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

GANES FOCUSED VALUE FUND – MARCH 2014

Unit Prices*

	31.03.2014	30.06.13	30.06.12	30.06.11	30.06.10	30.06.09	30.06.08	30.06.07	30.06.06
Entry Price ($)	$2.6271	$2.4721	$2.0377	$2.0438	$1.8024	$1.5322	$1.8130	$2.6617	$2.0250
Unit Price ($)	**$2.6179**	**$2.4635**	**$2.0306**	**$2.0366**	**$1.7961**	**$1.5268**	**$1.8067**	**$2.6525**	**$2.0179**
Exit Price ($)	$2.6088	$2.4549	$2.0235	$2.0295	$1.7898	$1.5215	$1.8003	$2.6432	$2.0108
Distribution (cents per unit)	**2.2927**	**4.5014**	**4.8340**	**6.7378**	**5.8396**	**6.6702**	**11.6800**	**18.1078**	**15.3199**

* 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	2.28%	1.99%	0.29%
6 months	3.69%	5.42%	-1.73%
1 Year	10.50%	12.97%	-2.47%
2 Years (p.a. compound)	14.18%	15.99%	-1.81%
3 Years (p.a. compound)	9.78%	8.05%	1.72%
5 Years (p.a. compound)	17.58%	13.20%	4.39%
8 Years (p.a. compound)	8.17%	5.00%	3.17%
11 Years (p.a. compound)	13.79%	10.46%	3.33%
Value of $10,000 invested at inception (14/10/2002)	**$41,602**	**$29,753**	

Portfolio Allocation

Top ten	42.1%
Other shares	12.9%
Cash	45.0%

Largest Five Holdings

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

* 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.

Markets

Solid performance by the banking sector offset weakness in the materials sector to produce a flat finish for the March quarter. International markets (especially in US$ terms) have had a good year thus far. This goes a long way to explain the popularity of international funds given the Australian market's lacklustre performance. Our mandate is to only invest in Australian equities, however we have sought to gain exposure to international economies and provide a cushion against the high Aussie dollar through investments in companies with overseas operations or investments.

Many of our largest holdings including Flight Centre, Cochlear, Computershare, Sonic Healthcare and ARB Corporation all earn a growing proportion of their income (if not the majority) from offshore. This will provide some tailwinds should the Australian dollar fall to levels that the Reserve Bank would like it to.

Property data released during the month demonstrates that, using the Reserve Bank's preferred measure, average house prices in Australia are now 4.4 times disposable income and look set to peak above levels set in 2006 and 2010. Reportedly, Australia has now overtaken Canada as the most overstretched housing market in the English-speaking world.

Given that housing often constitutes a large portion of net worth for many investors, following trends in the real estate sector is important when trying to gauge the overall health of an economy. Buoyant property values can spur spending and consumption, while the reverse can happen during periods of declining prices, making housing affordability a metric well worth watching.

It is difficult to know how this will play out, though the best case scenario is likely to be a long period of little or no growth in house prices. The worst case scenario doesn't bear thinking about....

Portfolio Performance

The fund reported a return of 2.28% for the quarter and a 12 month return of 10.5%. This is slightly behind the broader market and shows that holding a high percentage of cash in the fund has hurt short-term performance somewhat. However, we believe that in the current market remaining cautious rather than over-paying for growth remains the most prudent investment strategy for delivering outperformance over the longer term. On our preferred 5 year investment horizon we continue to outperform the broader market.

Investing in a frothy market
In our experience, the purchase price paid for any security is one of the most important determinants of the performance of that security over time. This means that, from the perspective of a value investor, it is not enough simply to find growing, well-managed companies to invest in. Instead, we look for securities of companies that are not only appealing from the standpoint of being well run and well positioned in a particular industry, but also from the standpoint of being attractively priced.

In this regard, we have currently identified a number of potential investments to add to the portfolio should prices decline to a level that presents us with advantageous entry points.

This valuation discipline is especially called-for during times of market frothiness such as we are seeing currently. By refusing to overpay for a stock, no matter how compelling the company's story may be, we accomplish two objectives for our investors. First, we help cushion the portfolio when a boom cycle turns to bust, and, second, we position ourselves to benefit from having cash on hand to take advantage of the bargain prices which usually become available in the securities of high quality companies in a market downturn.

Mauboussin on creating value in investing
Michael Mauboussin, noted author of *Thinking Twice*, *The Success Equation*, and *More Than You Know* is a market commentator we are happy to invest our time in reading and would recommend any of his recent books to investors. His thoughts on creating value are worth citing here:

From Mauboussin: "The value creation piece, there are really three big things. Things like interest rates and equity risk premium are very difficult to predict, so the three big things are:

One, what will the returns be on incremental investments? Am I going to invest in something with very high returns, market returns, or below the cost of capital returns?

The second component is, how much money can I invest? Sometimes you can have small spreads above the cost of capital but you can do a lot. Other times, you have high spreads but you can't do that much, so how much do you invest?

The third component is, for how long you can find investment opportunities? Because it's a finite world, and there's a lot of competition. The idea is, how long can I find investments that are profitable in this way?

Return on invested capital is the first component. The second component is the amount of investment, and the third is this time horizon component. Those are the three things that comprise that present value, future growth."

These remarks illustrate the value of the Fund's active approach to investment management. In a dynamic world, it takes constant monitoring of a company and its prospects to determine where the company fits in the valuation cycle and to determine both when and how much to invest in any given opportunity to maximize return on capital.

Company specific news

<u>Treasury Group</u>
This fund management business has been a strong performer for the portfolio, buoyed by last year's robust equity markets which saw the company report net profit up 30% in its latest half year report. This result was driven by a 31% increase in boutique management fees and expense reduction at the head office. Profitability was enhanced by an improved FUM (funds under management) mix favoring retail funds (Investors Mutual and Celeste). The company's balance sheet and cash flow remain strong.

Flight Centre
Flight Centre's latest report showed revenue rose to over $1 billion for the first time and profits increased 20.7% to $110 million. Particularly pleasing was the continuing rise in Total Transaction Value (this is the amount customers pay for their travel), which continued to grow at double-digit rates. However, it should be noted that the company was recently fined $11 million for attempted price fixing by the Australian Competition and Consumer Commission (ACCC). The Commission alleged that Flight Centre had on six occasions attempted to get airlines it competes with on the sale of international airfares to stop undercutting it in price.

The company intends to appeal the decision and the penalty but has taken up the fine in their accounts for 2014. The fine levied is not substantial in terms of materially affecting Flight Centre's results and does not impact on our valuation of the business.

Cochlear
Cochlear recently received approval from the Food and Drug Administration (FDA) to market its hybrid hearing loss implant in the U.S, giving it the ability to sell the product to those with partial hearing loss as well as those who are completely deaf. Approval of the implant had been delayed, hurting the company's half-year results. Now that marketing of the device is cleared, the company is free to ramp up its marketing and attempt to reap the rewards of the extensive research dollars it has spent on the product over the years.

Dr. Chris Roberts, Cochlear's CEO, has stated that the company intends to continue its strategy of investing in technology innovation, and continue to increase its geographic footprint, having established a logistics base in Panama last year to coordinate its investment in Latin America.

Cochlear is truly a global business and world leader in its markets but the latest half-year results were disappointing, so the approval from the FDA is welcome news. However, we are acutely aware the company has disappointed recently and is on notice to improve its results to justify its current share price.

Adelaide Brighton
The company turned in a solid result in the past year in the face of adverse conditions. However, the recent loss of a cement supply contract from Cement Australia has raised a question mark. For the past year, revenue was up 3.8%, with cash from operations a respectable $227 million and a full year profit of $151.1 million. Adelaide Brighton estimates the loss of the cement supply contract may reduce pre-tax income by up to $15.1 million.

However, with a strong balance sheet and capable management, we anticipate that the company will take all steps possible to overcome this setback and continue to deliver solid results. In addition the company has a landbank that it will release over the next decade offering the opportunity to pay special dividends to shareholders. This may be responsible for the resilient share price in the face of the adverse outcome with Cement Australia.

Outlook

The Australian market certainly faces a number of challenges going forward. Front and centre is the climbing unemployment rate, which makes it difficult for consumers and businesses to be optimistic and in the mood to spend and invest. The anticipated reining in of Commonwealth Government expenditure combined with higher taxation is not likely to improve this situation, at least in the short term. Historically high Australian house prices also enhance the downside risk.

At the market level, there are quite a number of high quality businesses that we own or would like to own. They are characterised by growing demand for their product or service, high profit margins and return on capital and a strong balance sheet and cashflow. Currently, there are few bargains to be found in this part of the market. However, we continue to watch and wait, confident that profitable opportunities will appear for the Fund.