QUARTERLY INVESTOR COMMENTARY
31 MARCH 2019

CONTRARIUS GLOBAL EQUITY FUND

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The Fund aims to earn a higher Total Rate of Return than the average of the world's equity markets, as represented by the MSCI World Index, including the reinvestment of dividends net of withholding tax ("MSCI World Index", "Benchmark"). It aims to achieve this without greater risk of loss, over the long-term. The Fund is an actively managed fund, and as such does not in any way seek to replicate its benchmark index, but may instead differ materially from the performance benchmark in order to achieve its objective.

CONTRARIUS GLOBAL EQUITY FUND AT 31 MARCH 2019

Total Rate of Return in US Dollars	Class [1]	Since Inception on 1 Jan 2009	Latest 10 Years	Latest 5 Years	Latest 3 Years	Latest 1 Year	2019 Year-to-date	Latest Quarter
		% Annualised				% Not Annualised		
Contrarius Global Equity	**Investor**	**16.4**	**17.2**	**6.0**	**12.4**	**(6.5)**	**16.8**	**16.8**
MSCI World Index		10.7	12.4	6.8	10.7	4.0	12.5	12.5
Average Global Equity Fund		8.6	9.8	4.5	8.3	0.3	12.4	12.4

Past performance is not a reliable indicator of future results. The Fund's share prices fluctuate and are not guaranteed. Returns may decrease and increase as a result of currency fluctuations. When making an investment in the Fund, an investor's capital is at risk.

[1] *Performance of other fee classes are available on our website.*

The Fund's Investor Class shares returned 16.8% for the quarter versus 12.5% for the benchmark MSCI World Index, including reinvested net income. As we have highlighted previously, our investment philosophy is not benchmark cognisant and our portfolios would normally vary materially from the benchmark World Index. The Fund's returns are therefore likely to deviate from those of the benchmark. Investors are reminded that given the long-term, contrarian, valuation-based investment philosophy, there will be times when the Fund will materially underperform its benchmark in the short-term in order to achieve its objective of long-term outperformance.

The Fund is overweight Consumer Discretionary, Energy, Materials, and Communication Services stocks. In terms of geographic exposure, the Fund continues to be overweight shares in North America.

Sector Exposure 31 March 2019	Weighting (%) Fund	MSCI World Index [1]	Over/(Under) Weight
Communication Services	20	8	12
Consumer Discretionary	27	10	17
Consumer Staples	4	9	(5)
Energy	22	6	16
Financials	6	16	(10)
Health Care	0	13	(13)
Industrials	0	11	(11)
Information Technology	3	16	(13)
Materials	16	5	12
Real Estate	0	3	(3)
Utilities	0	3	(3)
Total Shares	**99**	**100**	
Net Current Assets	1	-	
Net Assets	**100**	**100**	

[1] *Source: MSCI (attention is drawn to MSCI disclaimer in 'Notices')*

Geographic Exposure 31 March 2019	Weighting (%) Fund	MSCI World Index [1]	Over/(Under) Weight
North America	78	66	12
Europe	14	21	(7)
Japan	0	8	(8)
Asia ex-Japan	4	2	2
Other	2	3	(0)
Total Shares	**99**	**100**	
Net Current Assets	1	-	
Net Assets	**100**	**100**	

[1] *Source: MSCI (attention is drawn to MSCI disclaimer in 'Notices')*

Offshore Oil Drillers

Since we discussed Transocean in Q2 2017, the share has performed roughly in line with the benchmark. That masks considerable volatility in the meantime. Transocean, along with the other offshore drillers that the Fund holds, contributed to the Fund's underperformance in the second half of 2018. While some of that underperformance has reversed so far this year, we think that this is a good opportunity to re-examine the investment case.

Some of the main issues we considered in 2017 were:

- Oil reserve depletion and replacement;
- Financials of shale oil producers;
- Exploration & Production (E&P) investment by the major oil companies;
- Profitability of the oil services industry.

In all cases we believed that the trends were not sustainable. What do we believe with two more years' of data?

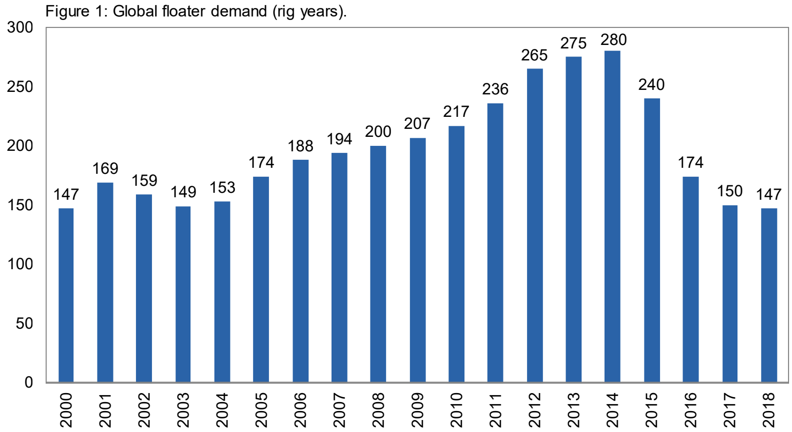
Update

The oil price has been volatile since mid-2017, with the benchmark Brent going up to $86/barrel, down to $50, and ending the quarter at $68 (well off the January 2016 low of $28). Oil is highly politicised, and so, even with hindsight, it can be hard to know what drives the ups and downs: the fortunes/woes of US shale oil producers; demand worries in light of trade wars and a slowing China; unstable leadership in many oil-producing countries; budget constraints in Saudi Arabia, and Russia; sentiment feeding on itself.

The prolonged period of low oil prices has been tough on the offshore drillers in the Fund. Contracted rig-years have just about halved, and, with day rates falling as well, revenues of the oil drillers we hold have fallen considerably since 2014: 62% for Diamond Offshore, 67% for Transocean, and 75% for Seadrill. (Acquisitions and disposals complicate the comparison in some cases. But, as Transocean acquired much more than it disposed, the published fall in revenue actually understates the carnage.) There have been bankruptcies (Seadrill, Ocean Rig, Pacific Drilling) and mergers (Transocean bought Songa Offshore and also Ocean Rig after it emerged from bankruptcy; Ensco bought Atwood Oceanics and is in the process of buying Rowan).

Floater demand stabilises after market downturn

Figure 1: Global floater demand (rig years).



Sources: Maersk Drilling; Contrarius Research

Oil in the Long Term

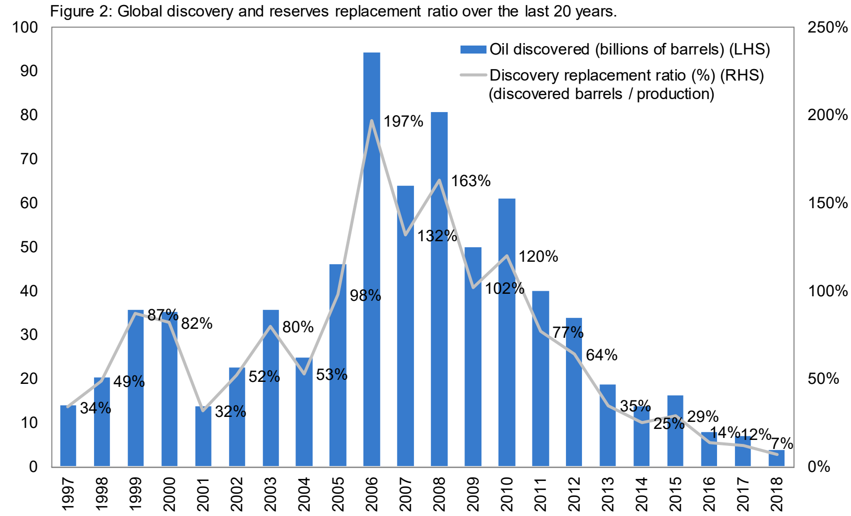
We find it easier to consider the longer-term dynamics rather than the short-term dynamics of oil. Consumption is flat or creeping down in many mature economies, and we imagine that this will eventually be true for the world in aggregate. In the meantime, though, some very big places need more oil. When they last reported, China, India, and Indonesia increased consumption by 4.0%, 2.9%, and 4.5%, respectively. They account for about 3 billion people, or 40% of the global population. The International Energy Agency (IEA) expects the world to need 7% more oil, 6.9 million barrels per day (mbpd), in the next 5 years.

Unlike metal commodities, oil can't be recycled and steady investment is needed to maintain reserves. In fact, a fixed level of investment is not enough: it has to increase over the long term as wells become harder to find and develop. Renewables are making progress but cannot yet compete on reliability and convenience. Coal for electricity generation is under enormous pressure, and there is little appetite for nuclear.

Yet oil reserve replacement is at generational lows. According to the IEA, at the current rate of project approvals, production would drop 9 mbpd by 2025, leaving the world 17 mbpd short. Presumably other investors believe that unconventional sources (e.g. shale fracturing) will make up the difference. But this seems to us to be too big an ask – it would mean adding twice the current US tight output – and the oil price is highly sensitive to small changes in the supply/demand balance.

Replacement of Global Oil Reserves

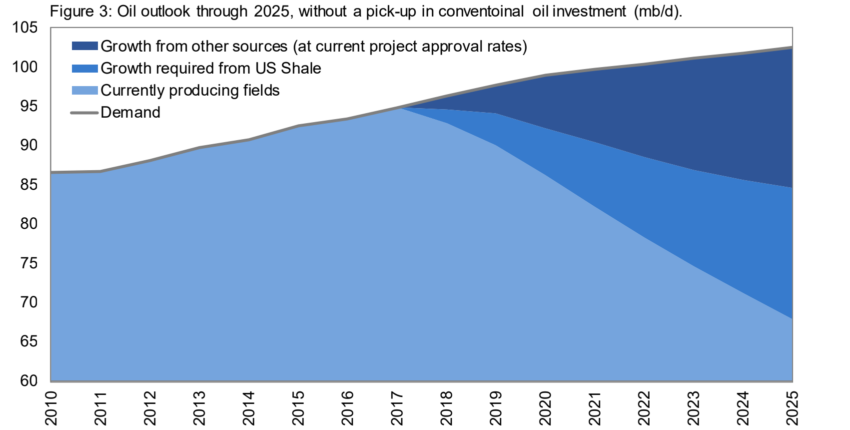
Figure 2: Global discovery and reserves replacement ratio over the last 20 years.



Sources: Transocean; Contrarius Research

Can unconventional sources meet forecast supply shortfall?

Figure 3: Oil outlook through 2025, without a pick-up in conventoinal oil investment (mb/d).



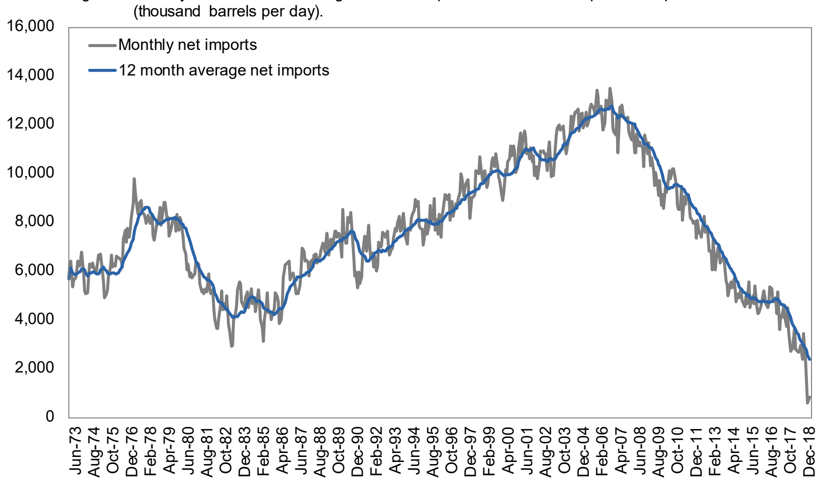
Sources: International Energy Agency; Contrarius Research

Economies of Shale

Americans are the thirstiest consumers of oil, knocking back 22 barrels per person per year compared to 20 for South Koreans, 11 for the Japanese and the Germans, and 9 for the British (compared to 3.4, 2.3, and 1.3, for the Chinese, Indonesians, and Indians, respectively). American demand was quenched by a lot of imports, peaking at 13 mbpd (12-month average) in 2006. But over the following 12 years, shale fracturing – until then a fringe method of extraction – went from negligible to more than 7 mbpd, or 9% of global output. US net imports in 2018 were only 2 mbpd (in November and December it was less than 1 mbpd).

Growth of U.S. domestic production has reduced net crude oil imports

Figure 4: Monthly and 12 month average U.S. net imports of crude oil and petroleum products (thousand barrels per day).



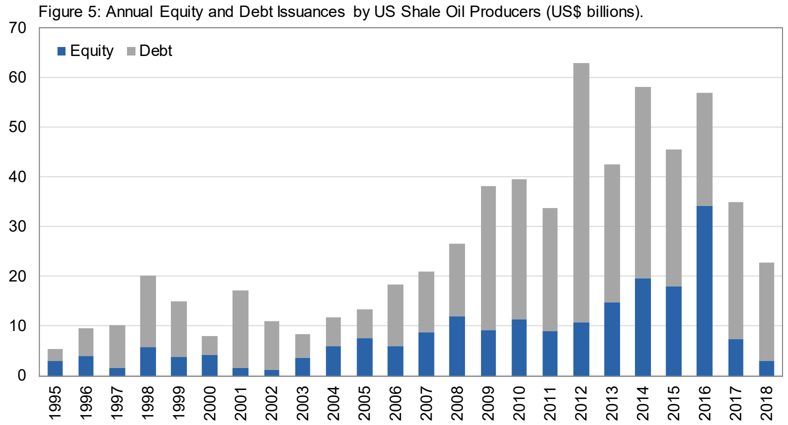
Sources: U.S. Energy Informaiton Administration; Contrarius Research

Oil has traditionally been a big-capex long-cycle business. Operators made big upfront investments to enjoy many years of cheap extraction. Shale promises a new business model. Wells are cheaper and quicker to develop, but also quicker to drain. This continuous-investment, continuous-production model can be seen as something like a factory: a steady supply of raw materials (land and drilling equipment) goes in one end, and product (oil) comes out the other.

But this factory is showing signs of middle age. The majority of investment (54% in 2018) now goes towards replacing depleted wells, and that is expected to be 75% in 2021. That is not necessarily a bad thing – after all, at steady-state *all* of a manufacturing operation's investment goes towards replacing production – but it does mean that growth must taper off. There are growing pains: several of the largest producers have reported a "parent-child" problem, where dense boring causes nearby wells to impair each other, lowering overall pressure, and reducing recoverable volumes. Despite the extraordinary feats of innovation, engineering, and doggedness, US shale does not yet appear to be self-funding, and continues to survive on debt and equity issues.

Equity and Debt Issuance by US Shale Oil Producers

Figure 5: Annual Equity and Debt Issuances by US Shale Oil Producers (US$ billions).



Sources: Dealogic; Wall Street Journal; Contrarius Research

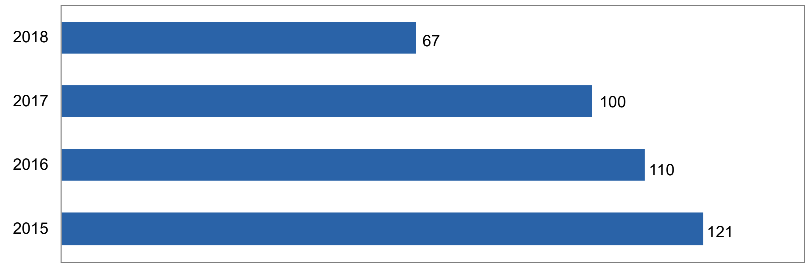
Cost Competitiveness

Offshore was historically an expensive way to get oil. Shale was too, initially, but the "frackers" aggressively cut costs, making it a more appealing place for the oil majors to invest. It's taken a few years to catch up but offshore costs are now broadly comparable, at $40-$50 per barrel compared to around $90 in 2014. Many things contributed to this, including better technology and falling input costs. But one of the primary contributors is that the drillers were forced to standardise and streamline their operations, increasing uptime and reducing well development time. Hess, an E&P business with both shale and offshore projects, recently showed that its new offshore Guyana development needs about $30 oil, compared to $40 for Delaware Basin shale oil, for a 10% annualised return on investment. It also noted that offshore costs are still going down but those of onshore shale are increasing.

Note, though, that offshore wells still typically need far higher upfront investment—it's just that it gets spread over a longer lifetime. Also, the time from decision to first production is far longer for offshore (years) than for onshore shale (months). So in tough times, when cash is scarce, offshore investment will probably be cut first, and we expect the shares to continue having exaggerated ups and downs.

Increasing Drilling Efficency

Figure 6: Days it takes to drill a deepwater well in Brazil.



Source: Transocean; Contrarius Research

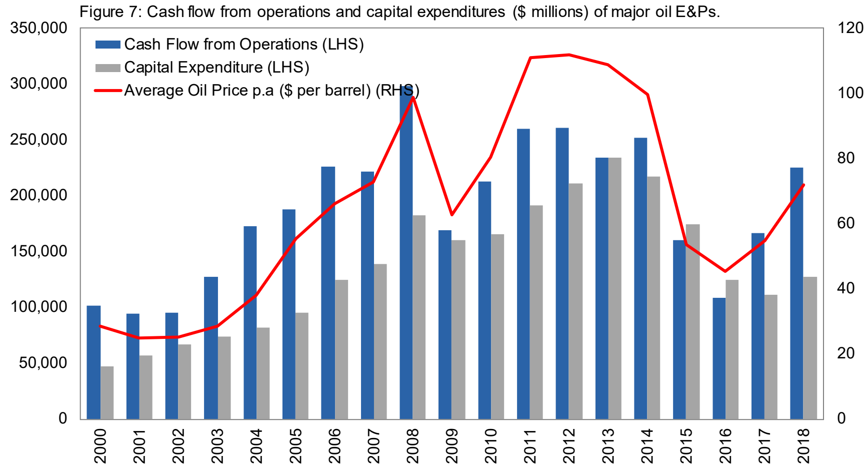
The need for offshore, and return of E&P investment

About 27% of the global oil supply comes from offshore, mostly developed in happier times. When the major operators' cash flows fell about 60% from 2014 to 2016, offshore projects were cancelled *en masse*, cutting capex by more than half in an effort to preserve free cash flow and dividends. They could do that because, having already spent the heavy upfront investment, the operators could milk the new wells for a few years. There was an oversupply of rigs as the sharp reduction of drilling demand combined, with terrible timing, with new rigs coming live. The benefits of drilling cost cuts accrued mainly to the operators since the drillers were in no position to negotiate.

The E&P operators' cash flows have bounced back but offshore investment has not. Being starved of investment has had the expected result: the average reserve life is down about 2 years (15%) since 2014. That presumably can only last so long—it's hard to see how the world can replace 27% of supply in the medium term. In the meantime, the rig supply has had a painful cleansing. Older, less efficient, machines have been scrapped or "cold-stacked" (turning the lights off, leaving it unmanned, but doing basic maintenance so that it doesn't fall into disrepair). Many more have been "warm-stacked" (parking it indefinitely, but keeping the lights on with a skeleton staff so that it can be returned to service more quickly). Transocean has mothballed or stacked 49 rigs, nearly half of what it once had.

Improved cash flows not met with increased offshore investment

Figure 7: Cash flow from operations and capital expenditures ($ millions) of major oil E&Ps.



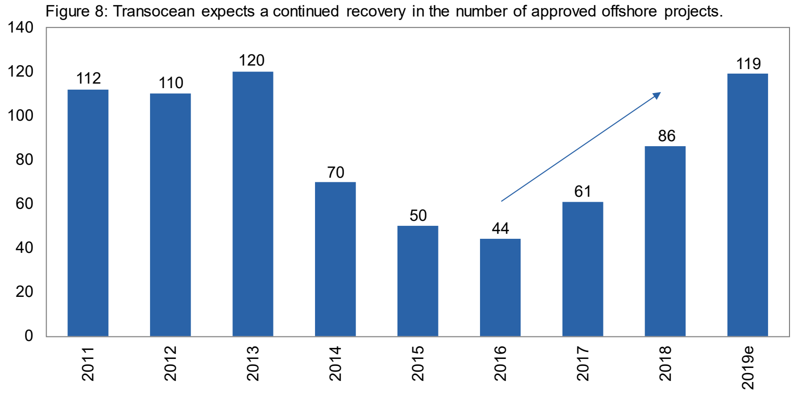
Major oil E&Ps includes BP, Cheveron, Conoco Phillips, Eni, Equinor, Exxon Mobil, Hess, Repsol, and Royal Dutch Shell.

Sources: Bloomberg; Contrarius Research

Signs of a recovery have been trickling in. Drillers are reporting pockets of high utilisation: ultra deep-water rigs in Latin America went from 15% contracted to 74% in a year; global utilisation of the highest spec drillships has increased to approximately 80%; nearly all of the jack-up rigs marketed by Rowan and Noble are contracted; all of Transocean's top-tier harsh-environment assets are committed. The number of offshore contracts awarded increased 24% in one year and 65% in two.

Step-up in the Number of Offshore Final Investment Decisions

Figure 8: Transocean expects a continued recovery in the number of approved offshore projects.



Source: Transocean; Contrarius Research

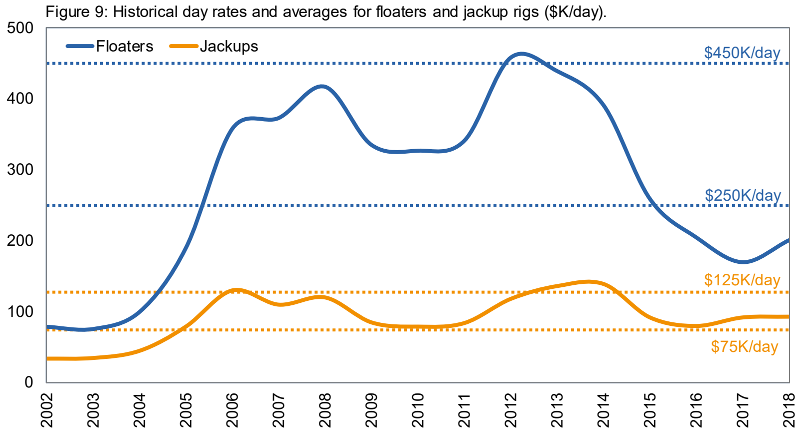
With increasing activity and so much destruction and consolidation of supply, you might expect pricing power to swing back in favour of the drillers. There is evidence of this too: some drillers report that rates are rising, and that operators are paying for unstacking, upgrading, and mobilising rigs.

The Best Few

Offshore drilling has been an unpleasant place for a few years, but a more consolidated industry is likely to be healthier. The bulk of the Fund's investment in the sector is in Transocean, Ensco, and Diamond Offshore, all of whom we believe have the financial flexibility to take advantage of the fallout. They *do* have debt, but not very much of it is due in the next five years, and, between cash on hand and undrawn facilities, we believe they have sufficient liquidity to see them through that time (Transocean, our biggest holding of this set, even generates free cash flow). They also have high-quality fleets.

Historical Average Day Rates

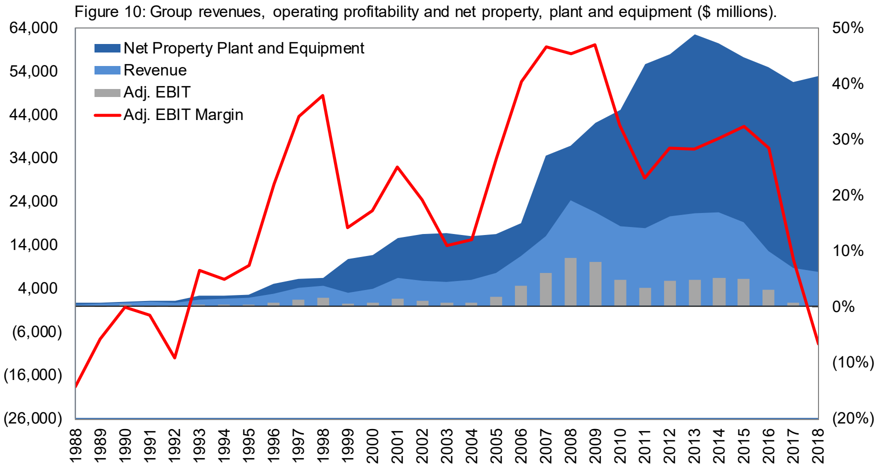
Figure 9: Historical day rates and averages for floaters and jackup rigs ($K/day).



Sources: Ensco; Contrarius Research

Drillers Profitability

Figure 10: Group revenues, operating profitability and net property, plant and equipment ($ millions).



Group includes Diamond Offshore, Ensco, Noble Corporation, Rowan Companies, and Transocean.

Sources: Bloomberg; Contrarius Research

There may still be a small tail of new builds that were ordered in better times, but there have probably been few (if any) new orders since 2014. Even if the decision to order was made now (unlikely, since the experience of the last five years has poisoned the appetite for offshore investment), it would take years to float a new drill ship. We expect a vacuum of modern rigs to be very positive for rates. To get a respectable return on a new floater, day rates would have to be roughly double where they are now—we expect the drillers the Fund owns to produce a lot of cash long before then.

Conclusion

In some sense it is disappointing that the original thesis has not yet played out. But we are used to being early and it has given us the time to re-examine the investment case. It appears to us that:

- Oil consumption is likely to continue growing for years, and at current rates of investment we expect the world to be short of oil within a few years;
- Offshore is critical to supply;
- US shale growth is slowing, and it is unlikely to fill that shortfall, let alone replace offshore;
- Offshore is a much healthier industry after bankruptcies, consolidation, and excising weak assets;
- E&P companies are making money again, and depletion is likely to force them to invest;
- Years of underinvestment, combined with a long delay in delivering new rigs, should boost lease prices.

Not only does the original thesis seem to be intact, but it seems stronger than it was in 2017. And yet the market does not appear to be pricing this in. As long-term, bottom-up stock pickers, we've used the opportunity to jack-up our positions further.

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Performance (net, per calendar year, since inception)	Fee Class	Currency	Best Performance		Worst Performance		Inception
			Year	%	Year	%	Date
Contrarius Global Equity Fund	Investor Class	US$	2009	94.5	2018	(19.4)	01-Jan-09
	Institutional Class	US$	2009	95.1	2018	(19.1)	01-Jan-09

These are the best and worst performing calendar years each specified fee class has experienced since inception, demonstrating the variability of performance. Annual figures for all calendar years since inception are also available on www.contrarius.com. South African residents interested in receiving a Prospectus or other information on these funds should contact the authorised representative for those funds, Contrarius Investment Services (South Africa) (Pty) Ltd at clientservice@contrarius.co.za. Contrarius Investment Services (South Africa) (Pty) is a member of the Association for Savings & Investment South Africa.

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