October 5, 2018

September Performance Update for LRT Global Opportunities, LP and Ltd.:

If you are an accredited investor, please contact us for performance information.

Year to Date

I think we can all agree that 2018 has been a chaotic year on many fronts from tariffs to taxes; Washington to Beijing. However, for LRT in terms of growth in fundamental value, our portfolio remains extremely well positioned. The businesses we own experience continued growth in value, which should eventually be reflected in their stock prices. I say this with conviction in our process and execution, which enables LRT to identify and invest in exceptionally strong businesses with growing moats, great management teams and exceptional long-term prospects, as each business is growing and reinvesting within very large markets.

For the long-term investor, short-term volatility is an opportunity not a source of fear. In fact, volatility is the “mother’s milk of investment performance”. With that said, as a result of our analysis, LRT has many “coiled springs” in our portfolio that will contribute to strong performance in the months and years ahead.

Two primary factors contributing to this month’s results were our long-term **US Treasury position (NYSE: TLT)** and our position in **Facebook (NYSE: FB)**.

- Facebook (FB: NASDAQ) declined sharply during September and the stock is now more than 25% below its all-time high established in late July. Concerns about future profitability and a slew of bad press have pushed the stock down. Although Facebook’s valuation is now the lowest it has ever been and the sentiment surrounding the company is at the worst level we have ever seen, the fundamentals for sustained growth are firmly entrenched. The building blocks of “fake news”, pure falsehoods and half-truths, are being daily reported as facts. While the share price has underperformed the broader market this year, discerning investors will eventually focus on what really matters: Growth and Profitability. Simply, FB is a cheap stock with a wide moat and ample growth opportunities. We expect excellent returns in the months ahead.
- Long term US interest rates rose during the month resulting in a decline in the value of our Treasury position. Markets often overshoot and currently they are overshooting with respect to the future prospects for rising US interest rates. We expect the current interest tightening cycle to end by mid next year. As the sugar rush from the recent tax cuts and boost in fiscal spending wears off, the expectations for US economic growth will decline and with it the future prospects for interest rates. Of note is the fact that current market positioning (as reported by the CFTC) indicates that market participants are short US Treasuries in record amounts, suggesting a large rise in Treasuries is possible once sentiment shifts and speculators are forced to unwind their bets.

Continuing the format from previous months in discussing two current portfolio holdings: the global aerospace market is growing faster than global GDP and is home to a large number of businesses of above average quality. At LRT we own shares in two of the very best: HEICO (NYSE: HEI, HEI-A) and MTU Aero Engines (DAX: MTX).

HEICO (NYSE: HEI-A)

HEICO, started in1957 as a small business, didn't begin to realize its full potential until acquired by Laurans Mendelson in 1990. Since then the company has grown through acquisition and today it is a business with a market capitalization in excess of $10 billion. The company makes mission critical replacement parts for planes and helicopters.

The company operates using a licensing scheme granted by the FAA to manufacture replacements parts called PMA (Parts Manufacturer Approval). No single part or airplane constitutes a large share of HEICO's revenues. Instead the company competes in hundreds of tiny markets making replacement parts that are usually cheaper than those made by original equipment manufacturers (OEMs). Barriers to entry are very high, as new entrants must secure FAA license approval for each individual part and acquire the specialized manufacturing know-how. Barriers to entry combined with very predictable demand and required aircraft maintenance schedules have led to high and stable returns on invested capital (ROIC) of over 15%.

As mentioned previously, HEICO growth mechanism is by acquisitions. The company usually acquires several complementary businesses each year. Acquisitions are then integrated into one of two the business units: Electronic Technologies Group or Flight Support Group. The company then harvests the cash flows from these businesses and uses it to acquire more companies. It is important to note that all acquisitions are done with cash and debt as the company is controlled by the Mendelson family and does not want to issue shares for acquisitions. Additionally, the company also has a dual class share structure, which further entrenches the controlling family. At LRT we own the A class shares which carry with them only 1/10th of the voting rights of the regular shares but have all the same economic rights. We own the A class shares because they trade at a 18% discount to the regular shares. Management has demonstrated excellent stewardship of capital both in terms of modest compensations and excellent capital allocation. Capital allocation is always important, but it is critical for businesses that grow primarily through acquisition. Discipline acquisition and integration of other companies is a rare skill that very few companies have truly mastered. HEICO is one of them.

In summary, HEICO management has a well-deserved and hard-earned reputation by demonstrating expertise in acquisitions, a clear strategy for capital allocation and a process to acquire regulatory licenses that has resulted in a stable moat enabling exceptional returns for shareholders, which LRT expects to continue for many years to come.

MTU Aero Engines (DAX: MTX)

MTU Aero is a German company that makes jet engine parts and overhauls existing engines. Their business is 60% new engine parts, 40% maintenance. The company is a key supplier to Pratt & Whitney (a division of United Technologies), Rolls Royce, General Electric and Safran – in other words all the jet engine manufactures of the world. It operates in an industry were reliability, quality and precision engineering are the primary concerns – not price. Making new jet engines is only one side of MTU's business – the other being making spare parts for existing engines and running repair centers around the world. The company currently has three facilities for its MRO operation (maintenance, repair, overhaul): Dallas, TX, Hannover, Germany and Zhuhai, China. This allows it to efficiently service airplanes operating anywhere in the world.

Barriers to entry in its businesses are incredibly high, as developing the know-how and reputation required to win and retain contracts takes decades of experience. The business also has very long development lead times, often with more than a decade of R&D taking place before a new product can be released. For example, MTU worked with Pratt & Whitney for more ten years to the develop the Geared Turbofan – a new type of high bypass jet engine that promises to reduce noise and burn significantly less fuel. The Geared

Turbofan engine combines the characteristics of a traditional jet engine with a reduction gearbox, allowing the fan and driveshaft to operate at different rates, which reduces the required number of air compression stages and improves engine efficiency. While the technical details are complex, the outcome for an airline customer is easy to understand: a meaningful reduction in fuel burn (up to 15% less). Very few companies in the world have the expertise and resources to compete with MTU Aero. Even the giants in the industry such as GE Aviation, Pratt & Whitney and Rolls Royce chose to partner and revenue share with MTU when developing a new engine instead of attempting it alone.

MTU Aero's business is slated to continue to grow in the years ahead as demand for new airplanes continues to be strong. The company has recently began manufacturing parts for the PW1000G – the first Geared Turbofan (GTF) engine which will be offered as an option to power the A320neo, A220 and the new Mitsubishi regional jet (MRJ). The PW1000G is just the first of a whole family of engines planned by Pratt & Whitney using the GTF technology. With the growing installed base of engines comes a growing MRO business accompanied by predictable revenue from maintenance and stable margins. Over time, the maintenance business alone should exceed the new parts business at MTU and the company's revenues should predictably stabilize. In summary, the company has ample growth ahead of it as it continues to reinvest cashflows into developing new engine technologies through partnerships and joint ventures with the major jet engine manufactures.

As an indispensable part of the aerospace industry, MTU Aero has delivered excellent returns to shareholders through a combination of a strong moat based on above average returns on invested capital, intangible assets, high switching costs, well-executed capital allocation and steady growth.

The continual growth in airplane sales should carry the company's stock price to new highs over the next several years to come. As such, LRT is pleased to own MTU Aero for a long time to come.

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