/E is for Developed Markets Tobacco
 Source: Ash Park, Refinitiv Datastream

The equity valuations of our Tobacco stocks seem exceptionally pessimistic now. In the example that we work through in the Appendix in the case of BAT, the current valuation is implying that cash flows are close to their peak and will start to decline at quite a rapid rate in the next 10 years or so. The credit market will lend these companies 30-year money at well under 4%, whereas the equity market demands dividend yields of 6-8% and attributes essentially zero value to cash flows after year 30 (Figures 23 & 24, Appendix).

Another way to look at things: at today's prices, by diverting all their free cash flow to share repurchases, three of our Tobacco holdings could buy back all their shares and take themselves private – without increasing debt levels – in eight to nine years.⁶

Potential for a self-help story

The return of a large amount of cash flow to shareholders has always been a mainstay of the investment case for Tobacco stocks. Over the last 20 years the companies have used a mix of buybacks and dividends to get that cash to shareholders, but the mix has shifted decisively in favour of dividends over the last few years as Altria, BAT and Imperial Brands have entered de-gearing mode following debt-financed acquisitions.

From 2002 to 2015 the average dividend payout ratio of the large companies also moved up steadily, from a little over 50% to almost 80% (Figure 21, Appendix), and despite drifting back slightly it's still well over 70% this year. Most of that recent drop in the average payout is due to Imperial's decision in May this year – sensible in our view – to rebase the dividend by one third.

Each of our Tobacco holdings already has investment-grade credit ratings from both S&P and Moody's (see Figure 22, Appendix, for the current picture). In the present environment we don't think the companies should be paying down debt more than is necessary to protect their current credit ratings and maintain some sensible flexibility for contingencies. Their equity valuation gives them the opportunity to create very substantial value for continuing shareholders, by repurchasing shares.

We have written to the Boards of each of our companies asking them to revisit their capital allocation policy. Although there is often a stigma associated with cutting dividends, it's hard to see how that stigma could be worse than that already implied by rock-bottom valuations: if you've got a dividend yield of 8%, by implication the market isn't giving you much credit for the dividend's future sustainability anyway. We would prefer to see dividend payouts rebased – perhaps to 50% – and for future flexibility to be preserved for companies to use remaining cash flows for either debt repayment, special dividends or share buybacks, depending on circumstances.

For instance, BAT should generate 'spare' cash flow – after its dividend – of £2.5bn next year, equivalent to over 3.5% of its current market cap. It could add more than £1bn to that figure by reducing its payout to 50% from 65%, and spend a total of £7.5bn if it temporarily suspended the dividend altogether. Our DCF work suggests that, conservatively, BAT's stock is worth £43-55. Buying a dollar for 55-70 cents has to be a good move. With the stock at £30, each £1bn spent on share repurchases would also save over £70m a year in dividend costs: buy-backs are accretive to cash flow.

Given the importance of income to some of BAT's shareholders, we acknowledge that a complete suspension of the dividend might be unpalatable for the board. But one of our holdings, Nomad Foods, has made a great success of paying no dividend and distributing its cash flows via share repurchases instead. We discuss this in more detail in the Appendix.

'I honestly don't feel like a victim'

Another point we have made to our Tobacco holdings is that there is more to be done in speaking up for the ownership of their equity (and debt) by responsible, engaged investors. We are convinced that will drive outcomes which are far superior to divestment, a movement driven principally by a desire to signal and shame, but which does virtually nothing to address the problem of the disease burden from smoking.

At the Global Tobacco & Nicotine Forum in September this year we heard Alex Clark, vaper and CEO of consumers' advocacy group

⁶ The fourth, PMI, could do so in 11 years.



ASH PARK

CASAA⁷, speak movingly of how people who smoke or use nicotine are very often ‘othered’ by people purporting to help them.

“I honestly don’t feel like a victim. I started smoking in the mid-90s, certainly I was subject to all kinds of messaging about why I shouldn’t smoke, not only why it would be negatively affecting my health but why it was essentially a character flaw, and I was a bad person.

... I didn’t start smoking because I thought it was cool. I didn’t start smoking because of peer pressure. And I certainly wasn’t tricked into smoking with some sort of slick marketing campaign.

...My journey from smoking to not smoking, and my journey through smoking, I think is a lot more complex than the narrative that’s been promoted, not just in the media, but in halls of decision-making.”⁸

Most of us probably have friends who smoke or use nicotine (if we don’t ourselves) who feel the same way and wouldn’t describe themselves as unwitting victims. Yet it’s practically taboo to discuss this – as our own discomfort in writing this section reminds us. The public discourse is still dominated by a 1990s *Tobacco Wars* attitude, where everybody knows that Tobacco is bad and pitted against the forces of good public health.⁹

Apart from the rather US-centric view this embodies¹⁰, in implicitly brushing aside the role of individual choice and agency it can short-circuit clear thinking about how best to address the issue of tobacco and nicotine use in society. We understand why there is so much focus on the health risks of smoking: around half of all people who smoke for their whole life will die prematurely and, on average, people who smoke die 10 years younger than non-smokers.¹¹ But can tobacco and nicotine use really be understood without acknowledging that consumers who choose to use these products also derive some pleasure and benefit from them?

Society’s long history of nicotine use, not to mention the example of other failed drug wars, suggests that persuading people to stop smoking is likely to require a solution considerably more complex than simply trying to take away their cigarettes, or companies deciding unilaterally to stop manufacturing them.¹² South Africa has been the latest country to experiment with prohibition, banning cigarette and alcohol sales for a period during this year’s

Covid outbreak. In the words of the *New York Times*, “It has gone as well as you might expect.”¹³

‘Engagement is futile’

A symptom – and cause – of the denial of consumer agency is that many tobacco control campaigners schooled during the 1990s fight against the large US companies insist that tobacco use is a problem that wouldn’t exist without a malign corporate force “responsible for getting hundreds of millions of tobacco users each year to want tobacco products and put them in their mouths”.¹⁴ For these people, tackling the problem of tobacco-related health harms is essentially synonymous with trying to stamp out the tobacco industry: get rid of it, and people will no longer want to smoke.

This is the motivation behind the Tobacco Free Portfolios initiative, which started in Australia and whose ‘Pledge’ now claims 155 signatories (primarily from Oceania, France, Benelux and Scandinavia) with USD11tn under management. There’s no mention of people who use tobacco or nicotine in the Pledge’s objectives, but instead a goal to “de-normalise financial and corporate associations with tobacco companies”.

This organisation’s view is that, amongst many controversial companies and sectors, “tobacco stands out as an exception that demands the strongest possible response from the finance sector – exclusion from financing and investment... Positive influence of the industry through professional engagement is futile, as the only acceptable outcome would be for tobacco companies to cease their primary business.”¹⁵

Tobacco Free Portfolios draws on the World Health Organization (WHO) and its Framework Convention on Tobacco Control (FCTC) for much of its authority. The FCTC, to which 182 states are now party, entered into force in 2005 as the first global public health treaty.

The FCTC’s objective is: “to protect present and future generations from the devastating health, social, environmental and economic consequences of tobacco consumption and exposure to tobacco smoke by providing a framework for tobacco control measures to be implemented by the Parties at the national, regional and international levels in order to reduce continually and substantially the prevalence of tobacco use and exposure to tobacco smoke.”

⁷ <https://casaa.org/mission/>

⁸ Alex Clark, CEO of Consumer Advocates for Smoke-free Alternatives Association (CASAA) – GTNF 2021 Keynote Speech, 22nd September 2020

⁹ That goes for fund managers too. In the recent words of somebody for whom we have a lot of respect and who’s taken a long position in BAT: “Owning businesses that are unethical, [and] businesses that are perceived to be unethical, exposes you to regulatory risk, and this one is unethical, let’s be honest about it. These are not nice companies.” *Inside the Rope with David Clark* podcast. Ep 79: John Hempton, 9th November 2020

¹⁰ We have no doubt that the behaviour of US tobacco companies, in their public playing-down of the health risks of smoking for many years, was very poor (and stupid). But the executives behind those policies are long-gone, and in other parts of the world where the tobacco industry behaved differently – and might have been controlled by governments – there isn’t good evidence that public health outcomes, in terms of smoking prevalence or the burden of disease, were any different.

¹¹ [Facts at a glance - key smoking statistics](#) – Action on Smoking & Health, September 2018

¹² For a good discussion of why the argument that tobacco companies should just stop selling cigarettes, or set a date for phasing them out, isn’t very helpful, see this blog post from Clive Bates, director of Counterfactual Consulting and former director of the UK public health charity Action on Smoking & Health: [Pariahs, predators or players? The tobacco industry and the end of smoking](#) 12th June 2017

¹³ [Taking on Covid-19, South Africa Goes After Cigarettes and Booze, Too](#) – *New York Times*, 8th May 2020. See also [Lighting up the illicit market: smoker’s responses to the cigarette sales ban in South Africa](#) – *University of Cape Town*, 15th May 2020. The cigarette sales ban has just been ruled unconstitutional: [Lockdown cigarette ban was ‘not necessary’ and unconstitutional, says WC high court](#) – *Sunday Times*, 11th December 2020

¹⁴ [Public Health Advocacy and Tobacco Control: Making Smoking History](#) – Simon Chapman, 2007

¹⁵ <https://tobaccofreeportfolios.org/why-go-tobacco-free/> For a list of current signatories: <https://www.unepfi.org/psi/tobacco-free-finance-signatories/>



Figure 13: FCTC definition of tobacco control



(d) “tobacco control” means a range of supply, demand and harm reduction strategies that aim to improve the health of a population by eliminating or reducing their consumption of tobacco products and exposure to tobacco smoke;

Source: WHO

Crucially, the FCTC’s definition of Tobacco control includes the notion of harm reduction (Figure 13).¹⁶

Tobacco harm reduction: from concept to reality

Harm reduction has deep roots in attempts to modify human behaviour to steer people away from the worst risks (eg regulation of the alcohol industry, or prescribing heroin to drug users) but became more developed as a framework during the 1980s, with the arrival of the HIV epidemic.

In the drug policy sphere it established a strong foothold through initiatives such as needle exchanges and opioid substitution treatments. The idea of harm reduction as a human right is now very firmly embedded across the UN system and its agencies or departments, such as the WHO and the Human Rights Council.¹⁷

As it relates to tobacco, the philosophy of harm reduction stems from the work of British addiction researcher Michael Russell. His insight was that “people smoke for the nicotine but they die from the tar” – that the real damage comes from people inhaling burnt organic matter that produces a large number of harmful or potentially-harmful chemicals, rather than the relatively benign stimulant nicotine.¹⁸

¹⁶ [WHO Framework Convention on Tobacco Control](#)

¹⁷ For instance, see this speech from Michelle Bachelet, UN High Commissioner for Human Rights, in April 2019, in which she declared: “Harm reduction measures have been recognised as essential for people who use drugs – by the General Assembly of the United Nations, the Human Rights Council, the World Health Organisation, UNAIDS, and multiple human rights Treaty Bodies and Special Rapporteurs.” [Harm Reduction International Conference 2019](#) – 28th April 2019, Porto

¹⁸ “Nicotine is not, however, in itself, a highly hazardous drug. It increases heart rate and blood pressure, and has a range of local irritant effects, but is not a carcinogen. Of the three main causes of mortality from smoking, lung cancer arises primarily from direct exposure of the lungs to carcinogens in tobacco smoke, COPD [Chronic obstructive pulmonary disease] from the irritant and proinflammatory effects of smoke, and cardiovascular disease from the effects of smoke on vascular coagulation and blood vessel walls. None is caused primarily by nicotine...it is inherently unlikely that nicotine inhalation itself contributes significantly to the mortality or morbidity caused by smoking. The main culprit is smoke and, if nicotine could be delivered effectively and acceptably to smokers without smoke, most if not all of the harm of smoking could probably be avoided.” – [Nicotine without smoke: Tobacco harm reduction](#) – Royal College of Physicians, April 2016

Figure 14: Reduced harm tobacco and nicotine products¹⁹



Source: Ash Park, companies

When the FCTC was negotiated in the early 2000s, tobacco harm reduction was still more concept than reality. Apart from nicotine gum (a de facto harm reduction product even if most often sold as a quit-smoking tool) the most comprehensive evidence base for a tobacco or nicotine product that was materially less dangerous than cigarettes belonged to snus²⁰ – but consumption of that product was largely confined to Sweden and Norway.

Nearly 20 years on, e-cigarettes, tobacco heating, nicotine pouches and other reduced-harm products (RRPs) are widely commercialised and have grabbed a material share of consumption.²¹ In the US, oral tobacco and nicotine pouches are taking share from combustible products: according to the CDC there were around 50m adult users of tobacco products (including e-cigarettes) in 2012-13, and 45m of them used a combustible product. In 2019 there were 50.6m adult users of tobacco products, but only 40.8m of them used a combustible product (see Figure 15).

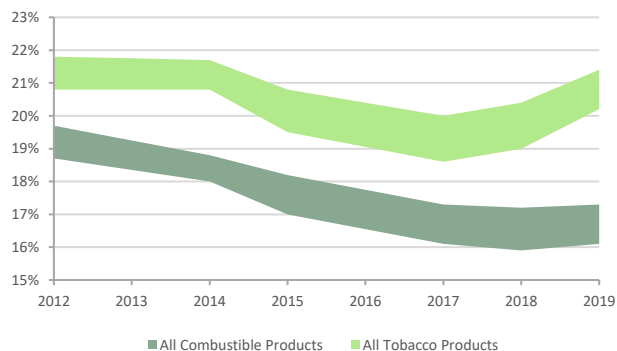
¹⁹ There is an increasing body of evidence to suggest that moist snuff, a traditional oral tobacco product in the US, should also be considered much less risky than cigarettes. Altria has filed a Modified Risk Tobacco Product (M RTP) application with the FDA concerning its Copenhagen brand. At a hearing in February 2019, the FDA’s Tobacco Products Scientific Advisory Committee (TPSAC) voted 8-0 (with one abstention) that scientific evidence supported the statement ‘IF YOU SMOKE, CONSIDER THIS: Switching completely to this product from cigarettes reduces risk of lung cancer’. Note that this vote is non-binding, and the FDA is still considering Altria’s application.

²⁰ Snus is the Scandinavian equivalent of US moist snuff. In October 2019, after an exhaustive evidence review, the FDA authorised Swedish Match to market its General brand of snus with the claim “Using General Snus instead of cigarettes puts you at a lower risk of mouth cancer, heart disease, lung cancer, stroke, emphysema, and chronic bronchitis.” [FDA grants first-ever modified risk orders to eight smokeless tobacco products](#)

²¹ RRP s = Reduced-Risk Products. Sometimes referred to as PREPs (Potentially Reduced Exposure Products), NGPs (Next-Generation Products), SNPs (Safer Nicotine Products) or THRP s (Tobacco Harm Reduction Products).



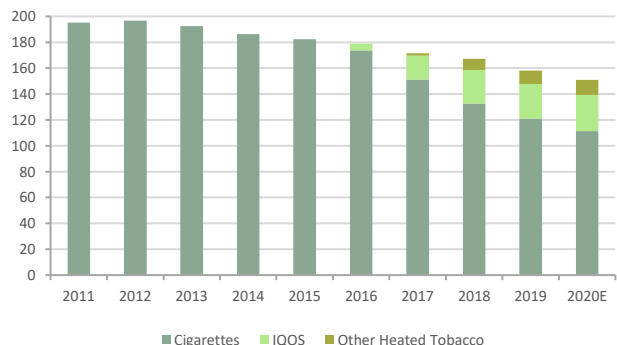
Figure 15: US adult (18+)²² tobacco use prevalence



Represents high and low ranges, 95% confidence interval
Source: Ash Park, CDC MMWR

There are other markets where reduced-harm products have made more progress; tobacco heating products such as PMI’s IQOS and BAT’s gLO now account for over a quarter of tobacco consumption in Japan, from zero five years ago. In Sweden and Norway the long-run decline of smoking prevalence continues, as adult tobacco consumers choose to use snus instead. In the UK, adult consumers have switched from smoking to e-cigarettes. (Figures 27-29, Appendix).

Figure 16: Tobacco consumption in Japan, bn cigarette equivs



2020 is an Ash Park estimate based on reported 9-month figures
Source: Cummings, Nahhas & Sweanor²³; Ash Park

Barriers to progress

When there were few widely-recognised examples of consumer acceptance of tobacco RRP, there was little practical contradiction between the WHO on the one hand vilifying cigarette companies, while on the other paying lip service to the idea of tobacco harm reduction. Now tensions within the tobacco control movement, not just at the WHO but also highly visible in the US and elsewhere, have been brought into sharp relief. Harm reduction as a human

right appears to be embedded in many parts of the UN and WHO systems, but not when it comes to tobacco.

Dr Derek Yach was 20 years ago a cabinet director at the WHO and ran the organisation’s Tobacco Free Initiative; he was a prime mover in the establishment of the FCTC. He now runs the Foundation for a Smoke-Free World, a non-profit organisation whose original funding came from PMI but whose constitution and governance model is carefully constructed to guarantee that it operates free of any commercial influence. In a recent publication he is quite scathing of the WHO’s approach to tobacco policy these days:

“Many current demands to ban all THRPs are based on a trio of World Health Organization papers that rely on cherry-picked research at least three years old that doesn’t compare the differences in potential harm between THRPs and combustible cigarettes. They also don’t address the power of addiction, the inevitable black markets that pop up to fill the void created by bans, and the concept of freedom of choice, which is an essential part of the way we live.

... Until recently, efforts to curtail smoking have focused solely on regulations, sanctions and warnings by stentorian officials that smokers must quit or die a horrible death. Governments, individual health authorities and the World Health Organization officially classify all smoking products as equally harmful, regardless of their actual health risk.

...The WHO, monolithic, rigid and ponderous, continues to presume that the best way to effect change is for countries to implement the articles of the FCTC, even though many of these articles are out of date.”²⁴

Dr Yach isn’t the only one dismayed at the WHO’s stance on tobacco. In May this year a group of international experts, coordinated by Iowa Attorney General Tom Miller, put out a release which sharply criticised the agency “for its backward-looking approach to innovation and new technology, such as vaping products. Experts say they are exasperated by the WHO’s dogmatic hostility towards new technology and fear the UN health agency will squander the opportunity to avoid millions of premature deaths that will be caused by smoking”.²⁵

The growth of RRP in the US (particularly e-cigarettes) has been slowed by the public’s misconceptions about what really causes tobacco-related disease, adverse publicity over 2019’s spate of deaths relating to the vaping of illicit THC products, and by concerns over a spike in youth vaping. All of these have contributed to (and been compounded by) a series of ham-fisted regulatory initiatives that have had the perverse effect of making life more difficult for RRP relative to combustible cigarettes.

²² At the start of 2020 the minimum age for purchasing tobacco products in the US was raised to 21, but the National Health Interview Survey has to date collected adult figures for 18+.

²³ [What Is Accounting for the Rapid Decline in Cigarette Sales in Japan?](#) – Cummings, Nahhas & Sweanor, *International Journal of Environmental Research and Public Health*, March 2020

²⁴ [Phasing Out Combustible Cigarettes: Reducing Tobacco Harm](#) – Dr Derek Yach, Foundation for a Smoke-Free World, September 2020. The whole of brief paper is an excellent introduction to tobacco harm reduction, its current application and controversies.

²⁵ [International experts in tobacco policy say WHO is blocking innovation and wasting opportunities to save millions of lives](#) – Iowa Department of Justice Office of the Attorney General, 29th May 2020

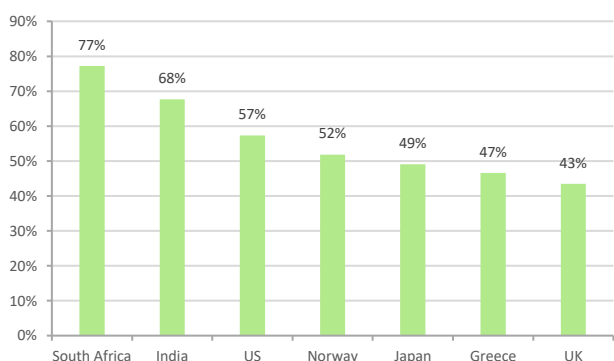


ASH PARK

A large proportion of the public – even consumers of tobacco – wrongly believe that nicotine is the primary cause of tobacco-related cancers, and not just in the US (Figure 17). By extension, there is therefore widespread belief that next-generation tobacco and nicotine products are just as dangerous as cigarettes.

That’s a legacy of previous public health campaigns highlighting the addictive nature of the nicotine in cigarettes²⁶, and the efforts of the WHO and large anti-tobacco campaign groups (many of them funded by Mike Bloomberg) which have produced a tsunami of misinformation on RRP’s.²⁷ The point isn’t that RRP’s are 100% safe: it’s that they’re very much less dangerous than smoking.

Figure 17: Many consumers think nicotine causes cancer



% of current and former tobacco users answering yes to the question: “is tobacco-related cancer primarily caused by nicotine?”

Source: Rajkumar et al²⁸; Ash Park

The justification for engagement

An important problem for investors is that the WHO might generally be regarded as an authority in other health-related matters, and a good guide as to the right way to behave, but in tobacco policy – harm reduction in particular – that’s not necessarily the case.

From what we can see, the approach taken by Tobacco Free Portfolios aligns largely with the outdated and unenlightened WHO view: there’s no mention of harm reduction in the Tobacco Free Portfolios literature, and it’s where their insistence that ‘engagement is futile’²⁹ appears to miss the bigger picture.

In our view, there is an enormous amount of good that can be achieved for society – with a massive and measurable reduction in the long-term burden of tobacco-related disease – if consumers

²⁶ We are so used to hearing that nicotine is addictive that it seems strange to discuss the idea that, for humans, it might not be – or might be less addictive – outside the context of cigarettes. For instance, people don’t seem to get addicted to nicotine patches. And some definitions of addiction, or the more severe forms of addiction, specify a harm beyond merely wanting to do or use something again. Without the harm of a smoking-related disease, is an addiction to nicotine that comes from, say, nicotine pouch use any worse than the dependence many of us have on our morning coffee?

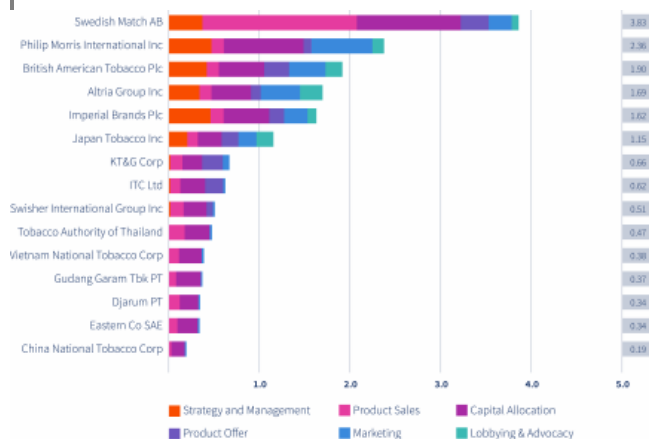
²⁷ See Chapter 5, ‘Project Fear: the war against nicotine’ of the encyclopedic [Burning Issues: The Global State of Tobacco Harm Reduction 2020](#) – Harry Shapiro, November 2020

who smoke can be persuaded to switch to cleaner forms of tobacco or nicotine. That process is likely to be helped by engagement from responsible, knowledgeable investors.

With due respect to those with very strong moral views who might object to owning Tobacco stocks (or Alcohol, for that matter), we equate a strict divestment-only in all circumstances approach with an abdication of responsibility: it might make the seller feel good, but it doesn’t address the underlying problem. To the extent that a less scrupulous group of investors ends up owning the shares instead, the effects could actually be counterproductive; companies and managements could become more focused on the short term and on profit maximisation if public market valuations imply that they’ll be gone in a decade.

In September this year the Foundation for a Smoke-Free World published the first edition of its Tobacco Transformation Index, intended to provide a roadmap for ‘responsible active owners’ and a ‘benchmark to guide and accelerate’ tobacco company efforts to transform their businesses.³⁰ We have engaged with the team behind the Index from the early consultation stage and support its aims, notwithstanding room for improvement in the methodology and other areas.

Figure 18: Tobacco Transformation Index – Overall Ranking



Source: Tobacco Transformation Index

At the core of the Index is the ranking of the world’s major tobacco companies according to their relative progress on harm reduction. As the Index noted (we agree), there’s still major room for improvement from most of the large international tobacco companies, but it’s notable that the large, publicly-listed cigarette

²⁸ [Perceptions of nicotine in current and former users of tobacco and tobacco harm reduction products from seven countries](#) – Rajkumar et al, *Drugs & Alcohol Today*, May 2020

²⁹ The most common rebuttal of the good faith of tobacco companies when it comes to harm reduction is to argue that, if they were serious about it, they should stop selling cigarettes immediately. “This is more of an empty campaigning posture than a plausible way to make progress. No public company could do this unilaterally... Somebody would end up selling the cigarettes.” – [Nicotine science and policy Q&A](#) – Clive Bates, 17th February 2020. We don’t know for sure if this is an argument TFP makes because up to now our own attempts to engage with them have not borne fruit.

³⁰ <https://tobaccotransformationindex.org/>



ASH PARK

businesses do a lot better than private and state-owned companies. The Index believes that's in part because the public companies are "subject to more reporting requirements and scrutiny from investors and other stakeholders".

Our recently embarking on an exciting new partnership at Ash Park has subjected our views on Tobacco to considerable and rigorous scrutiny and caused us to think hard about both the financial and the ethical implications of holding these stocks in our portfolio.

We have come out of that exercise still more convinced that there is substantial upside in these positions. The ESG divestment trend pushes up risk for investors, but that same dynamic also increases prospective returns: if Tobacco stocks get cheaper but their business dynamics don't change, the investors that hang on are going to get better cash flow yields: bigger dividends and buybacks that add more value at the expense of the shareholders who exit.³¹

We have equally high conviction that harm reduction – and persuading companies to offer products which persuade tobacco and nicotine users to consume less-risky products – will do a lot more good for society than a wrong-headed insistence that the only ethical action tobacco companies can take is to put themselves out of business tomorrow.

We'll be in touch with a short update on performance and recent portfolio activity in early January; meanwhile thank you for your support and your interest in Ash Park; our best wishes for Christmas and the holiday season.

The Ash Park team 15th December 2020

Jonathan Fell
jf@ashparkcapital.com
+44 (0)20 3411 6434

Jamie Isenwater
ji@ashparkcapital.com
+44 (0)20 3411 6433

Harold Thompson
ht@ashparkcapital.com
+44 (0)20 3411 6435

Mark Purdy
mp@ashparkcapital.com
+44 (0)20 3411 6432

All data sourced from Ash Park unless otherwise stated.

Performance for other share classes of the Fund may differ. Please refer to your individual statements or contact Ash Park for further information.

Note: Throughout this newsletter 'Consumer Staples' or 'Staples', where the term is capitalised, refers to the Ash Park definition or proprietary indices of the consumer staples sector, which include Food, Beverage, Tobacco and Household & Personal Care companies; the S&P Global Consumer Staples index also includes the Food Retail sector.

³¹ Cliff Asness has made the point eloquently and entertainingly that investment managers might sell ESG as a free lunch, but accepting lower returns is embedded in how ESG is supposed to work: "...one man's discount rate is another man's expected return... we showed that investors will demand a higher expected return from the sinful companies, due to shunning by the virtuous and the necessity to bribe the sinners to hold more of them. It also directly follows that the sinful companies will have to use a higher discount rate (or, perhaps more clearly in this case, 'cost of capital')

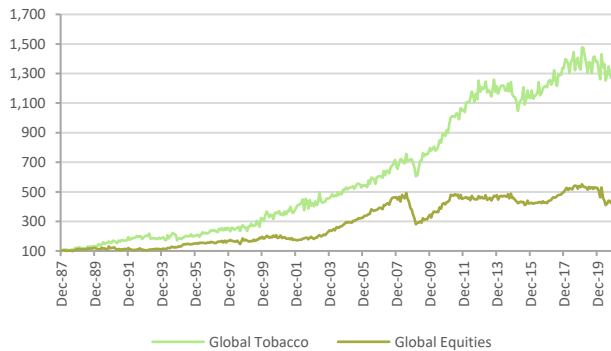
in their 'should we undertake this project?' calculations. This is truly Finance 101. That means quite simply that fewer sinful projects will show positive NPVs and fewer will be undertaken. Put simply, if the virtuous are not raising the cost of capital to sinful projects, what are they doing?" [Virtue Is its Own Reward: Or, One Man's Ceiling Is Another Man's Floor](#) Cliff Asness, AQR, 18th May 2017.



Appendix

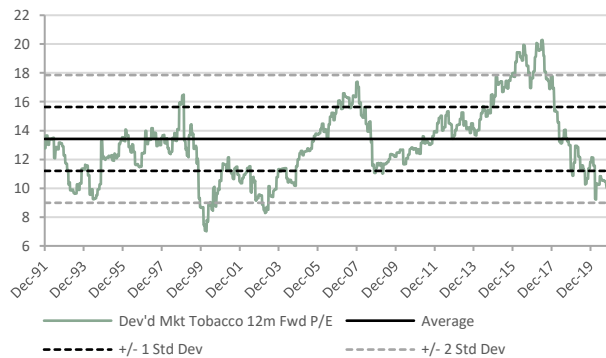
A few more valuation and debt charts

Figure 19: Long-term Tobacco earnings growth v market



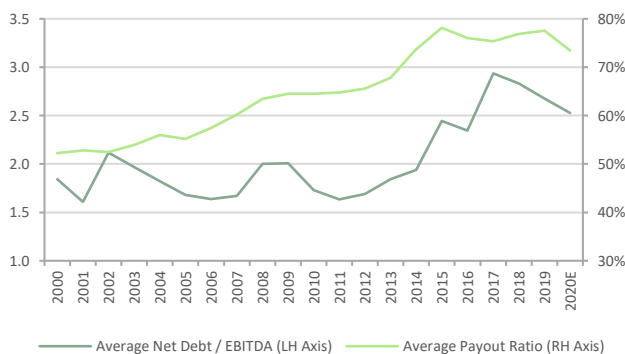
12m forward earnings estimates in USD, 31st Dec 2010 = 100
Source: Ash Park, Refinitiv Datastream

Figure 20: Developed market Tobacco 12m forward P/E



Source: Ash Park, Refinitiv Datastream

Figure 21: Large Tobacco dividend payout and gearing



Simple average for Altria, BAT, Imperial Brands and PMI
Source: Ash Park

Figure 22: Current long-term debt ratings

	S&P	Moody's	PMI S&P	Moody's	Altria S&P	Moody's	BAT S&P	Moody's	Imperial S&P	Moody's
Upper Grade	A+	A1	Stable	Stable						
Medium Grade	A	A2			Stable					
Lower Grade	A-	A3				Stable				
Upper Grade	BBB+	Baa1					Stable			
Medium Grade	BBB	Baa2			Stable		Stable	Stable	Stable	
Lower Grade	BBB-	Baa3								Stable

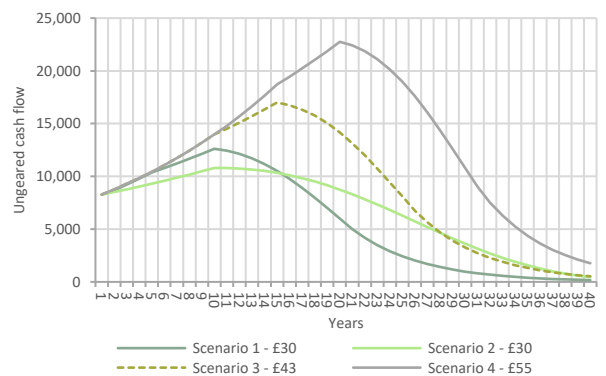
Source: S&P, Moody's

BAT DCF Scenarios

We conservatively estimate that BAT's weighted-average cost of capital (WACC) is around 8.1%.³² For 2020 the company should produce notional post-tax unlevered cash flow of about £8.3bn, adjusted net debt at the end of 2019 was £42.5bn, and there are around 2,293m diluted shares outstanding.

At £30, BAT's share price is discounting something like the cash flow profiles of Scenarios 1 or 2 in Figure 23: ie cash flows are near their peak, and in the next 10 years will start to decline at a fairly rapid rate. For context, we estimate that BAT has grown USD ungeared cash flow per share at a 6.7% annual rate over the last 5 years (4.2% over 10 years, 7.6% over 20 years).

Figure 23: BAT DCF scenarios



Source: Ash Park

With a Scenario 1 or 2 cash flow profile and an 8.1% WACC, 75% of the current enterprise value of the stock (at £30) is generated by cash flows in the next 12-14 years; almost all of the current enterprise value comes from cash flows in the next 25 years – in other words, the equity market is saying the company might not exist beyond that point, which is not the view that credit markets seem to be taking (Figure 24).

For comparison, a typical Consumer Staples business with a WACC of around 7.5% and trading on a prospective EV/NOPAT multiple of 22x (roughly equivalent to a P/E of 20x), will have generated enough cash flow to justify half of its current enterprise value in the next 10-14 years, and 75% after 25 years; it reaches 95% after 50 years.

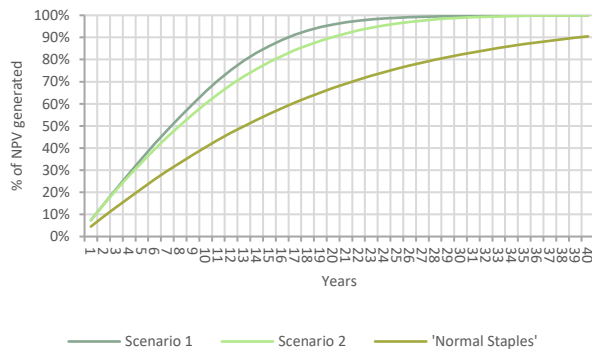
fair value by around 10-12% in Scenarios 1 & 2 of Figure 23, and by around 13-15% for the longer-duration Scenarios 3 & 4.

³² Assumes cost of debt = 4%, cost of equity = 9%, tax rate 25.5%, target net debt / EV of 15%. A one percentage point change in the WACC moves



ASH PARK

Figure 24: % of cumulative net present value generated by year



Source: Ash Park

If BAT manages to ‘fight the fade’ and extend annual cash flow growth of around 5% out another 5 years to year 14 before the decline kicks in, it could be worth £43 with the same 8.1% WACC (Scenario 3 in Figure 23). Adding a further five years of growth on to that (Scenario 4) would push today’s fair value up to £55.

We have now been writing about BAT for 25 years, and the point at which cash flows will start declining seems as far off as it did in 1995. To the extent that Scenario 4 – which would put the stock on the nosebleed valuation of... a bit under 16x 2021 earnings – will turn out to have been wrong when we look back in another 25 years, we suspect that’s most likely to be because it was too conservative.

Nomad Foods – a case study

As an extreme example of how lowly-rated businesses can gain significant benefits from not paying a dividend and using free cash flow primarily to repurchase stock, Nomad Foods is an interesting case study. Since it was formed in 2015 it has never paid a dividend, instead using its cash flow initially to reduce debt, and subsequently buy three businesses.

Figure 25: Nomad 12m forward P/E



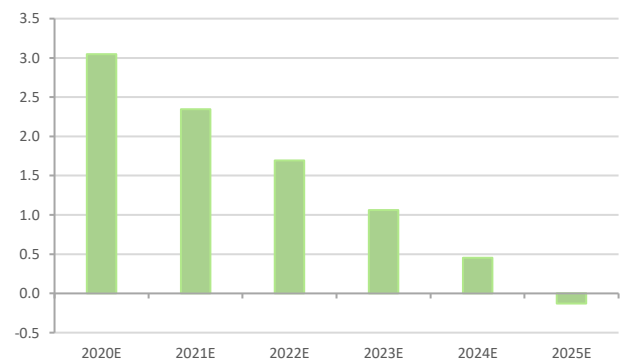
Source: Refinitiv Datastream, Ash Park

However, it’s the change in emphasis during 2020 that makes it such an interesting case study for the Tobacco sector. In the absence of any material M&A opportunities (now also largely true for Tobacco), Nomad has bought back 14% of its equity this year, leaving its net debt / EBITDA at 3x (up from 2.4x in 2019). It has

been rewarded with a share price that is now up 50% over two years, in part driven by a re-rating of its P/E ratio from 11x to 13x as the benefits of its capital allocation strategy became more appreciated by investors.

What is also notable is how quickly, in the absence of any further buy-backs, Nomad would continue to reduce its debt from here. We estimate that it will be in a net cash position in five years, and if it maintains its debt profile for 2025 (3x EBITDA) it would have the scope to buy back another 40% of its equity – which would, on our forecasts, enhance its earnings per share by almost 50%. Even with just 3% annual sales growth, EPS would more than double over the five-year period.

Figure 26: Nomad 12m forward P/E



Source: Refinitiv Datastream, Ash Park

There has been much debate about the merits of share buy-backs, and whether (short-term) earnings per share accretion is the correct measure against which to benchmark them. We prefer to use our DCF estimates of a company’s value; this is where the reliable compounding nature of the consumer franchise cash flows, together with, we hope, a management team that thinks of the long-term, should come in to their own.

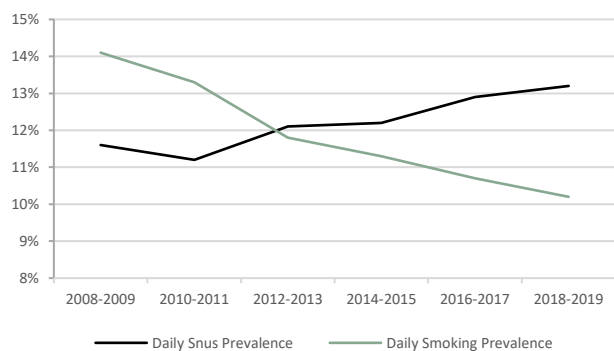
Most DCF models will assume that perpetuity growth from year five or 10 ‘normalises’ to a very modest number. However, underlying successful long-term investing in consumer franchises is the ‘patience arbitrage’: knowing that well-run businesses can continue to grow at their current rate for decades, and maybe centuries.

We estimate Nomad’s DCF value is at least \$40 per share. At a current share price of just \$25, it clearly makes sense for the company to buy a lot of its shares. To translate that back to earnings multiples, as we have shown in one of our favourite charts, the P/E you could have paid for a successful consumer business back in the 1970s could have been 100x or more if the target IRR was a 10% annualised return 50 years later. It is the inability of most investors to think of the very long term that can make buy-backs so attractive for successful consumer franchises. And in the case of lowly-rated businesses like Nomad Foods and the Tobacco sector, the case is compelling.



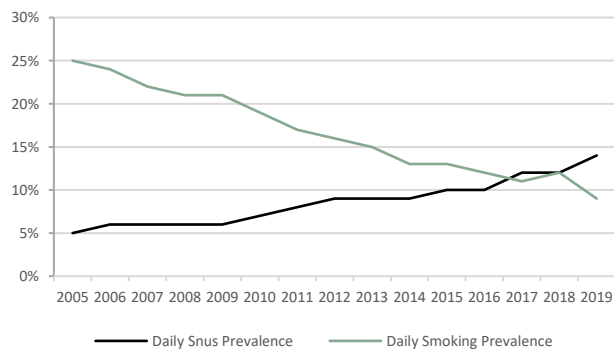
Harm reduction

Figure 27: Smoking and snus use prevalence in Sweden, 16+



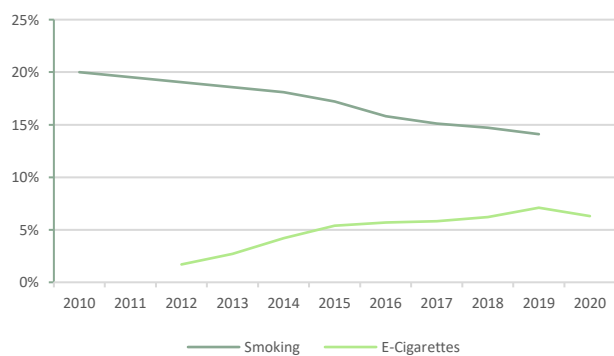
Source: Ash Park, [Statistics Sweden](#)

Figure 28: Smoking and snus use prevalence in Norway, 16-74



Source: Ash Park, [Statistics Norway](#)

Figure 29: Smoking and e-cigarette use prevalence in UK, 18+



Source: Ash Park, [Action on Smoking & Health](#), [Office for National Statistics](#)



Ash Park is a division of Kingsway Capital Partners Limited. This newsletter is issued by Kingsway Capital Partners Limited which is authorised and regulated by the Financial Conduct Authority in the United Kingdom (the "FCA"). The investment products and services of Kingsway Capital Partners Limited are only available to persons who are professional clients and eligible counterparties for the purposes of the FCA's rules. They are not available to retail clients. This document is not intended for distribution to, or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

This newsletter refers to Ash Park Global Consumer Franchise Fund (the "Fund") which launched on 11th January 2016. The Fund is a sub-fund of Kingsway Capital ICAV, an umbrella type Irish collective asset management vehicle with variable capital and with segregated liability between sub-funds registered and authorised by the Central Bank of Ireland with registration number C142851, pursuant to Part 2 of the Irish Collective Asset-management Vehicle Act, 2015.

This presentation does not constitute an offer to buy or sell shares in the Fund. The offering materials of the Fund are the only authorized documents for offering of shares of the Fund. The offering materials may only be distributed in accordance with the laws and regulations of each appropriate jurisdiction in which any potential investor resides. Neither the Fund nor the interests therein will be registered under the Securities Act of 1933, as amended, the Investment Company Act of 1940, as amended, or the securities laws of any of the States of the United States. Distribution of the Fund's offering materials to a "US persons", can only be made to persons that are "accredited investors", as defined in the Securities Act 1933, as amended, and "qualified purchasers", as defined in the Investment Company Act 1940, as amended.

The Fund is only suitable for sophisticated investors who are aware of the risks of investing in alternative investment funds. **Investors are also reminded that past performance is not a guide to future performance and that their capital will be at risk and they may therefore lose some or all of the amount that they choose to invest in the Fund.** Investors in the UK are reminded that they will not benefit from the UK investors compensation scheme. Investment in the Fund carries risks, which are more fully described in the prospectus. Kingsway Capital Partners Limited neither provides investment advice to, nor receives and transmits orders from, investors in the Fund nor does it carry on any other activities with or for such investors that constitute "MiFID or equivalent third country business" for the purposes of the FCA's rules.

Nothing in these materials should be construed as a recommendation to invest in the Fund or as legal, regulatory, tax, accounting, investment or other advice. Potential investors in the Fund should seek their own independent financial advice. In making a decision to invest in the Fund, prospective investors may not rely on the information in this document. Such information is preliminary and subject to change and is also incomplete and does not constitute all the information necessary to adequately evaluate the consequences of investing in the Fund. The Fund is only intended for sophisticated investors and an investment in it presents certain risks which are more fully described in the offering materials. Nothing described herein is intended to imply that an investment in the Fund is "safe", "conservative", "risk free" or "risk averse". Investors are also reminded that past performance is not indicative of future performance and that they might not get back the amount that they originally invested.

The following is a brief summary of only some of the risk factors which may apply to the Fund: *Political and Economic Risk* Political unrest and other factors may disrupt financial markets and economic conditions in certain markets in which the Fund may invest and result in a temporary suspension of the determination of the Net Asset Value of the Fund; *No Guarantee on Investment Model and Potential to Lose All of the Sum Invested* An investment in a Fund should not in itself be considered a balanced investment program; inherent in an investment in the Fund is the potential to lose the entire sum invested; *Lack of Operating History* The Fund was recently formed. There can be no assurance that the Fund will achieve its investment objective; *Redemption Risk* Large redemptions may require the Fund to realize investments at values which are lower than the anticipated market values of such investments; *Dependence on Key Personnel* If the services of Ash Park personnel were to become unavailable, this could result in substantial losses for the Fund. *Management Risk* There is a risk that investment techniques or strategies are unsuccessful and may incur losses for the Fund. There can be no assurance that the AIFM or, where relevant, an investment manager will realise returns comparable to those achieved in the past or generally available on the market. *Diverse Investors* The conflicting interests of individual Investors in the Fund may relate to or arise from, among other things, the nature of Investments made by a Fund, the structuring or the acquisition of investments and the timing of disposition of investments. *Equity Risks* Shares' prices on equity markets may fluctuate namely pursuant to investor's expectations or anticipations, causing high potential volatility risk. *Liquidity Risk* Some markets, on which the Fund may invest, may prove at time to be insufficiently liquid or illiquid. This affects the market price of such the Fund's securities and therefore its Net Asset Value; *Concentration of Investments* The Fund may at certain times hold relatively few investments or have a significant exposure to a single issuer, counterparty or asset, and therefore be subject to significant losses if it holds a large position in a particular investment that declines in value or is otherwise adversely affected; *Market Risk* Some of the markets and exchanges in which the Fund may invest may be less well-regulated than those in developed markets and may prove to be illiquid, insufficiently liquid or highly volatile from time to time. This may affect the market price of a value of Shares of the Fund and, therefore its Net Asset Value; *Currency Risk* Assets of a Fund may be denominated in a currency other than the Base Currency of the Fund and changes in the exchange rate between the Base Currency and the currency of the asset may lead to a depreciation of the value of the Fund's Assets as expressed in the Base Currency. It may not be possible or practical to hedge against such exchange rate risk.

The foregoing summary list of risk factors does not purport to be a complete enumeration or explanation of the risks involved in an investment in the Fund. Prospective investors must read the entire Prospectus of the Fund and consult with their own legal, tax and financial advisers before deciding to invest in the Fund.

Kingsway Capital Partners Limited has taken all reasonable care to ensure that the information contained in this document is accurate at the time of publication, however it does not make any guarantee as to the accuracy of the information provided. While many of the thoughts expressed in this document are presented in a factual manner, the discussion reflects only Kingsway's Capital Partners Limited beliefs and opinions about the financial markets in which it invests portfolio assets following its investment strategies, and these beliefs and opinions are subject to change at any time. The information contained in this newsletter is confidential. No part of this report may be divulged to any other person, distributed, and/or reproduced without the prior written permission of Kingsway Capital Partners Limited.