URB INVESTMENTS LIMITED

ABN: 89 615 320 262

QUARTERLY REPORT

THE URB EQUITIES PORTFOLIO

In this report, we discuss several stocks in the URB Equities Portfolio. With the recent volatility in global equities markets, we thought it was appropriate. From an overall portfolio perspective, URB has held up relatively well. The market (as measured by the S&P/ASX 300 Accumulation Index) peaked in late August and has since declined by 9.3% to 30 November 2018. By comparison, the URB Portfolio has increased in value by 0.2% over the same period.

DECEMBER 2018

URB is managed by Contact Asset Management
AFSL 494045

Welcome to the sixth issue of the URB Investments Limited (URB) Quarterly Report, prepared by Contact Asset Management. As we approach the end of the year, we wish you and your families a safe and happy Christmas. Thank you for your continued support.

These reports provide us with an opportunity to communicate with URB shareholders on topics of interest. The reports will be available on the website at www.urbinvest.com.au. We also encourage you to subscribe to the URB mailing list.

Our recent Quarterly Reports have covered a number of high-level topics including the upcoming shortage of industrial property, Western Sydney population growth and the infrastructure boom.

In this report, we delve into a little more detail and discuss several stocks in the URB Equities Portfolio. With the recent volatility in global equities markets, we thought it was appropriate. From an overall portfolio perspective, URB has held up relatively well. The market (as measured by the S&P/ASX 300 Accumulation Index) peaked in late August and has since declined by 9.3%[1]. By comparison, the URB Portfolio has increased in value by 0.2% over the same period. .

Our Equities investments form an important part of the overall URB Portfolio. At the end of November 2018, the Equities Portfolio accounted for approximately 42% of total assets.

THE URBAN RENEWAL UNIVERSE

The URB Equities portfolio is created from a proprietary Urban Renewal Universe. The Universe is made up of over 90 ASX listed companies and in our opinion, all these companies have exposure to urban renewal and regeneration. This is our opportunity set for Equity Investments.

There are no Banking or Resource companies in the Urban Renewal Universe – we view URB as an alternative asset class and we seek to complement more mainstream portfolios, most of which already hold banking and resource companies.

In recent months, the performance of the Universe has been quite resilient. Many REITs and Infrastructure businesses are being viewed as relative safe havens and have outperformed.

LOOKING LONG-TERM FOR LENDLEASE

In our opinion, Lendlease Group (LLC) is a great example of an Australian business benefiting from the urban renewal theme on a global scale. Our investment case on LLC has been tied to its enormous pipeline of urbanisation projects – which stands at $56 billion globally. We were disappointed in early November when LLC reported a $350 million provision (after tax) on a small number of local projects within their Engineering and Services division. In FY18, the Construction segment accounted for less than 10% of EBITDA.

LLC's announcement was subsequently followed by a sharp decline in the share price. However, our investment case remains unchanged and we see the pullback as an opportunity to add to our investment. At current prices, LLC is trading on a FY20 P/E multiple of 8 times, well below its historical average in the low-to-mid teens. A significant amount of earnings are derived from asset management and recurring revenue streams. Yet the LLC multiple implies that it is a high risk, pure play construction business. The reality is that the Investment and Development segments are the real growth drivers of LLC, growing by 35% and 22% respectively in FY18. Funds Under Management exceed $30 billion in the Investments division – this is a significant business.

The urbanisation thematic remains strong. By 2030, the UN expects over 60% of the world's population to live in urban areas. Global infrastructure spending is estimated to rise to an average US$5.1 trillion per year between now and 2035. We have no doubt that LLC will be a beneficiary of these trends over the long term.

We toured LLC's Chicago Riverline Project, one of LLC's gateway city urban renewal developments, in May. The project is zoned to offer as many as 2,700 units across five high rises. The site fits well with the urbanisation trends being well located within close proximity to the CBD, green space, recreational amenities, train lines and bus routes, the new McDonald's headquarters and Google's Midwest headquarters.

Southbank Chicago, Source: LendLease

Finally, and a part of the business that is often overlooked, LLC is a beneficiary of aging populations. Internationally, the number of people aged over 60 is

[1] To 30 November 2018

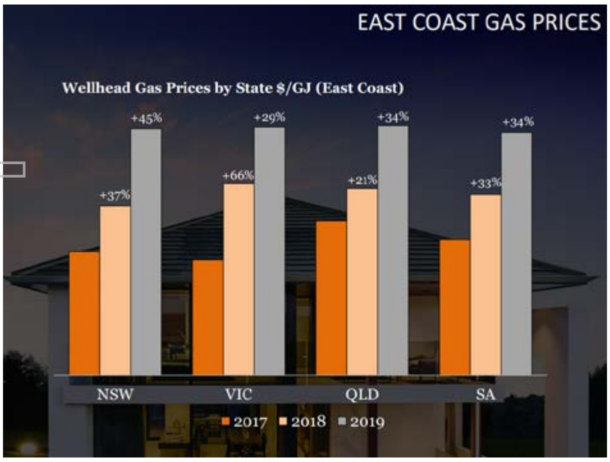
projected to grow three times faster than the overall population (2.4% vs 0.8% p.a.) in average annual terms between 2015 and 2050. LLC operate one of the largest Retirement Living businesses in Australia and is seeking to establish a scale platform in China. Steve Lombardo, LLC Asia Chief Executive, has stated that the company is seeking to win another four to five big projects in China.

GOING GLOBAL

Throughout the year, there were a number of companies within the Urban Renewal Universe seeking growth outside of Australia. These companies include Boral, Brickworks, Reece Group and Reliance Worldwide Corporation[2]. The cost of doing business in Australia relative to other parts of the world is one factor hindering growth domestically and driving companies offshore.

At the Brickworks AGM, Managing Director Lindsay Partridge noted the significant contrast in operating conditions between Australia and the US which was a factor in diversifying offshore. This includes tax policies that are supportive of business, proactive energy policy that is placing downward pressure on prices, and efficient transport infrastructure.

Brickworks noted that in January this year gas prices across the east coast increased by between 21% and 66%, depending on the State. At the same time, electricity prices increased by between 14% and 160%! An additional gas price increase of between 29% and 45% has been contracted, and will take effect in January 2019. The total annual cost impact of almost $24m is one third of Brickworks' Building Products earnings.



Source: Brickworks AGM Presentation

A report by the United States Study Centre shows that although both Australia and the US have experienced a gas boom, the US has used its shale gas growth to keep power prices flat for consumers and industry while Australia's focus on LNG exports played a role in rising energy prices. The energy crunch in Australia has driven an unsustainable increase in operating costs for businesses across Australia. Short-sighted Government policy, combined with our failure to take advantage of our abundance of energy resources has compounded the problem according to Manufacturing Australia Chairman James Fazzino. Without intervention and change to support Australian businesses we will continue to see overseas investments favoured, resulting in missed opportunities for domestic growth.

INDUSTRIAL GROWTH

Goodman Group has been a positive contributor to the URB equities portfolio during 2018 and we believe their well-positioned assets and development pipeline will enable them to continue to benefit from the growing global industrial demand driven by ecommerce.

Deutsche Bank recently conducted a survey into the ecommerce behaviours of Australia's Top 50 retailers. Demand for same day delivery by consumers continues to grow significantly. Three years ago, only 9% of retailers offered the service. That number is now 32% and is expected to increase. The majority of bricks and mortar retailers who offer same day delivery use their retail shops as collection points and despite retail stores having an advantage over industrial warehouses, Deutsche Bank note a 95% cost premium in retail outlets over industrial warehouses. As online retailing and delivery evolves, there will be a shift towards flagship stores, supported by small last mile distribution centres and fewer retail shops.

With total Assets Under Management of $39.6 billion and a development workbook of $3.6 billion with a forecast yield on cost of 7%, spread across Australia, New Zealand, Europe, Americas and Asia we remain positive on the outlook for Goodman Group.

Domestically, Stockland is another beneficiary of these trends, with plans to increase its exposure to the logistics sector to 20% and a workplace and logistics pipeline of $600m largely from their existing land bank. One example is the $77 million development of Coopers Paddock Logistics Centre in Warwick Farm which we visited in May. The site is fully leased with an initial yield of 7.3% and an expected IRR of 10.7%.

[2] Boral Ltd is the only one of these companies currently owned in the URB portfolio.

THE EFFECT OF INCREASING RATES

Over the course of the past year, we have received a few questions regarding the impact of rising bond yields on two of our key equity holdings – Sydney Airport (SYD) and Transurban Group (TCL).

While we recognise the importance of interest rates on the valuations of businesses, we have witnessed on several occasions the market being overly pessimistic on the impact of rising rates on the bond proxies. Stocks with large levels of headline debt such as SYD and TCL get caught up in this scenario every time this occurs. However, few investors appreciate that these companies fix long dated debt out 10-20 years at levels well within their scope of payback.

To ensure the debt profile is stable and can be serviced, we ensure the core business is sound. SYD and TCL boast resilient revenues, capable management teams, growing distributions and yield. If the slowdown scenario does play out, as the recently inverted yield curve might suggest, we expect these core infrastructure stocks will outperform the broader market.

The resilient revenues point is an important and often overlooked one. Transurban is a very good example. Periods of increasing long bond rates are generally tied to periods of inflation. As a toll road operator, Transurban has CPI escalators tied in to its tolling contracts. Simply put, if inflation increases, so does toll revenue. Further, there are many of the Transurban tolls that cannot be lowered as a result of deflation.

In its Master Plan 2039, Sydney Airport expects international travellers passing through its terminals to double over the next two decades and underpin an expected 50% increase in passenger numbers (from 43.3 million in 2017 to 65.6 million in 2039). In our opinion, Sydney Airport is an attractive way to invest in the growth in Australian tourism.

PORTFOLIO POSITIONING

At 30 November, the Equity Portfolio exposure was 42% of the total portfolio, down from 49% at the end of July caused partially by increase in Direct Property valuations. Contact seeks to invest in high quality businesses that are beneficiaries of this strong Urban Renewal thematic. The Equity Portfolio has delivered good relative returns and generated much needed income for the URB Portfolio.

We consciously reduced the exposure to several stocks in the portfolio in September, once they traded on an ex-dividend basis. As it stands, with the recent volatility in the market, the decision to increase the cash position has been prudent. We are watching closely but are yet to add to positions despite the market now trading on more attractive valuations.

URB has a flexible investment mandate across various industries, and there is no limit to the level of cash to be held in the Investment Portfolio. At the end of November, URB had approximately 9% of the portfolio held in cash.

We also provided an update on PURT3 Kingsgrove and PURT5 Prestons in the November NTA Report as follows:

- PURT 3 - Settlement of Lots 1 & 1A occurred on 11th December 2018. A partial uplift in fair value will therefore be reflected in the December accounts and NTA. Latter stages of development are continuing with Lots 2 - 7 and whilst completion remains subject to obtaining approvals from various authorities, we are hopeful that settlement for the remaining Lots at Kingsgrove will occur within the next 30 days.
- PURT 5 – Directors included a partial uplift in fair value in the September NTA based on an 80% completion status. The construction program of the Prestons project is now 99% complete. The Occupancy Certificate under DA 861 has now been achieved and Practical Completion is expected shortly.

Given the status of the above-mentioned properties, we are currently reviewing a number of potential unlisted property opportunities.

urb. Investments Limited

Level 2, 160 Pitt Street Mall
Sydney NSW 2000
T (02) 9210 7000
F (02) 9210 7099
W: www.urbinvest.com.au