Eschler Asset Management LLP

www.eschlerasset.com

			Annualised Net Total Returns			Since Inception[3]
	Q2'19	2019	1-year	3-year	5-year	(8 Oct 2012)
Eschler Recovery Fund - NET USD [1]	**3.0%**	**15.3%**	**5.5%**	**5.0%**	**2.7%**	**6.2%**
HFRX Equity Hedge Index USD	0.0%	6.0%	-4.2%	3.2%	0.7%	2.4%
Russell 2000[2]	2.1%	17.0%	-3.4%	12.2%	7.1%	11.2%
S&P 500[2]	4.3%	18.5%	10.4%	14.0%	10.7%	13.3%

(1) Results are for an investor since inception in B share class, net of all fees with a "high watermark" threshold.
(2) All benchmark indices include reinvested dividends net of 30% withholding tax. HFRX Equity Hedge Index (EFRXEH) on Bloomberg
(3) 2012 results are for 3 months (8/10/12 - 31/12/12)

Dear Partners,

Q2'19 saw ERF rise 3% net of fees and expenses bringing the year-to-date net return to +15.3%. Thematically, precious metals and energy were strong contributors while uranium and a couple special situations detracted. The top five contributors were Goodwin Plc, Kirkland Lake Gold, Bank of Cyprus, Tesla (short) and Alamos Gold. The top five detractors were Biglari Holdings, De La Rue, Seadrill, Abitibi Royalties and Buenaventura. I discussed the two largest detractors in the May commentary. The fund is currently 102% long and 21% short with 81% net exposure to the market. 90% of that net exposure is currently gold, silver, energy and uranium holdings.

Outlook

Over the past year the fund has returned +5.5% net of fees and expenses. In that time, junior precious metals stocks, a large holding, rose 7.4%--trouncing a flat performance from none other than the FANGs! Nobody can predict the future but it would be unusual if junior precious metals stocks have finished their move. More likely, we are climbing the proverbial wall of worry with the mania somewhere ahead. Why? Reversion to the mean. In many ways the best strategy of the past several years was to bet *against* reversion to the mean. In industries where disruption is a way of life that approach makes sense. In cyclical industries it does not. So while gold stocks have doubled off their bear market bottom they remain 75% off their recent bull market highs. Just to get halfway back entails a further doubling and we know that markets do not just stop at the mean but tend toward excess in both directions. More recently, just three years ago gold was 5% lower than where it currently trades but junior gold stocks were 38% *higher* than today. This year, despite a market-beating return the juniors have been left behind by the large cap gold stocks which have benefited from nibbling by generalist investors. By my reckoning, these juniors remain vastly undervalued. Future generalist institutional and retail capital flows into the gold industry are the catalyst that could re-rate this unloved area.

Strategy

Over the past year fund holdings skewed toward royalty and streaming companies and larger-cap gold equities with growing production. The idea was that by growing production these businesses could thrive if gold stayed around $1,300/oz. What I didn't anticipate is the extent to which these segments would benefit from investor capital moving back into the industry after the cyclical bear market from mid-2016 to mid-2018. Returns from the likes of Kirkland Lake Gold, Agnico-Eagle, Sandstorm and Buenaventura were more than satisfactory, despite a stable gold price.

More recently, the outlook for gold improved as Federal Reserve interest rate policy flipped dovish and real interest rates fell. Against this changing backdrop, starting in May I decided to position the precious metals book for higher gold prices again. The question I posed was: If gold goes to $2,000, which stocks will provide the best return? With such a wide disconnect between the large and small caps the decision was obvious. I sold the above producers and trimmed Sandstorm, redeploying the proceeds into several mid-tier producers and advanced stage developers on my watch list. I also increased exposure to silver stocks. I have met with many dozens of gold and silver companies over the past year but most do not meet my criteria. With such low prices on offer last quarter I was able to purchase several businesses, combining great assets and managements with underrated capital allocation trackrecords. The following example illustrates the opportunity I am trying to capture.

<u>New Holding: Pan-American Silver (PAAS)</u>

Following the acquisition of Tahoe Resources last November PAAS owns the largest silver reserve base in the world with assets spread across the Americas. PAAS combines high exposure to silver (48% of attributable reserve value), gold and base metals with scale, liquidity, a strong balance sheet and shrewd management. When investors think of silver they think of Fresnillo but while PAAS' market value is less than half of Fresnillo's its reserve and resource base, margins and free float are much greater. The $2.5bn market cap at our purchase ($11.9 per share) looked like a genuine bargain. With Tahoe (purchased for $1.3bn) came not only Escobal (in Guatemala), the largest silver mine in the world with 264m oz of reserves and 21 million oz of potential production pending a restart, but also 500,000 oz of gold production next year at an all-in-sustaining cost of circa $1,000/oz. Because of its minimal downside and blue-sky upside PAAS is now the fund's largest holding. Let's examine the building blocks of a $20 per share base case value (70% above our cost) ignoring PAAS' vast undeveloped resources and assuming stable metals prices:

PAAS currently produces 25m oz of silver at all-in costs of $10-11/oz which generates $100m in annual free cash flow at $15 silver and supports at least <u>$1bn</u> of equity value. Tahoe purchased its gold assets in two transactions in early 2015 and early 2016 for approximately <u>$1.7bn</u> combined. They secured a good deal making these purchases right at the bottom of the bear market. Escobal ceased production in July 2017 after the Guatemalan Ministry of Energy and Mines revoked its mining license due to a dispute with an indigenous tribe. PAAS is now in a consultation process of unknown duration with this Ministry with the objective of restarting operations. We know what Escobal is worth in production because from 2014 through mid-2017 it produced 20-21m oz of silver annually at all-in-sustaining-costs of $8-9/oz. At $15/oz silver the mine thus generates free cash flow of $130-150m and can conservatively sustain equity value of <u>$1.5bn</u> (Tahoe's market cap peaked around $5bn). Approximately $4bn in combined enterprise value (net of $240m in net debt) yields $20 per share.

What could PAAS be worth in a blue sky scenario if gold goes to $2,000, silver goes to $50 (40 gold/silver ratio) and 100% owned Navidad in Argentina, one of the world's largest undeveloped primary silver deposits, is valued by the market? This is where it gets exciting. Let's conservatively assume PAAS' all-in silver costs double to $20/oz and gold costs increase to $1,200/oz. PAAS' base silver business (25m oz per year) would generate $750m in free cash flow and Escobal and Navidad could earn $600m a piece (each could produce 20m oz per year) implying a combined equity value of $19-20bn at a 10x multiple. The gold assets would generate another $400m annually or $4bn in equity value at a 10x multiple. Overall, in this upside scenario PAAS could hypothetically be worth over $100 per share. In recent years PAAS has reached $40 per share twice (early '08 and late '10) and $20 per share as recently as 2017 when its asset endowment was much smaller. The above analysis hopefully underscores the real potential for all-time share price highs (>3x our cost), indeed the possibility of nearly 10x blue sky upside, if a major bull market in silver plays out. Do you feel any better about the fund's holdings in silver equities now?

Risks to the thesis are the amount of time we have to wait for 1) the price of silver to reach new highs and generate genuine interest in the industry again and 2) the Escobal mine in Guatemala to restart. We mitigate these two risks through the margin of safety, our understanding of the precious metals cycle and our willingness to be patient.

Subscriptions and redemptions

At the end of Q2'19 we received a $1m subscription and a $100,000 redemption. As a reminder, the fund offers two share classes. The A share class management and incentive fees are 1% and 15% over a 3% annual compounding hurdle with high water mark. The B share class fees are 0% and 25% over a 6% annual compounding hurdle. We know of few other managers who willingly guarantee a 6% annual compound return before levying any fees.

Business Update

Eschler has come a long way over the past year. We have created full-time positions in operations and business development and third-party advisors now rely on our regulatory and fund infrastructure. We have secured investment for the LLP significantly increasing our capital base. Eschler Recovery Fund, now registered with the Cayman Monetary Authority and with a strong multi-year trackrecord, has seen multiple small subscriptions and, more recently, a slightly larger one. We are now actively seeking opportunities on both sides of the Atlantic to partner with asset owners ahead of what could be better times for a strategy focused on less correlated, deep value themes centred around mispriced public equities in cyclical industries. If you would like to further discuss the strategy, receive materials or make an investment I invite you to contact either myself (theron@eschlerasset.com) or Matthew Anthony (matthew@eschlerasset.com).

Theron de Ris
Portfolio Manager
22 July 2019