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Ganes Focused Value Fund *ARSN 117 119 712*
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GANES CAPITAL MANAGEMENT LTD

GANES FOCUSED VALUE FUND – DECEMBER 2014

Unit Prices*

	31.12.14	30.06.14	30.06.13	30.06.12	30.06.11	30.06.10	30.06.09	30.06.08	30.06.07
Entry Price ($)	$2.6001	$2.5716	$2.4721	$2.0377	$2.0438	$1.8024	$1.5322	$1.8130	$2.6617
Unit Price ($)	**$2.5911**	**$2.5626**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**	**$1.5268**	**$1.8067**	**$2.6525**
Exit Price ($)	$2.5820	$2.5537	$2.4549	$2.0235	$2.0295	$1.7898	$1.5215	$1.8003	$2.6432
Distribution (cents per unit)	**3.1451**	**4.0178**	**4.5014**	**4.8340**	**6.7378**	**5.8396**	**6.6702**	**11.6800**	**18.1078**

* Unit prices are quoted pre-distribution. The *total* distribution paid during the financial year is shown.

Past Performance*

	Ganes Focused Value Fund	ASX300 Accumulation Index	Margin
3 months	**0.9%**	**2.9%**	**-2.0%**
6 months	1.8%	2.4%	-0.6%
1 Year	**1.9%**	**5.3%**	**-3.4%**
2 Years (p.a. compound)	8.9%	12.3%	-3.3%
3 Years (p.a. compound)	**12.6%**	**14.7%**	**-2.1%**
5 Years (p.a. compound)	9.3%	6.5%	2.8%
10 Years (p.a. compound)	**9.0%**	**7.4%**	**1.6%**
Inception (p.a. compound)	12.4%	9.4%	3.0%
Value of $10,000 invested at inception (14/10/2002)	**$41,438**	**$30,720**	

Portfolio Allocation

Top ten	44.2%
Other shares	20.1%
Cash	35.7%

Largest Five Holdings

Flight Centre (FLT)
Woolworths (WOW)
Treasury Group (TRG)
Spark Infrastructure (SKI)
Austbrokers (AUB)

* Fund performance is net of all fees and expenses, and assumes reinvestment of distributions. Investments can rise and fall in value. Past performance is not necessarily indicative of future performance. The Fund currently invests substantially in smaller companies that may involve unique risks. The Product Disclosure Statement details the risks associated with an investment in the Fund and is essential reading for investors.

After recording nearly 20% return in calendar year 2013, a return that far exceeded the underlying performance of the economy, the local market has finished 2014 with a return of 5.3% for the year, while we have recorded a 1.9% return. The Fund produced a 16% return in calendar year 2013 despite holding the largest cash weighting in the history of the Fund. Therefore, if we were to outperform the market in 2014 we needed the existing portfolio to seriously outperform the market, find some attractive new investments to put available cash to use, or the market needed to fall and the cash provide a buffer to unit holders against this outcome.

The existing portfolio performed reasonably well, and we did manage to find some small opportunities to invest cash. But these gains were not enough to offset the large fall in the price of Flight Centre, the largest holding in the Fund. Flight Centre started 2014 as a market darling after a string of profit upgrades in 2013 along with a strong share price gain. Fast forward 12 months and Flight Centre has finished the year as the most shorted company in the market and the share price has fallen 32% for the year. Unfortunately this has had the effect of taking about 4% off our annual return this year, but we are now more comfortable that the shares represent better value today than they did this time last year.

Stock Market Predictions

At the start of 2014 would anyone have predicted that Qantas would rise more than 100% while Flight Centre would fall 30%? We doubt it. The headline in the Sydney Morning Herald of February 28 last year was 'Analysts predict more cuts for struggling Qantas' at the same time that Flight Centre had already risen 20% in just two months. In the article a number of analysts were quoted, all expressing doubts and concerns about the business. Another headline only a month later was 'How Qantas went from national icon to corporate tragedy'. This is not a reflection on the analysts involved, but simply to reflect the inherently difficult nature of making predictions and how quickly they can look quite silly in this industry.

You can see then why we don't make predictions, and why we will never make promises explicitly or implicitly to you regarding Fund returns. News headlines and market commentators are there to sell advertising space and one should always regard them in this light, not as information to be acted upon.

We try to predict the future performance of the business, rather than share price movements, looking at the underlying economics of the business and assessing its merits for providing a good long term outcome for investors. Our investment approach is to hold our investments for the long term because eventually the share market performance should reflect the underlying performance of the business. We call these businesses compounding machines. And what we are ideally trying to find are businesses that can produce high incremental returns by being able to employ additional capital at attractive rates of return. If we return to Flight Centre, the share price has returned 10% per annum over the past decade, which is roughly analogous to the financial performance of the underlying business.

Continued overleaf....

Other examples of businesses we like in this category are 4WD parts supplier ARB Corporation which has produced a 10 year return of 17% per annum and funeral home operator Invocare, which has provided a 10 year return of 18% per annum. We think that spending time finding these types of companies are the best uses of our time rather than worrying excessively about whether the price may rise or fall in the short term.

As we have said over the last dozen years, some years we will outperform the market and some years we will underperform but over the long term we believe our approach should see us deliver outperformance that is attributable to our skills rather than luck, and to that end our long-term track record is still superior to that of the market.

At this time of the year it is opportune to reflect on what worked in the portfolio (and our investment process), what didn't work, and more importantly what lessons can we learn from this. This is a business where continual learning and improvement is vital.

What worked:

1. We continued to improve our investment process and now have a comprehensive database that allows us to scour results for companies in the portfolio and pull apart these results on a longitudinal basis. We think this will add value by both identifying when businesses are improving but also highlight when business performance is deteriorating. This database is proprietary to Ganes and has involved many, many hours of work that may only be reflected in our returns over the long term, but nevertheless we believe should provide benefits to unit holders.

2. Our commitment to stick within our circle of competence saw us avoid many of the disasters within the resources and associated mining services industries. These sectors are now well and truly beaten-down with some share prices down 90% in just a year. There are probably some bargains in amongst them and no doubt some astute investors, and perhaps some lucky ones too, will make a fortune in this sector but it probably won't include us. We have a 'too hard' bin and mining services have been filed in there for now at least.

3. Our belief that the Australian dollar was overvalued and that exposure to international markets would benefit investors continued to play out further this year. Our most direct example of this is via Magellan Flagship Fund, a Listed Investment Company (LIC) that invests internationally without hedging its currency exposure. The share price was up a further 19% this year, and has returned 40% per annum for the past three (3) years. We have made our returns from three components to the investment. First, when we started buying the shares they were selling at a discount to their net asset backing. That discount has now disappeared so the narrowing of the discount provided some return. Second, the value of the portfolio of international companies has risen, and lastly the Australian dollar has fallen against the US dollar providing further returns.

What didn't work:

1. Being too conservative on valuations. We looked at many, many investments that we thought met our investment criteria, but they usually failed our valuation metric. Some of those companies went on to double in the past year or two. In hindsight we could have lowered our valuation metric as interest rates declined and the value of franked dividends made equities more valuable as an asset class. We won't chase prices or tweak our valuation models just to make them line up with current prices but we would have performed much better in the past year or two if we had acted earlier on this.

2. Failing to predict the decline in the Coca-Cola Amatil business. This once strong business is showing signs of stress as the major supermarkets show no sign of abating their desire to extract value from their suppliers. We had exited all our investments in suppliers to the supermarket channel but thought Coca-Cola would be better placed to withstand this pressure, however, that has not proven to be the case. The share price was down 19% for the year, and we reduced our exposure but we should have been more decisive in our response.

3. Failing to grasp the poor execution of the Masters rollout at Woolworths. Given that Coca Cola has suffered at the hands of the supermarkets, it is somewhat ironical that we would include Woolworths in this list as well. The rollout of the Masters hardware division has been a failure at this stage by any account - over budget, delayed and moving targets on profitability. We believe Australia can support another big box hardware supplier, however, the rollout has been far more difficult than expected. Woolworths is an inherently attractive business with wonderful returns on capital but Masters is not going well and this has been reflected recently in the share price.

We have finished the year with our cash weighting reduced to 36% and we believe the portfolio offers much better value now than it has for some time and hopefully we will get the opportunity to deploy this cash at some point during the year. Finding someone that will manage your money as carefully as you would manage it yourself is not easy and we take our responsibility seriously. For the trust you have placed in us we thank you and we look forward to your continued support in 2015.